Annual report & consolidated financial statements

Clydesdale Bank PLC

For the year ended 30 September 2017

Company Number: SC001111

Clydesdale Bank PLC

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Contents

Officers and professional advisers	1
Strategic Report	2
Risk Report	10
Report of the Directors	57
Statement of Directors' responsibilities	60
Independent auditor's report to the members of Clydesdale Bank PLC	61
Consolidated financial statements	69
Glossary	146
Abbreviations	154
Other information	155
Forward looking statements	156

Overview

Clydesdale Bank PLC ('the Bank'), together with its subsidiary undertakings (which together comprise 'the Group'), operate under the Clydesdale Bank, Yorkshire Bank and B brands. It offers a range of banking services for both retail and business customers through retail branches, Business Banking centres, direct and online banking, including B, and brokers. It is the main operating subsidiary of its immediate parent, CYBG PLC.

Certain figures contained in this document, including financial information, may have been subject to rounding adjustments and foreign exchange conversions. Accordingly, in certain instances, the sum or percentage change of the numbers contained in this document may not conform exactly to the total figure given.

The forward looking statements disclaimer can be found on page 156.

Officers and professional advisers

Directors	David Duffy Ian Smith Debbie Crosbie Clive Adamson David Bennett David Browne Paul Coby Adrian Grace Fiona MacLeod Jim Pettigrew Dr Teresa Robson-Capps Tim Wade
Secretary	Lorna McMillan James Peirson
Registered office	20 Merrion Way Leeds West Yorkshire LS2 8NZ
Independent auditors	Ernst & Young LLP Bridgewater Place 1 Water Lane Leeds LS11 5QR

Strategic Report

The Directors of the Bank and its subsidiary undertakings (which together comprise 'the Group') present their Strategic Report for the year ended 30 September 2017.

Principal activities

The Group operates a full service UK-focused retail and commercial banking business under the brand names 'Clydesdale Bank', 'Yorkshire Bank' and 'B' across its core regional markets (Scotland, North East England, North West England, Yorkshire and the Humber) and selected national markets. Clydesdale and Yorkshire Banks are strong, low risk retail-only banks focused on providing residential mortgages, personal and business current accounts, savings, personal loans and credit cards, loans for small and medium businesses, and payment and transaction services.

Business review

Summary balance sheet as at 30 September	2017 £m	2016 £m
Customer loans	31,967	30,147
Other financial assets	10,105	9,216
Other non-financial assets	1,242	600
Total assets	**43,314**	39,963
Customer deposits	(27,679)	(27,000)
Wholesale funding	(8,623)	(5,827)
Other liabilities	(3,548)	(3,915)
Total liabilities	**(39,850)**	(36,742)
Ordinary shareholders' equity	(3,039)	(2,796)
AT1 equity	(425)	(425)
Equity	**(3,464)**	(3,221)
Total liabilities and equity	**(43,314)**	(39,963)

Summary income statement –underlying and statutory basis [1] for the year ended 30 September	2017 £m	2016 £m
Net interest income	845	807
Non-interest income	172	183
Total operating income	**1,017**	990
Total operating and administrative expenses	(671)	(726)
Operating profit before impairment losses	**346**	264
Impairment losses on credit exposures[2]	(48)	(39)
Underlying profit on ordinary activities before tax	**298**	225
Restructuring expense	(67)	(45)
Separation costs	(8)	(11)
Impairment of intangible assets	-	(45)
Conduct charges	(592)	(484)
Gain on defined benefit pension scheme reforms	88	-
Gain on disposal of VocaLink share	20	-
Gain on disposal of VISA share	-	7
Net gain on debt restructuring	-	1
Statutory loss on ordinary activities before tax	**(261)**	(352)
Tax expense	(33)	(206)
Statutory loss attributable to equity holders	**(294)**	(558)

[1] The summary income statement is presented on a statutory and underlying basis. The underlying basis excludes certain items that are included in the statutory results, as management believe that these items are not reflective of the underlying business and do not aid meaningful year on year comparison. Full details on the adjusted items are included in the Glossary on page 146.

[2] Impairment losses on credit exposures relate solely to loans and advances to customers (refer to note 3.5 to the financial statements) and exclude credit risk adjustments on loans at fair value through profit or loss which are incorporated in the movement in other assets and liabilities at fair value within non-interest income (refer to note 2.3 to the financial statements).

Strategic Report (continued)

Business review (continued)

The Group reports another year of strong financial performance, with an increase in underlying profit before tax of £73m (32%) to £298m, reflecting the significant progress that has been made against the Group's strategic priorities during the year. The Group made a statutory loss after tax of £294m (2016: £558m), primarily due to conduct charges of £592m for the year.

The Group's performance in the year is reviewed in the context of its key strategic priorities: delivering sustainable customer growth, driving efficiencies across the business, and capital optimisation.

1. Sustainable customer growth

	2017 £m	2016 £m*
Mortgages	**23,480**	21,836
SME lending[3] – core	**6,821**	6,438
– non-core	**504**	720
Unsecured personal lending	**1,162**	1,153
Gross loans and advances to customers	**31,967**	30,147
Current accounts	**13,948**	13,248
Variable rate savings accounts	**7,730**	8,240
Fixed rate term deposits[5]	**5,983**	5,500
Other wholesale deposits	**18**	12
Total customer deposits	**27,679**	27,000

** The 2016 comparative has been restated to reflect the reclassification of £80m of SME loans from the non-core to the core portfolio*

2017 has been a year of strong business growth against a highly competitive backdrop and uncertain economic conditions. In targeting sustainable growth in our customer balances we enhanced our product offerings to attract the right mix of customer profile to deliver longer term value. In doing so we have delivered growth while maintaining asset quality, adhering to our underwriting standards and controlled risk appetite leading to a well balanced and diverse portfolio.

The growth in our customer lending in the year has tempered the impacts of base rate cuts and, together with lower funding costs driven by active management of rates across the savings portfolio, has contributed to an increase in net interest income of £38m (4.7%) to £845m. This was achieved in spite of rate pressures across the board, as a consequence of the base rate reduction in August 2016 and a corresponding fall in LIBOR rates, which together impacted 45% of the Group's customer lending portfolio which is on a variable rate. The effects of these rate reductions combined with competition in the market continued to exert downward pricing pressure on the Group's lending portfolio, with average yields reducing by 19bps to 2.85%. Conversely, average rates on interest bearing liabilities reduced by 25bps to 0.75% as a result of the rate cuts, a shift in mix in the deposits portfolio and lower wholesale funding costs.

The asset quality of the Group's credit exposures remains stable relative to the growth in portfolio size, evidenced by the reduction in the level of impaired assets to £179m (2016: £233m) and a modest increase in 90 DPD to £161m (2016: £150m). In aggregate, impaired assets and 90 DPD represent 1.06% of gross loans (2016: 1.27%).

The increase in impairment charge, from £39m to £48m, reflects a modest increase in charges taken on our unsecured Retail portfolios together with impairment of a small number of individual SME exposures. The cost of risk has consequently increased by 5bps from 0.09% to 0.14%, but remains low reflecting the continuing benign credit environment.

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[3] Includes financial assets at fair value of £477m (September 2016: £750m)
[5] Includes financial liabilities at fair value of £26m (September 2016: £48m)

Strategic Report (continued)

Business review (continued)

1. Sustainable customer growth (continued)

Mortgages

The mortgage book remains the Group's largest asset portfolio and has a significant impact on our overall financial performance. This year we delivered record levels of new mortgage business, which supported net growth of 7.5% in the year, higher than system growth[6] of 2.9%, and saw our market share increase from 1.67% to 1.73%.

In line with our competitors, we continued to see a growing number of customers favour fixed rate mortgage products, as they sought to further capitalise on the prevailing low interest rate environment. As a result, the fixed rate book grew to 73% of mortgage balances (2016: 68%) and accounted for 95% of mortgages drawn in the year (2016: 93%).

The split of our mortgage book between buy to let and owner occupied properties remained broadly stable, although owner occupied accounted for 70% of drawdowns in the year (2016: 59%) as we focused on our strategy to support the residential market and manage within our risk appetite limits. The average LTV of new lending was 71% and, as a consequence, the average LTV of the mortgage book increased from 55.8% to 57.5%.

Our proportion of residential mortgages 90 days in arrears has remained stable at 0.52% (September 2016: 0.51%).

SME lending

Our core SME lending portfolio increased by £383m (5.9%) in the year, ahead of system growth[7] of 3.9%. The main drivers for the increase were improved origination flows, coupled with lower attrition in the second half of the year as we implemented a number of new propositions and developed new capabilities to better support the funding needs of our SME customers. These included a new proposition for the financial services sector, and the establishment of an agency capability. Growth Finance and Cash Flow Finance also performed well.

We maintained a robust approach to credit decisions on new lending in the year, reflective of the continued reduction in the impaired asset portfolio to £126m (2016: £146m). Notwithstanding an increase in specific provisions on a small number of exposures, the underlying credit quality of the portfolio has remained stable.

In line with our strategy we continued to run off our non-core portfolio, which reduced from £720m to £504m.

Unsecured personal lending

Following a brief period of contraction in our unsecured personal lending book, which comprises credit cards, personal loans and overdrafts, the second half of the year saw modest growth of £9m year on year. Within this, the fixed rate personal loan book was the largest contributor, showing growth of £33m (5%) from £625m at 30 September 2016 to £658m at 30 September 2017. This growth was driven in the main by the launch of an improved personal loan proposition with competitive pricing in the third quarter, supported by enhanced scorecards and a simplified online application process. The uptake in this new offering contributed to higher loan origination in the second half of the year.

Credit card balances were broadly flat at £396m (2016: £400m).

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[6] System growth is sourced from the BoE "Mortgages outstanding by type of lender, UK (BOE)" report (MM4)

[7] System growth is sourced from the BoE "Industrial analysis of monetary financial institutions' lending to UK residents" report (c1.2), and excludes individuals and individual trusts, activities auxiliary to financial intermediation, insurance companies & pension funds and financial intermediation (excluding insurance and pension funds) results.

Strategic Report (continued)

Business review (continued)

1. Sustainable customer growth (continued)

The smallest element of our unsecured lending portfolio is comprised of variable rate personal loans and overdrafts, which fell by £20m in the year from £131m to £111m. Variable rate loans continue to reduce as although these products remain on sale they are not actively promoted or targeted.

Current accounts

Funding provided by current accounts increased by £0.7bn (5.3%) since September 2016, due principally to continued growth in business current account balances (up £387m) driven by the 25 month fee free offer we launched in December 2016, and system growth. Personal current account balances also continued to grow, with the B current account (up £200m) attracting both existing and new to bank customers throughout the year as we delivered further enhancements in product functionality.

Our Current Account Plus product also contributed growth of £140m with the average case size offsetting a declining stock balance. Whilst stock levels across the book fell overall, new account openings were in line with our strategy to grow sustainably in a way that recruits the right profile of customer with whom we have an opportunity to build a long-term relationship.

Variable rate savings accounts

Funding from variable rate savings accounts benefited from growth of £0.7bn in B savings accounts and £0.3bn in business savings accounts. This partially offset attrition of £1.2bn following the product rationalisation and repricing of our ISA portfolio. In addition, we saw attrition of £0.2bn across other savings products as, in line with market trends, we saw a shift in consumer behaviour towards easier access accounts such as instant access and current accounts.

Fixed rate term deposits

Our fixed rate term deposit book increased by £483m (8.8%) as a result of actions taken in the second half of the year, including the repricing of maturing term deposits and competitive retail product launches in the digital bond space and fixed rate cash ISA's along with the launch of new notice accounts for SME depositors.

Funding and liquidity

The Group continues to maintain its strong funding and liquidity position and seeks to achieve an appropriate balance between profitability and liquidity risk. Our focus on delivering customer growth, together with a managed reduction in volumes of variable rate savings accounts, and drawdown of £1.9bn of lower cost funding from the Bank of England's Term Funding Scheme ('TFS'), has resulted in an increase in the Loan to Deposit ratio ('LDR') from 112% to 115%.

The Liquidity Coverage Ratio ('LCR') was higher at 164% at 30 September 2017 (2016: 140%) due to the pre-funding of RMBS callable in November 2017. Net Stable Funding Ratio ('NSFR') was 118% at 30 September 2017 (2016: 124%).

The Group has evolved its approach to managing the liquid asset buffer (LAB) to more efficiently utilise cash to reduce the cost of the LAB while still holding high quality, low risk liquid assets, by broadening the composition of the portfolio. The Group has diversified by investing in a broader range of supranational and covered bond issuances. Previously, liquidity was mainly held in BoE accounts, earning base rate, alongside holdings of UK Sovereign bonds (Gilts).

The issue of £300m of senior debt in June provided further funding to the Group and marked an important first step in our journey towards meeting the BoE's Minimum Requirement for Own Funds and Eligible Liabilities (MREL) by 2022.

Strategic Report (continued)

Business review (continued)

2. Delivering on our efficiency programme

Operating and administrative expenses	2017 £m	2016 £m
Personnel expenses	248	280
Depreciation and amortisation expense	87	88
Other operating and administrative expenses	336	358
Total underlying operating and administrative expenses	671	726
Restructuring expense	67	45
Gain on defined benefit pension scheme reforms	(88)	-
Separation costs	8	11
Conduct charges	592	484
Impairment of intangible assets	-	45
Total statutory operating and administrative expenses	1,250	1,311

This year marked the first phase of the Group's three year efficiency programme, during which we demonstrated our ability to execute on our strategy with clear focus and at pace, and have set a strong foundation to deliver the next phase of savings in 2018.

We continued to improve our operational efficiency during the year through the restructuring and streamlining of our business. As our strategic initiatives gathered pace, the costs required to deliver the programme amounted to £67m in the year. These largely comprised property closure, redundancy and consultancy costs and arose in the main as we implemented our branch closure and voluntary severance programmes. We started to reap the benefits of these actions as the year progressed, and saw our full year underlying costs reduce by £55m (8%) from £726m to £671m.

During the year we implemented a new reward programme for colleagues across the business, including a revised pension proposition. As part of these reforms, the Group closed the defined benefit pension scheme to future accrual on 1 August 2017 for the majority of current colleagues, with affected colleagues' future benefits being provided through an enhanced defined contribution scheme. The closure of the Scheme resulted in the recognition of a past service credit of £88m.

On an underlying basis, personnel expenses reduced by £32m in line with headcount, which reduced from 6,718 to 6,040[8]. Other operating and administrative expenses fell by £22m due to the impact of branch closures and tighter cost control across the board.

Whilst our priorities have been focused on maximising efficiencies across the business, we have nevertheless sought to maintain investment in our key strategic priorities. During the year we invested heavily in significantly transforming the personal customer experience, through increasing online account opening capability, enhancing service functionality and releasing new applications across all brands. In addition, we continued to invest to ensure we remain compliant with our regulatory obligations and in enhanced security to maintain and strengthen the resilience of our operations.

During the year the Group continued to make progress on removing its reliance on NAB for certain processes and systems. Spend in the year in relation to separation costs was £8m (2016: £11m) and the Group is on track to exit all NAB services provided under Transitional Services Agreements by December 2018.

[8] Based on average core FTEs during the year. Actual core FTEs were 5,739 as at 30 September 2017 (2016: 6,313). Core FTEs exclude legacy conduct FTEs.

Strategic Report (continued)

Business review (continued)

3. Capital optimisation

The Group continued to maintain its strong capital position throughout the year. Underlying capital generation by the core business post AT1 distribution was 13bps, largely driven by strong underlying profits offset by growth in mortgages and SME lending and investment spread, with RWAs increasing by £649m. After absorbing the net impact of AT1 distributions, pension movements, and exceptional charges such as restructuring charges, separation costs and the Group's proportion of conduct provision charges, the Group's CET1 ratio was 12.2% at September 2017, 20bps lower than the prior year.

During the year the Group reassessed the level of provision that was considered appropriate to meet current and future expectations in relation to the mis-selling of payment protection insurance policies and concluded that a further charge of £494m was required, incorporating the Group's estimate of the impact of the Regulator's policy statement issued on 2 March 2017 relating to a proposed time bar for complaints in August 2019. It also incorporated a reassessment of the costs of processing cases and the impact of experience adjustments. The Group also raised further provisions of £98m for other non PPI conduct related matters.

Strengthening our capital base

The Group continually considers opportunities to further strengthen its capital base. The closure of the defined benefit pension scheme to future accrual for the majority of colleagues, coupled with the impact of the Scheme's triennial valuation, resulted in a reduction in the Scheme deficit (on a trustee funding basis) from £450m to £290m and no change to the deficit repayment schedule agreed with the Trustee in June 2014.

In addition, the submission of our waiver application to the PRA requesting permission to apply IRB modelling in the calculation of credit risk RWA's marked a key milestone in our path to IRB accreditation.

The Group is working towards implementation of the requirement to meet a minimum requirement for own funds and eligible liabilities (MREL) on 1 January 2022, and issued £300m of senior debt in June as the first step to meeting this requirement. The BoE provided the Group's MREL guidance, including transitional arrangements, in late 2016. An interim MREL requirement of 18% of RWAs has been set at the Group level from 1 January 2020 until 31 December 2021. The BoE will advise the Group on its ultimate MREL requirement in 2020. The Group expects to issue further senior debt gradually over the next four years to ensure compliance with MREL in 2022.

Key performance indicators

The Directors do not rely on key performance indicators at the individual subsidiary level. The performance of the Group is included in the Annual Report & Accounts of CYBG PLC ('CYBG'). The business is managed within the CYBG Group and the results are consistent with the Group's status as a fully integrated and wholly owned subsidiary of the CYBG Group. For this reason, the Company's Directors believe that providing further indicators for the Group itself would not enhance an understanding of the development, performance or position of the Group.

Strategic Report (continued)

Principal risks and mitigating actions

The Board is responsible for determining the nature and extent of the principal risks it is willing to take in order to achieve its strategic objectives.

The Directors have performed a robust assessment of the principal risks facing the Group, including those that would threaten its business model and future performance, solvency or liquidity.

Principal risks	Key mitigating actions
Credit Risk is the risk of loss of principal or interest stemming from a borrower's failure to meet contracted obligations to the Group in accordance with the terms agreed. Credit risk is evident at both a portfolio and transactional level.	• Significant credit risk strategies, credit risk appetite and tolerances for credit risk are approved and reviewed by the Board and Board's Risk Committee. • The credit portfolio is closely monitored with actions initiated where required.
Balance Sheet & Prudential Regulation Risks cover a number of categories of risk, which affect the manner in which the Group can support its customers in a safe and sound manner. The risks include the need to withstand times of stress for the loss of funding (liquidity), the impact of restricted access to future sources of deposits (funding), the impact of providing a defined benefit scheme to colleagues (pension) and the need to withstand severe unexpected losses (capital).	• Liquidity is managed in accordance with standards that are approved by the Board and supported by annual Funding and Contingency Funding Plans. The Group also completes a formal annual assessment of liquidity adequacy which is shared with the PRA. • The Group completes a formal annual assessment of its capital requirements which is shared with the PRA.
Regulatory and Compliance Risk is the risk of failing to understand and comply with relevant laws, regulations, licence conditions, supervisory requirements, self-regulatory industry codes of conduct and voluntary initiatives.	• Continued and significant Board and senior management focus is directed towards maintaining regulatory compliance. The Board or Executive Risk Committee approves all material changes to regulatory policy and protocols.
Conduct Risk is the risk of undertaking business in a way which is contrary to the interests of our customers, resulting in the delivery of inappropriate customer outcomes, customer detriment, regulatory censure, redress costs and/or reputational damage.	• The Group has a Conduct Framework, with supporting target outcomes and operating principles. Governance oversight and reporting are in place to ensure those objectives are met.
Operational Risk is the risk of loss resulting from inadequate or failed internal processes and systems or from external events. It includes legal risk, and operational risks associated with the execution of the strategy.	• The Group has an established Operational Risk Framework to enable identification, management and mitigation of operational risks. Risk categories are used to categorise and facilitate the consistent identification, assessment, mitigation, monitoring and reporting of risks and events.
Financial Crime Risk is the risk that the Group's products and services will be used to facilitate financial crime against the Group, its customers or third parties.	• The Group has an established Financial Crime Framework supporting ongoing management, monitoring and mitigation of financial crime risk. The Group operates zero tolerance for internal fraud and has a control framework in place to mitigate this risk.
Strategic, Business and Financial Performance Risk is the risk of significant loss, loss of earnings and / or damage arising from business decisions that impact the long term interests of stakeholders or from an inability to adapt to external developments.	• The Board approves and oversees the execution of the Strategic Plan and associated strategic risk following the recommendations of the CEO and Executive Leadership Team. The Group's risk appetite statement (RAS) sets out the risk it is able and willing to take to achieve its strategic objectives.
People Risk is the risk of not having sufficiently skilled and motivated colleagues who are clear on their responsibilities and accountabilities and who behave in an ethical way.	• Roles, responsibilities and performance expectations are defined in role profiles and expanded through objective setting and ongoing performance management. • The quality and continuity of our leadership is reviewed and assessed through succession planning and talent management activity.

Strategic Report (continued)

Outlook

Over the next twelve months the Group will continue to support CYBG, the Group's ultimate parent, in delivering its targets and executing its strategy.

The Strategic Report was approved by the Board of Directors on 20 November 2017 and was signed on its behalf by:

David Duffy

Chief Executive Officer

Clydesdale Bank PLC

Risk Report

Effective management of risk is a key capability for a successful financial services provider and is fundamental to the Group's strategy. The Group has continued to advance and strengthen its risk capabilities, evolving in line with industry developments and best practice.

Risk Principles

Risk exists in every aspect of the Group's business and is a core consideration within the strategic plan. The Group's approach to risk management is based on the principle that risk management capability must be embedded across all areas of the Group to be effective. This overriding principle embodies the following concepts:

- commercial decisions are made on the basis of proactive consideration of risk and the potential impact on customers;
- business managers use the Risk Management Framework (RMF) to support decision making involving risk and reward trade offs; and
- colleagues are responsible for risk management in their day to day activities.

Risk Culture

Central to the Group's risk culture is the fair treatment of customers and meeting obligations to stakeholders, including shareholders, regulators and colleagues. The Board and senior management are responsible for offsetting and clearly communicating a strong risk culture through their actions and words, and proactively addressing any identified areas of weakness or concern.

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 that aligns to, and supports, the strategic objectives of the Group. The Group strives to instil a culture that supports compliance with all relevant laws, codes and policies and builds constructive regulatory relationships.

Initiatives that support appropriate risk culture include: the performance management framework; the formal whistleblowing framework that allows colleagues, in confidence and anonymously, to raise concerns about matters of conduct; and messaging from the CEO and members of the Executive Leadership Team emphasising the importance of risk identification, management and mitigation.

Underpinning the RMF and at the heart of the Group's risk culture, is the concept of personal accountability for risk management at source. This is enabled through a risk management accountability model and a formal delegation framework through which colleagues are able to make risk based decisions.

Risk Strategy

The Group has a clearly defined strategy in order to manage and mitigate risk in the daily course of its business. The strategy consists of:

- ensuring all principal and emerging risks are identified and assessed;
- ensuring risk appetite is clearly articulated and influences the Group's strategic plan;
- a clearly defined risk culture which emphasises risk management throughout all areas of the business while maintaining independent oversight;
- ongoing analysis of the environment in which the Group operates to proactively address potential risk issues as they arise; and
- supporting commercial decisions and people with appropriate risk processes, systems and controls.

Risk Appetite Statement (RAS)

Risk Appetite is defined as the level and types of risk the Group is willing to assume within the boundaries of its risk capacity, to achieve its strategic objectives. The RAS articulates and supports communication of the Group's appetite to stakeholders. This is important as it provides the definitive view of risk taking activity the Board is comfortable that the Group undertakes and allows decision makers (including those with delegated authority and also those providing oversight) to exercise judgement with greater confidence and speed.

The RAS aligns to the risks identified and defined in the RMF. The design and structure of the RAS has taken into consideration best practice articulated by the European Central Bank which is aimed at ensuring Boards should be strongly involved in the validation process and monitoring of the RAS.

Risk Report (continued)

Risk Appetite Statement (RAS) (continued)

The Group's RAS is prepared by the Group Chief Risk Officer (CRO) with consideration of the strategic objectives and business model, as well as the environment in which the Group operates. Monthly reporting to Executive Committees and Board includes details of performance against relevant RAS settings, breaches and trends.

Risk Policies and Procedures

The policy framework is a key component of the Group's RMF providing structure and governance for the consistent, effective management of policies. In developing the policy framework, the Group sets the tone that demonstrates the risk culture expected across the organisation. This aligns with the behavioural expectations for all colleagues which form a core part of our performance management approach. Policy statements and supporting policy standards define the minimum control requirements which must be observed across the Group to manage material sources of risk within risk appetite.

Principal risk categories

See page 8 in the Strategic Report for details on the Group's principal risk categories.

Emerging risks

The Group monitors the environment in which it operates to identify emerging risks that may have an impact on its operations and strategy. The Group currently considers its top emerging risks to be:

Emerging risks	Key mitigating actions
Macroeconomic environment	With a customer base that remains predominantly UK based, the Group is exposed to inherent risks arising from increased geopolitical uncertainty, which has the potential to impact the UK macroeconomic outlook. The banking sector may be placed under increasing pressure as it is exposed to risks relative to credit conditions which may impact the financial performance of the Group. The Group's credit portfolios will continue to be monitored closely with appetite adjusted where appropriate and risk sensitivity analysis conducted on an ongoing basis. Regular assessments of strategic plans are undertaken to minimise and negate potential impacts.
The UK vote to leave the EU ('Brexit')	The Group continues to monitor developments regarding the UK's withdrawal from the European Union and the potential consequences for our customers, products and operating model. As the period of economic uncertainty and market volatility persists, the Group will continue to monitor and assess the external implications and re-evaluate our mitigating actions as appropriate.
Consumer Credit	In the current benign credit environment, the Group maintains an awareness of the risk of significant unforeseen credit losses occurring within a short time period which has the potential to have a detrimental impact on earnings and profitability. Credit risk strategies, appetite and tolerance levels are reviewed and approved by the Board and regular monitoring of the credit portfolio, including risk sensitivity analysis and reviews of asset quality metrics, is undertaken to ensure early identification and mitigation of potential risk areas. Unsecured consumer lending is an area of considerable regulatory focus and one where the Group is particularly alert to the potential regulatory, economic and customer impacts.
Cyber security and IT	The Group, in line with the industry, is subject to increasing levels of attempted cyber-attack, with criminal groups employing increasingly sophisticated knowledge of financial markets and internal activities/processes, leading to potential reputational and financial detriment. The Group continues to invest in and enhance its information security capabilities, monitoring of the external/internal threat landscape and the changing risk profile of the business.
Financial crime (including cybercrime)	The Group is exposed to the risk of its products and services being used to facilitate crime against its customers, third parties or the Group itself. The management of financial crime remains a key area of regulatory focus and the Group continues to enhance its framework for monitoring, management and mitigation of financial crime.
Regulatory Change	The Group, in common with the financial services industry as a whole, continues to face a significant agenda of regulatory changes. Compliance with the developing regulation remains a key focus. The Group continues to monitor the emerging requirements and ensure it is well placed to respond with effective regulatory change management. Specific forthcoming changes, such as Open Banking and PSD2, bring both risk and opportunity to the competitive environment in which the Group operates. Senior management is considering the strategic impacts of these changes for the Group.

Risk Report (continued)

Risk Management Framework (RMF)

The Group identifies and manages risk using the RMF which is the totality of systems, structures, policies, processes and people that identify, measure, evaluate, control, mitigate, monitor and report all internal and external sources of material risk.

Risk Governance and Oversight

The Group's risk governance structure strengthens risk evaluation and management, while also positioning the Group to manage the changing regulatory environment in an efficient and effective manner.

Three Lines of Defence

Effective operation of a Three Lines of Defence model is integral to the Group's approach to risk management and is based on the overriding principle that risk capability must be embedded within the first line of defence teams to be effective. This principle embodies the following concepts:

- commercial decisions are made on the basis of proactive consideration of risk and the impact on customers;
- risk management activities are focused on enhancing sustainable business performance;
- management must use the RMF to support decision making involving risk and reward trade offs;
- regular assessments are undertaken to confirm the effectiveness of the risk and control frameworks in relation to both the current and emerging risk profile; and
- risk management responsibilities are clearly understood by all colleagues when carrying out their day to day activities.

Control is exercised through a clearly defined delegation of authority, with communication and escalation channels throughout the Group.

Stress testing

Stress testing is an important and recognised risk management tool, used to assess the vulnerability of financial institutions through the modelling of adverse scenarios. The Group undertakes stress testing, following the Basel Committee principles, and utilising, where appropriate, scenarios provided by the PRA, aimed at understanding potential impacts arising from adverse conditions relevant to its business and to aid the development and understanding of potential management actions and contingency plans.

Stress testing forms an integral part of the overall governance and risk management culture. Involvement from the Board and senior management in the stress testing programme is essential for its effective operation.

Methodology

Stress testing within the Group complies with regulatory requirements and is subject to a rigorous review and challenge process. The Group's approach ensures that a clear link exists between the economic scenarios and stress testing outputs, supported by a structured review and sign off process.

While the stress testing process is underpinned by models, it is also reliant on judgements made by senior management and key personnel across the Group who:

- manage the macroeconomic scenario process and prepare and review stressed business plans;
- prepare and review credit stress outputs, including impairment charges, RWA and write offs;
- provide funding and liquidity impacts and construct capital plans based on the outcomes of stress testing; and
- guide on potential management actions in response to stress scenario mitigation.

Reverse Stress Testing

Reverse stress testing requires a different approach. It starts from an outcome of business failure and identifies instances where this might occur. Severe but plausible scenarios with an unacceptably high risk are used to inform business planning to prevent or mitigate specific business risks. Reverse stress tests are also utilised as the start point for recovery and resolution planning scenarios. The Group also monitors a range of early warning indicators to give management early visibility of potential risks that could give rise to the need to invoke actions in recovery plans.

Risk Report (continued)

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

Stress testing outputs are used to inform the strategic planning process and the RAS. The plan is subjected to sensitivity analysis, forming a key element of the planning process from an overall risk assessment perspective, and provides the Board with further detail when looking to approve the plan.

Stress testing informs the assessment and quantification of risk exposures in the course of calculating capital requirements as part of the ICAAP. The Group runs a number of adverse macroeconomic stresses in order to determine the impacts on the Group's financial and capital position, considering changes to impairments, margins, volumes and costs relative to the base case plan and considers the actions which the Group may choose to deploy in response to such events materialising.

Stress testing is also a key feature of the ILAAP where stress testing scenarios are modelled regularly to provide insight into potential vulnerabilities in the Group's funding and liquidity strategies. Stress testing results of liquidity are also reported to ALCO on a monthly basis.

The Executive Leadership Team and Board engages at critical points of the stress testing cycle to provide a robust challenge in relation to the selection and development of scenarios and, thereafter, considers how the results are integrated into future strategic decision making, contingency planning, capital and business planning and risk appetite.

In advance of Board submission, ALCO reviews the scenarios, assumptions and results of liquidity and capital stress testing and provides an initial review and challenge of outputs.

Risk Management and Internal Controls

The Board actively monitors the Group's risk management and internal control systems. A review of the effectiveness of those systems has been performed incorporating all material controls, including financial, operational and compliance controls.

Risk Report (continued)

CREDIT RISK

Credit risk is the risk that a borrower or counterparty fails to pay the interest or capital due on a loan or other financial instrument.

Credit risk manifests itself in the financial instruments and / or products that the Group offers, and those in which the Group invests (including, among others, loans, guarantees, credit related commitments, letters of credit, acceptances, inter-bank transactions, foreign exchange transactions, swaps and bonds). Credit risk can be found both on and off balance sheet.

Risk Appetite

The Group controls the levels of credit risk it takes by placing limits on the amount of risk accepted in relation to one borrower, or group of borrowers, and to geographical, product and industry segments. The management of credit risk within the Group is achieved through both approval and monitoring of individual transactions, regular asset quality analysis of the performance of the various credit risk portfolios, and the independent oversight of credit portfolios across the Group.

Credit Strategies and Policies

Credit risks associated with lending are managed through the application of detailed lending policies and standards which outline the approach to lending, underwriting criteria, credit mandates, concentration limits and product terms. The Group maintains a dynamic approach to credit management and aims to take necessary steps if individual issues are identified or if credit performance deteriorates, or is expected to deteriorate, due to borrower, economic or sector specific weaknesses.

Roles and responsibilities for the management, monitoring and mitigation of credit risk within the Group are clearly defined in line with the Group's RMF.

Significant credit risk strategies and policies are approved, and reviewed annually, by the Credit Risk Committee. For complex credit products and services, the Head of Business Risk, Head of Retail Risk and Credit Risk Committee provide a policy framework which 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, with appropriate oversight through governance committees.

Exposures

Credit risk exposures are categorised as Retail (secured and unsecured) and SME. In terms of loans and advances, credit risk arises both from amounts loaned and commitments to extend credit to customers. To ensure appropriate credit limits exist, especially for SME lending, a single large exposure policy is in place within the Group and forms part of the risk appetite measures that are monitored and reported on a monthly basis. The overall composition and quality of credit portfolio exposures are monitored and periodically reported to the Board and, where required, to the relevant supervisory authorities. Exposures are also managed in accordance with the large exposure reporting requirements of the CRR.

Unless otherwise noted, the amount that best represents the maximum credit exposure at the reporting date is the carrying value of the financial asset.

Measurement

The Group uses statistical models to measure credit risk exposures. Models are supported by both internal and external data. The 'probability of default' (PD) (that borrowers will not meet their contractual obligations), current exposures, and the likely loss ratio on defaulted obligations are calculated to measure and mitigate credit risk. Portfolios are assessed using segmentation for measurement, reporting and monitoring purposes.

Subject to regulatory approval, the Group is progressing toward attaining permission to use IRB models to measure the credit risk of loans and advances to customers. Meantime, all exposures are measured under the standardised approach for regulatory capital.

Risk Report (continued)

CREDIT RISK (continued)

Maximum exposure to Credit Risk (audited)

The table below shows the maximum exposure to credit risk 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 the Group's and Bank's banking operations.

	Group		Bank	
	2017	2016	**2017**	2016
	£m	£m	**£m**	£m
Cash and balances with central banks (note 3.1)	**6,937**	5,955	**6,937**	5,955
Due from related entities (note 5.3)	**366**	7	**1,547**	1,605
Due from other banks	**810**	945	**407**	425
Financial assets available for sale (note 3.2)	**2,076**	1,731	**2,070**	1,724
Other financial assets at fair value (note 3.3)	**477**	750	**477**	750
Derivative financial assets (note 3.4)	**282**	585	**136**	388
Loans and advances to customers (note 3.5)	**31,293**	29,202	**30,236**	27,683
Due from customers on acceptances	**4**	4	**4**	4
	42,245	39,179	**41,814**	38,534
Contingent liabilities (note 5.1)	**111**	123	**111**	123
Other credit commitments (note 5.1)	**8,408**	7,690	**8,382**	7,660
Maximum Credit Risk exposure	**50,764**	46,992	**50,307**	46,317

Mitigation

The management and mitigation 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 product, industry or geographic concentrations and delinquency trends.

There is regular analysis of the borrower's ability to meet their interest and capital repayment obligations with early support and mitigation steps taken where required. Credit risk mitigation is also supported, in part, by obtaining collateral, and corporate and personal guarantees where appropriate.

Other mitigating measures are described below:

Specialist expertise
Credit quality is managed and monitored by skilled teams including, where required, specialists who provide dedicated support for customers experiencing financial difficulty. Credit decisions utilise credit scoring techniques and manual underwriting, as appropriate. These tasks are performed by skilled and competent specialists acting within agreed delegated authority levels set in accordance with their experience and capabilities.

Credit policy and adherence to Policy Standards
Specialist teams oversee credit portfolio performance as well as adherence to credit risk policies and standards. Activities include targeted risk based reviews, providing an assessment of the effectiveness of internal controls and risk management practices. Bespoke assignments are also undertaken in response to emerging risks and regulatory requirements. Independent assurance reviews are also regularly undertaken by Internal Audit.

Portfolio oversight
Portfolios of credit and related risk exposures and the key benchmarks, behaviours and characteristics by which those portfolios are managed in terms of credit risk exposures are regularly reviewed. This entails the production and analysis of regular portfolio monitoring reports for review by senior management.

Risk Report (continued)

CREDIT RISK (continued)

Mitigation (continued)

Controls over rating systems
The Group has an Independent Model Validation Unit that sets common minimum standards. The standards are designed to ensure risk models and associated rating systems are developed consistently, and are of sufficient quality to support business decisions and meet regulatory requirements.

Stress Testing
Stress test scenarios are regularly prepared with the outcomes reviewed and relevant actions taken. Outputs will typically include impairment charges, RWA and write offs. Management will consider how each stress scenario may impact on different components of the credit portfolio. The primary method applied uses migration matrices, modelling the impact of PD rating migrations and changes in portfolio default rates to changes in macroeconomic factors to obtain a stressed position for the credit portfolios. Loss Given Default is stressed based on property price movements.

The Group also utilises other instruments and techniques across its wider balance sheet. These include:

Derivatives:
The Group maintains control limits on net open derivative positions. 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 may only be a small fraction of the contract, or notional values used to express the volume of instruments outstanding. This credit risk is managed as part of the customers overall exposure together with potential exposures from market movements.

Master netting agreements:
The Group further restricts its exposure to credit losses by entering into master netting arrangements with counterparties with whom it undertakes a significant volume of transactions. Master netting arrangements do not generally result in an offset of balance sheet assets and liabilities, as transactions are usually settled on a gross basis. However, credit risk associated with the favourable contracts is reduced by a master netting arrangement to the extent that if any counterparty failed to meet its obligations in accordance with the agreed terms, all amounts with the counterparty are terminated and settled on a net basis.

Derivative financial instrument contracts are typically subject to the International Swaps and Derivatives Association ('ISDA') master netting agreements, as well as Credit Support Annexes ('CSA'), where relevant, around collateral arrangements attached to those ISDA agreements. Derivative exchange or clearing counterparty agreements exist where contracts are settled via an exchange or clearing house.

Risk Report (continued)

CREDIT RISK (continued)

Credit Assessment and Mitigation for Retail & SME Customers

The Group uses a variety of lending criteria when assessing applications for Retail customers. The approval process uses credit scorecards, as well as manual underwriting, and involves a review of an applicant's previous credit history using information held by credit reference agencies.

The Group also assesses the affordability for the borrower under stressed scenarios including increased interest rates. In addition, the Group has in place quantitative thresholds such as maximum limits on the level of borrowing to income and the ratio of borrowing to collateral. Some of these limits relate to internal approval levels and others are hard limits above which the Group will reject the application.

For residential mortgages, the Group's policy is to accept only standard applications with a LTV less than 95%. The Group has maximum percentage LTV limits which depend upon the loan size. Product types such as BTL and residential interest only mortgages are controlled by transactional limits covering both LTV and value.

For SME customers, credit risk is managed in accordance with lending policies, the Group's risk appetite and the RMF. Lending policies and performance against risk appetite are reviewed regularly. Credit risk is further mitigated by focusing on business sectors where the Group has specific expertise and through limiting exposures on higher value loans and to certain sectors. When making credit decisions for SME customers the Group will routinely assess the primary source of repayment, most typically the cash generated by the customer through its normal trading cycle. Secondary sources of repayment are also considered and, whilst not the focus of the lending decision, collateral will be taken when appropriate. The Group seeks to obtain security cover and, where relevant, personal guarantees from borrowers.

Monitoring

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.

- *Credit Risk Committee (CRC)* The CRC ensures that the Credit RMF and associated policies remain effective. The Committee has oversight of the quality, composition and concentrations of the credit risk portfolio and considers strategies to adjust the portfolio to react to changes in market conditions.
- *RAS measures* Measures are monitored monthly and reviewed bi-annually, at a minimum, to ensure that the measures accurately reflect the Group's risk appetite, strategy and concerns relative to the wider macro environment. All measures are subject to extensive engagement with the Executive Leadership Team, the Board and are subject to endorsement from Executive Governance Committees prior to Board approval. Regulatory engagement is also scheduled as appropriate.
- *Risk concentration* Concentration of risk is managed by client/ counterparty, by product, by geographical region and by industry sector. In addition, single name exposure limits exist to control exposures to a single entity / counterparty. Concentrations are also considered through the RAS process focussing particularly on comparing the portfolio against market benchmarks.
- *Single large exposure excesses* All excesses are reported to the Transactional Credit Committee (TCC) and the relevant Head of Risk. Any exposure which continues or is expected to continue beyond 30 days will also be submitted to the TCC with proposals to correct the exposure within an agreed period, not to exceed 12 months.

Risk Report (continued)

CREDIT RISK (continued)

Concentrations

Loans and advances to customers (audited)

	Group		Bank	
	2017	2016	**2017**	2016
	£m	£m	**£m**	£m
Overdrafts	**1,524**	1,536	**1,524**	1,536
Credit cards	**396**	400	**396**	400
Lease finance	**594**	515	**575**	504
Mortgages	**23,480**	21,836	**22,442**	20,331
Other term lending – SME	**4,762**	4,393	**4,762**	4,393
Other term lending – retail	**709**	690	**709**	690
Trade finance	**23**	26	**23**	26
Gross loans and advances to customers	**31,488**	29,396	**30,431**	27,880
Accrued interest receivable	**75**	76	**72**	70
Unearned income	**(28)**	(26)	**(27)**	(25)
Deferred and unamortised fee income	**(32)**	(29)	**(33)**	(30)
Impairment provisions on credit exposures (note 3.6)	**(210)**	(215)	**(207)**	(212)
	31,293	29,202	**30,236**	27,683

The Group also has a portfolio of fair valued business loans and advances of £477m (2016: £750m) (note 3.3). Combined with the above this is equivalent to total loans and advances of £31,770m (2016: £29,952m).

Industry concentration of assets

The following tables show the levels of industry concentration of Credit Risk as at 30 September:

	Group		Bank	
Gross loans and advances to customers including loans designated at fair value through profit or loss (audited) [1]	**2017**	2016	**2017**	2016
	£m	£m	**£m**	£m
Government and public authorities	**32**	36	**32**	36
Agriculture, forestry, fishing and mining	**1,454**	1,458	**1,454**	1,458
Financial, investment and insurance	**650**	698	**650**	698
Property – construction	**279**	262	**279**	262
Manufacturing	**574**	577	**574**	577
Instalment loans to individuals and other personal lending (including credit cards)	**1,274**	1,344	**1,274**	1,344
Property – mortgage	**23,480**	21,836	**22,442**	20,331
Asset and lease financing	**594**	515	**575**	504
Other commercial and industrial	**3,630**	3,421	**3,630**	3,421
	31,967	30,147	**30,910**	28,631

[1] Includes balances due from customers on acceptances and excludes accrued interest.

Risk Report (continued)

CREDIT RISK (continued)

Contingent liabilities and credit related commitments (audited)	Group 2017 £m	Group 2016 £m	Bank 2017 £m	Bank 2016 £m
Government and public authorities	**426**	422	**426**	422
Agriculture, forestry, fishing and mining	**375**	382	**375**	382
Financial, investment and insurance	**165**	125	**165**	125
Property – construction	**154**	156	**154**	156
Manufacturing	**588**	658	**588**	658
Instalment loans to individuals and other personal lending (including credit cards)	**1,945**	1,931	**1,945**	1,931
Property – mortgage	**2,305**	1,780	**2,279**	1,750
Asset and lease financing	**125**	98	**125**	98
Other commercial and industrial	**2,436**	2,261	**2,436**	2,261
	8,519	7,813	**8,493**	7,783

Credit quality of loans and advances

For SME lending, the Group has an internally developed credit rating system, as defined under the Group's credit risk management policy, which 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 PD for each customer and can be broadly mapped to external agencies rating scales. Impaired assets consist of SME lending and secured Retail lending where current circumstances indicate that losses of loan principal and / or interest may be incurred.

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

Mitigation and Management of Credit Risk

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 ratings policy.

The table below represents the credit quality of SME loans and advances that are neither past due nor impaired (audited):

	Group 2017 £m	Group 2016 £m	Bank 2017 £m	Bank 2016 £m
Senior investment grade	**946**	1,077	**943**	1,075
Investment grade	**1,807**	1,557	**1,802**	1,555
Sub-investment grade	**3,873**	3,533	**3,862**	3,526
	6,626	6,167	**6,607**	6,156

Risk Report (continued)

CREDIT RISK (continued)

Credit quality of loans held at fair value through profit or loss that are neither past due nor impaired (audited):

	Group		Bank	
	2017	2016	**2017**	2016
	£m	£m	**£m**	£m
Senior investment grade	**3**	6	**3**	6
Investment grade	**231**	259	**231**	259
Sub-investment grade	**237**	466	**237**	466
	471	731	**471**	731

For Retail lending, the Group has developed specific credit rating systems for both origination of new lending and for ongoing customer and account management purposes. These systems assign risk estimates to all Retail lending and enable active management of customer exposures and portfolios.

Collateral

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 can vary, 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 with the proceeds used to reduce or repay the outstanding balance. In general, the Group does not occupy repossessed properties for its own business use.

Risk Report (continued)

CREDIT RISK (continued)

Collateral held as security and other credit enhancements (continued)

The LTV ratio of Retail mortgage lending, coupled with the relationship of the debt to customers' income, is key to the credit quality of these loans. The table below sets out the indexed LTV analysis of the Group's Retail mortgage stock.

LTV ratio (audited)[1]	2017 %	2016 %
Less than 50%	33	34
50% to 75%	49	50
76% to 80%	7	6
81% to 85%	4	4
86% to 90%	4	2
91% to 95%	1	1
96% to 100%	-	-
Greater than 100%	-	-
Unknown	2	3
	100	100

[1]LTV of the mortgage portfolio is defined as mortgage portfolio weighted by balance and indexed using the MIAC Acadametrics indices at a given date. Prior period comparatives have been restated on the new basis of indexation, the previous basis adopted the Halifax house price index. Unknown represents loans where data is not currently available due to front book data matching still to be completed and a *de minimis* amount due to weaknesses in historic data capture processes.

Residential Mortgages

Residential property is the Group's main source of collateral and means of mitigating loss in the event of the default credit risk inherent in its residential mortgage portfolios. All lending activities are supported by an appropriate form of valuation using either professional or indexed (subject to policy rules and confidence levels) valuations.

Commercial property

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

Risk Report (continued)

CREDIT RISK (continued)

Non property related collateral

In addition to residential and commercial property based security, the Group also takes other forms of collateral when lending. 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.

The following table shows the total non property collateral held by sector at 30 September in terms of cash, guarantees (these guarantors are predominantly other financial institutions who are considered to be of a high credit 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 where 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 elsewhere in this section.

Group (audited) 2017	**Cash £m**	**Guarantee £m**	**Netting £m**	**Total £m**	**Exposure £m**
Central Government or Central Bank	3,264	-	-	3,264	4,629
Corporates	27	25	42	94	104
Financial institutions	874	-	-	874	970
Past due items	-	-	-	-	4
Public sector entities	-	-	-	-	-
Regional Government or local authorities	-	-	59	59	59
Retail	-	-	-	-	-
Secured by mortgages on commercial real estate	3	-	31	34	74
Secured by mortgages on residential property	1	-	3	4	9
	4,169	25	135	4,329	5,849

Group (audited) 2016	Cash £m	Guarantee £m	Netting £m	Total £m	Exposure £m
Central Government or Central Bank	721	-	-	721	1,027
Corporates	49	40	32	121	135
Financial institutions	504	-	-	504	600
Past due items	-	-	-	-	3
Public sector entities	-	-	-	-	-
Regional Government or local authorities	-	-	94	94	94
Retail	-	-	-	-	-
Secured by mortgages on commercial real estate	4	-	35	39	107
Secured by mortgages on residential property	2	-	3	5	12
	1,280	40	164	1,484	1,978

The increase in cash collateral held and corresponding exposure is due to increased repurchase (repo) and similar transactions outstanding at 30 September 2017 (including TFS drawings), reflected within Central Governments or Central Banks. The increase in cash collateral held and corresponding exposure in financial institutions is due to an increase in the reimbursement receivable from NAB via CYBG in relation to the conduct indemnity deed.

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

Risk Report (continued)

CREDIT RISK (continued)

Forbearance

Forbearance is considered to take place when the Group grants concessions to assist customers who are experiencing, or who are about to experience, difficulties in meeting their financial commitments to the Group. The Group's forbearance policies and definitions comply with the guidance established by the European Banking Authority for FINREP reporting. Forbearance concessions include the granting of more favourable terms and conditions than those provided either at drawdown of the facility or which would not ordinarily be available to other customers with a similar risk profile. Forbearance 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 makes every effort to treat customers fairly and aligns its forbearance practices to that principle.

Whilst forbearance alone is not necessarily an indicator of impaired status, it is a trigger for the review of the customer's credit profile and forbearance is only granted when there is a realistic prospect of the customer repaying all facilities in full. If there is any concern over future cash flows and the Group incurring a loss, then forborne loans will also be classified as impaired in accordance with the Group's impairment policy.

Exposures classified as forborne and performing at the date forbearance measures are granted, continue to be reported as subject to forbearance for a minimum period of two years from that date (the 'probation period'). Exposures classified as forborne and which are non performing when customers were granted forbearance cannot exit non performing status for a minimum of twelve months from the date forbearance was granted, and cannot exit forbearance status for a further two years from the date of returning to performing status (three years in total).

The Group has identified a number of situations that in isolation are not considered to be forbearance:

- 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 to a level where actual, or apparent, financial stress is not evident.
- Where changes are made to the terms of a borrower's interest structure or repayment arrangement on a commercial basis.
- Late provision of financial information, in the absence of other indicators of financial difficulty, is not in all cases considered a 'non commercial' breach of non-financial covenants.

For both Retail and SME, where the Group has made a demand for repayment, the customer's facilities have been withdrawn or where a debt repayment process has been initiated, the exposure is classified as forborne if the debt is subject to any of the mentioned forbearance concessions.

Retail forbearance

The Group utilises various forbearance measures for retail customers, specific to the individual customer and their circumstances. Customers may potentially be subject to more than one forbearance strategy at any one time where this is considered to be the most appropriate course of action.

Debt management for Mortgage customers in financial difficulty

To support customers who are encountering financial difficulties, cases are managed on an individual basis, with the circumstances of each customer considered separately and the action taken judged as being affordable and sustainable for the customer. Operationally, the provision and review of such assistance is controlled by various methods. These include the application of an appropriate policy framework, controls around the execution of policy, regular review of the different treatments to confirm that they remain appropriate, monitoring of customers' performance including the level of payments received, and management visibility of the nature and extent of assistance provided and the associated risk.

Help is provided through the Financial Care Team where tailored repayment programmes can be agreed. Customers are actively supported and referred to free money advice agencies when they have multiple credit facilities, including those at other lenders, that require restructuring.

Risk Report (continued)

CREDIT RISK (continued)

Retail forbearance (continued)

Debt management for Mortgage customers in financial difficulty (continued)
One component of the Group's approach is to contact customers showing signs of financial difficulty to discuss their circumstances and offer solutions to prevent their accounts falling into arrears.

The tables below summarise the level of forbearance in respect of the Group's mortgage portfolio:

Group (audited) As at 30 September 2017	Total loans and advances subject to forbearance measures			Impairment allowance on loans and advances subject to forbearance measures	
	Number of loans	Gross carrying amount £m	% of total portfolio	Impairment allowance £m	Coverage %
Formal arrangements	1,614	164	0.69	3.9	2.43
Temporary arrangements	1,418	174	0.74	3.0	1.72
Interest only conversion	202	30	0.13	0.2	0.56
Term extension	149	12	0.05	0.1	0.51
Other	29	2	0.01	-	0.61
Legal	167	16	0.07	0.9	5.66
	3,579	398	1.69	8.1	2.04

Group (audited) As at 30 September 2016	Total loans and advances subject to forbearance measures			Impairment allowance on loans and advances subject to forbearance measures	
	Number of loans	Gross carrying amount £m	% of total portfolio	Impairment allowance £m	Coverage %
Formal arrangements	1,843	169	0.78	5.5	3.27
Temporary arrangements	1,460	160	0.73	2.7	1.68
Interest only conversion	154	22	0.10	0.1	0.26
Term extension	123	11	0.05	0.1	0.61
Other	22	2	0.01	-	0.84
Legal	195	20	0.09	1.1	5.60
	3,797	384	1.76	9.5	2.48

The Group also has a number of customers with interest only mortgages past maturity, not subject to forbearance. The Group has formal processes embedded to proactively track and facilitate prematurity customer engagement to bring the cases to a formal conclusion which is generally aimed to be achieved within six months after the loan has reached maturity. Complex cases can take longer than this to reach conclusion. At 30 September 2017, the Group had 97 (2016: 102) customers with interest only mortgages not subject to forbearance and which were post six month maturity with a total value of £14m (2016: £12m).

A further forbearance reserve of £4m (2016: £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 £12.1m (2016: £13.5m) and to increase overall coverage to 3.05% (2016: 3.52%). 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 2017 there were 50 repossessions of which 13 were voluntary (2016: 78 including 27 voluntary).

Risk Report (continued)

CREDIT RISK (continued)

Retail forbearance (continued)

Retail forbearance – unsecured consumer credit
The Group currently exercises limited forbearance strategies in relation to other types of consumer credit, including current accounts, unsecured loans and credit cards. The Group has assessed the total loan balances subject to forbearance on other types of consumer credit lending to be £11m at 30 September 2017 (2016: £14m), representing 1.02% of the unsecured Retail portfolio (2016: 1.33%). Impairment provisions on forborne balances totalled £3.1m at 30 September 2017 (2016: £4.2m), providing overall coverage of 27.18% (2016: 29.02%).

SME Forbearance

Forbearance is considered to exist for SME customers where one or more concessions are granted on a non commercial basis. The Group reports SME forbearance at a customer level and at a value which incorporates all facilities and the related impairment allowance irrespective of whether each individual facility is subject to forbearance. Authority to grant forbearance measures for SME customers is held by the Group's Strategic Business Services unit and is exercised, where appropriate, on the basis of detailed consideration of the customer's financial position and prospects.

Where a customer is part of a larger group, forbearance is exercised and reported across the Group at the individual entity level. Where modification of the terms and conditions of an exposure meeting the criteria for classification as forbearance results in derecognition of loans and advances from the balance sheet and the recognition of a new exposure, the new exposure shall be treated as forborne.

The tables below summarise the total number of arrangements in place and the loan balances and impairment provisions associated with those arrangements.

Group (audited) As at 30 September 2017	Total loans and advances subject to forbearance measures			Impairment allowance on loans and advances subject to forbearance measures	
	Number of loans	Gross carrying amount £m	% of total portfolio	Impairment allowance £m	Coverage %
Term extension	206	190	2.58	12.8	6.71
Deferral of contracted capital repayments	109	141	1.91	20.4	14.47
Reduction in contracted interest rate	3	1	0.02	-	3.37
Alternative forms of payment	5	28	0.37	8.1	29.40
Debt forgiveness	3	11	0.15	1.4	12.70
Refinancing	19	33	0.44	4.4	13.41
Covenant breach/reset/waiver	50	155	2.11	8.1	5.24
	395	559	7.58	55.2	9.88

Risk Report (continued)

CREDIT RISK (continued)

SME Forbearance (continued)

Group (audited) As at 30 September 2016	Total loans and advances subject to forbearance measures			Impairment allowance on loans and advances subject to forbearance measures	
	Number of loans	Gross carrying amount £m	% of total portfolio	Impairment allowance £m	Coverage %
Term extension	350	320	4.43%	25.3	7.90%
Deferral of contracted capital repayments	118	143	1.99%	18.2	12.69%
Reduction in contracted interest rate	7	8	0.12%	0.6	7.01%
Alternative forms of payment	7	35	0.48%	11.2	32.37%
Debt forgiveness	8	26	0.36%	2.4	9.16%
Refinancing	22	51	0.70%	4.9	9.76%
Covenant breach/reset/waiver	62	208	2.88%	8.6	4.12%
	574	791	10.96%	71.2	8.99%

Included in other financial assets at fair value is a portfolio of loans that is included in the above table. The principal value of fair value loans subject to forbearance at 30 September 2017 is £45m (2016: £101m), representing 0.61% of the total SME portfolio (2016: 1.40%). Impairment allowances on these amounts totalled £4m (2016: £11m), a coverage of 8.89% (2016: 10.82%).

Risk Report (continued)

CREDIT RISK (continued)

Credit Quality of Customer Lending

An assessment of the credit quality of loans and advances to customers is shown below.

Distribution of loans and advances to customers by credit quality (audited)

Group
As at 30 September 2017

	Retail overdrafts £m	Credit cards £m	Other retail lending £m	Mortgages £m	Lease finance £m	SME lending[1] £m	Total £m
Gross loans and advances:							
Neither past due nor impaired	51	384	635	23,104	572	6,054	30,800
Past due but not impaired	7	12	16	327	22	129	513
Impaired	-	-	-	49	-	126	175
	58	396	651	23,480	594	6,309	31,488

As at 30 September 2016

	Retail overdrafts £m	Credit cards £m	Other retail lending £m	Mortgages £m	Lease finance £m	SME lending[1] £m	Total £m
Gross loans and advances:							
Neither past due nor impaired	57	388	612	21,485	502	5,665	28,709
Past due but not impaired	6	12	15	285	11	144	473
Impaired	-	-	-	66	2	146	214
	63	400	627	21,836	515	5,955	29,396

Bank
As at 30 September 2017

	Retail overdrafts £m	Credit cards £m	Other retail lending £m	Mortgages £m	Lease finance £m	SME lending [1] £m	Total £m
Gross loans and advances:							
Neither past due nor impaired	51	384	635	22,099	553	6,054	29,776
Past due but not impaired	7	12	16	300	22	129	486
Impaired	-	-	-	43	-	126	169
	58	396	651	22,442	575	6,309	30,431

As at 30 September 2016

	Retail overdrafts £m	Credit cards £m	Other retail lending £m	Mortgages £m	Lease finance £m	SME lending [1] £m	Total £m
Gross loans and advances:							
Neither past due nor impaired	57	388	612	20,015	491	5,665	27,228
Past due but not impaired	6	12	15	258	11	144	446
Impaired	-	-	-	58	2	146	206
	63	400	627	20,331	504	5,955	27,880

[1]SME lending includes business overdrafts.

Risk Report (continued)

CREDIT RISK (continued)

Credit Quality of Customer Lending (continued)

Credit risk categorisation	Description
Neither past due nor impaired	Loans that are not in arrears and where there is no objective evidence of impairment
Past due but not impaired	Loans that are in arrears but have not been individually assessed as impaired
Impaired	Loans which have been individually assessed for impairment as there is objective evidence of impairment including changes in customer circumstances

Loans and advances which were past due but not impaired

Loans and advances that are past due but 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.

Unsecured retail lending and credit cards are written off when they reach 180 DPD and are not designated as impaired, in compliance with the EU Payment Accounts Directive.
The distribution of gross loans and advances that are past due but not impaired is analysed below:

Group
2017 (audited)

	Retail overdrafts £m	Credit cards £m	Other retail lending £m	Mortgages £m	Lease finance £m	SME lending [(1)] £m	Total £m
1 to 29 DPD	5	6	6	142	22	88	269
30 to 59 DPD	1	2	3	32	-	10	48
60 to 89 DPD	-	1	2	30	-	2	35
Past due 90 days and over	1	3	5	123	-	29	161
	7	12	16	327	22	129	513

Group
2016 (audited)

	Retail overdrafts £m	Credit cards £m	Other retail lending £m	Mortgages £m	Lease finance £m	SME lending [(1)] £m	Total £m
1 to 29 DPD	5	6	6	81	11	82	191
30 to 59 DPD	-	2	3	65	-	27	97
60 to 89 DPD	-	1	2	28	-	4	35
Past due 90 days and over	1	3	4	111	-	31	150
	6	12	15	285	11	144	473

[(1)]SME lending includes business overdrafts.

Risk Report (continued)

CREDIT RISK (continued)

Loans and advances which were past due but not impaired (continued)

Bank 2017 (audited)	Retail overdrafts £m	Credit cards £m	Other retail lending £m	Mortgages £m	Lease finance £m	SME lending [1] £m	Total £m
1 to 29 days past due	5	6	6	132	22	88	259
30 to 59 days past due	1	2	3	28	-	10	44
60 to 89 days past due	-	1	2	27	-	2	32
Past due 90 days and over	1	3	5	113	-	29	151
	7	12	16	300	22	129	486

Bank 2016 (audited)	Retail overdrafts £m	Credit cards £m	Other retail lending £m	Mortgages £m	Lease finance £m	SME lending [1] £m	Total £m
1 to 29 days past due	5	6	6	70	11	82	180
30 to 59 days past due	-	2	3	61	-	27	93
60 to 89 days past due	-	1	2	26	-	4	33
Past due 90 days and over	1	3	4	101	-	31	140
	6	12	15	258	11	144	446

[1]SME lending includes business overdrafts.

Risk Report (continued)

CREDIT RISK (continued)

Movement in impairment provisions throughout the year

Group
2017 (audited)

	Retail overdrafts £m	Credit cards £m	Other retail lending £m	Mortgages £m	Lease finance £m	SME lending[1] £m	Total £m
Opening balance	3	6	10	39	2	155	215
Charge for the year	2	6	9	(2)	-	33	48
Amounts written off	(4)	(9)	(13)	(4)	-	(45)	(75)
Recoveries of amounts written off in previous years	3	4	6	-	-	5	18
Other[2]	-	-	-	-	-	4	4
Closing balance	4	7	12	33	2	152	210
Specific	-	-	-	13	-	43	56
Collective	4	7	12	20	2	109	154
	4	7	12	33	2	152	210

Group
2016 (audited)

	Retail overdrafts £m	Credit cards £m	Other retail lending £m	Mortgages £m	Lease finance £m	SME lending[1] £m	Total £m
Opening balance	5	7	11	39	2	166	230
Charge for the year	(1)	3	5	1	1	30	39
Amounts written off	(4)	(9)	(14)	(2)	-	(39)	(68)
Recoveries of amounts written off in previous years	4	5	7	1	-	1	18
Other[2]	(1)	-	1	-	(1)	(3)	(4)
Closing balance	3	6	10	39	2	155	215
Specific	-	-	-	19	1	44	64
Collective	3	6	10	20	1	111	151
	3	6	10	39	2	155	215

[1]SME lending includes business overdrafts.
[2]Other includes the recognition of certain impaired loans which were previously recorded at Fair Value through Profit or Loss, the unwind of net present value elements of specific provisions and other minor movements.

Risk Report (continued)

CREDIT RISK (continued)

Movement in impairment provisions throughout the year (continued)

Bank 2017 (audited)	Retail overdrafts £m	Credit cards £m	Other retail lending £m	Mortgages £m	Lease finance £m	SME lending [1] £m	Total £m
Opening balance	3	6	10	36	2	155	212
Charge for the year	2	6	9	(2)	-	33	48
Amounts written off	(4)	(9)	(13)	(4)	-	(45)	(75)
Recoveries of amounts written off in previous years	3	4	6	-	-	5	18
Other [2]	-	-	-	-	-	4	4
Closing balance	4	7	12	30	2	152	207
Specific	-	-	-	11	-	43	54
Collective	4	7	12	19	2	109	153
	4	7	12	30	2	152	207

Bank 2016 (audited)	Retail overdrafts £m	Credit cards £m	Other retail lending £m	Mortgages £m	Lease finance £m	SME lending [1] £m	Total £m
Opening balance	5	7	11	35	2	166	226
Charge for the year	(1)	3	5	-	1	30	38
Amounts written off	(4)	(9)	(14)	(2)	-	(39)	(68)
Recoveries of amounts written off in previous years	4	5	7	1	-	1	18
Other [2]	(1)	-	1	2	(1)	(3)	(2)
Closing balance	3	6	10	36	2	155	212
Specific	-	-	-	17	1	44	62
Collective	3	6	10	19	1	111	150
	3	6	10	36	2	155	212

(1) SME lending includes business overdrafts.
(2) Other includes the recognition of certain impaired loans which were previously recorded at Fair Value through Profit or Loss, the unwind of net present value elements of specific provisions and other minor movements.

Risk Report (continued)

CREDIT RISK (continued)

Other Credit Risks

The Group is exposed to credit risk on its other banking activities, which are subject to mitigation and monitoring. No provisions are currently held for these exposures.

Offsetting of financial assets and liabilities

The Group does not have any financial assets or financial liabilities that are offset with the net amount presented on the balance sheet. This is because IAS 32 'Financial Instruments – Presentation' states that there should be both an enforceable right to set off and the intention either to settle on a net basis or to realise the asset and settle the liability simultaneously. Neither of these conditions are met by the Group. The table below illustrates the amounts for financial instruments that are covered by enforceable netting arrangements (*i.e.* offsetting agreements and any related financial collateral). The table excludes financial instruments not subject to offset and that are only subject to collateral arrangements (*e.g.* loans and advances).

The net amounts presented in the table are not intended to represent the Group's exposure to credit risk, as the Group will use a wide range of strategies to mitigate credit risk in addition to netting and collateral.

Group 2017 (audited)				**Net amounts not offset in the balance sheet**		
	Gross Amounts £m	**Gross amounts offset in the balance sheet [1] £m**	**Net Amounts presented on balance sheet [1] £m**	**Financial instruments £m**	**Cash Collateral Pledged/ Received £m**	**Net Amount £m**
Assets						
Derivative financial instruments [2]	282	-	282	(72)	(22)	188
Liabilities						
Derivative financial instruments [2]	376	-	376	(72)	(203)	101
Securities sold under repurchase agreement	1,864	-	1,864	(1,864)	-	-

Group 2016 (audited)				Net amounts not offset in the balance sheet		
	Gross Amounts £m	Gross amounts offset in the balance sheet [1] £m	Net Amounts presented on balance sheet [1] £m	Financial instruments £m	Cash Collateral Pledged/ Received £m	Net Amount £m
Assets						
Derivative financial instruments [2]	585	-	585	(306)	(55)	224
Liabilities						
Derivative financial instruments [2]	598	-	598	(306)	(245)	47
Securities sold under repurchase agreement	1,226	-	1,226	(1,226)	-	-

[1] Collateral amounts (cash and non-cash financial collateral) are reflected at their fair value; however this amount is limited to the net balance sheet exposure in order to exclude any over collateralisation.

[2] Derivative financial instruments comprise of both trading and hedging derivative assets and liabilities.

Risk Report (continued)

CREDIT RISK (continued)

Offsetting of financial assets and liabilities (continued)

Bank 2016 (audited)	Gross Amounts £m	Gross amounts offset in the balance sheet [1] £m	Net Amounts presented on balance sheet [1] £m	Net amounts not offset in the balance sheet: Financial instruments £m	Net amounts not offset in the balance sheet: Cash Collateral Pledged/ Received £m	Net Amount £m
Assets						
Derivative financial instruments [2]	136	-	136	(72)	(22)	42
Liabilities						
Derivative financial instruments [2]	376	-	376	(72)	(203)	101
Securities sold under repurchase agreement	1,864	-	1,864	(1,864)	-	-

Bank 2015 (audited)	Gross Amounts £m	Gross amounts offset in the balance sheet [1] £m	Net Amounts presented on balance sheet [1] £m	Net amounts not offset in the balance sheet: Financial instruments £m	Net amounts not offset in the balance sheet: Cash Collateral Pledged/ Received £m	Net Amount £m
Assets						
Derivative financial instruments [2]	388	-	388	(172)	(55)	161
Liabilities						
Derivative financial instruments [2]	587	-	587	(172)	(309)	106
Securities sold under repurchase agreement	1,226	-	1,226	(1,226)	-	-

[1] Collateral amounts (cash and non-cash financial collateral) are reflected at their fair value; however this amount is limited to the net balance sheet exposure in order to exclude any over collateralisation.

[2] Derivative financial instruments comprise of both trading and hedging derivative assets and liabilities.

Derivative financial instrument contracts are typically subject to ISDA master netting agreements, as well as CSAs, where relevant, around collateral arrangements attached to those ISDA agreements, or derivative exchange or clearing counterparty agreements if contracts are settled via an exchange or clearing house. The amounts included in Financial Instruments column refers to amounts that are subject to relevant close out netting arrangements under a relevant ISDA agreement.

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS

Balance Sheet Risks in the financial services industry are highly regulated with ongoing changes in the regulatory environment expected to influence the risks and their management. The key risks include Capital, Liquidity and Funding Risks, Market Risk which in the case of the Group is non traded market risk (incorporating Interest Rate and Foreign Exchange Risks), Pension Risk and Non Traded Equity Risk.

12.4%	115%	164%
Common Equity Tier 1	Loan to Deposit Ratio	Liquidity Coverage Ratio

Risk appetite

The primary objective for the management of balance sheet risks is to maintain the risk profile within approved risk limits, to maintain the confidence of the Group/s customers and other stakeholders, Balance sheet risks are also managed to protect current and future earnings from the impact of market volatility. The Group applies a prudent approach to balance sheet risks in order to safeguard the on-going strength and resilience of the balance sheet.

Risk appetite is approved for balance sheet risks by the Board, with authority delegated to ALCO for subsequent implementation and monitoring. The Board has established a range of measures of risk appetite for capital including Common Equity Tier 1, leverage and minimum holdings of capital. Measures for funding and liquidity risks consider the structure of the balance sheet and include, amongst others, measures relating to the proportion of customer funding, the Group's overall funding profile and an Overall Liquid Asset Rule (OLAR). The OLAR covers the Board's appetite in relation to regulatory liquidity requirements and also covers the need to maintain a volume of high quality liquid assets that is sufficient to accommodate outflows of funds in a range of stress scenarios over a 3 month period.

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. The Group establishes an appetite for these risks based on an overriding principle that the Group will not engage in proprietary risk taking.

In assessing the adequacy of its capital resources, the Group considers its risk appetite, the material risks to which it is exposed and the appropriate strategies required to manage those risks. The Group is committed to maintaining a strong capital base.

Capital

Capital is held by the Group to protect its depositors, to cover inherent risks in a normal and stressed operating environment and to support the Group's strategy of sustainable customer growth. Capital risk is the risk that the Group has insufficient quantity or quality of capital to support its operations.

Mitigation measures

The Group's Capital Risk Standard provides the framework for the manner in which capital is managed within the Group. The objectives of the Standard are to manage efficiently the capital base to optimise shareholder returns whilst maintaining robust capital adequacy, meeting Regulators' requirements, managing the ratings agencies assessment of the Group and ensuring that excessive leverage is not taken. A shortfall in capital resources would occur when the Group exceeds its risk appetite and is at risk of not having sufficient capital to support future growth objectives.

Measurement

The Group manages capital in accordance with prudential rules issued by the PRA and FCA, which implemented CRD IV legislation with effect from 1 January 2014. The Group's approach to Pillar 1 is to use the standardised approaches to calculating RWA. The standardised approaches are inherently conservative and the Group is developing the capability to apply for a waiver to utilise IRB methods for the calculation of credit risk capital.

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

Measurement (continued)

A rigorous approach is taken to assess risks that are not adequately covered by Pillar 1, including IRRBB and pension risk. The Group also undertakes a range of stress scenarios in order to test the impact on capital arising from severe yet plausible scenarios. These approaches to capital are thoroughly documented in the Group's ICAAP and this is subject to review, challenge and approval by the Board.

Capital Buffers

The regulatory capital buffer framework is intended to ensure firms maintain a sufficient amount of capital above their regulatory minimum in order to withstand periods of stress. The UK is implementing the provisions on capital buffers outlined in the CRD to create combined capital buffers including a: Capital Conservation Buffer (CCB); Countercyclial Capital Buffer (CCyB); Global Systemically Important Institution Buffer; and Systemic Risk Buffer (SRB). In the UK, the CCB has been introduced with transitional provisions from 2016 (0.625%) to 2019 (2.5%).

The CCyB has been effective from 1 May 2014 and is dependent upon the BoE view of credit conditions in the economy. On 27 June 2017 the BoE Financial Policy Committee (FPC) increased the UK CCyB rate to 0.5% from 0%, to take effect from 27 June 2018. Absent a change in the outlook, and consistent with its stated policy for a standard risk environment and of moving gradually, the FPC expects to increase the rate to 1% at its November 2017 meeting which will take effect in November 2018.

The Group's capital planning considers the impact of all relevant capital buffers.

The PRA's final rules on the approach to identifying other systemically important institutions (O-SII) were published in February 2016. In line with expectations the Group was not designated an O-SII. Similarly the FPC issued its final framework for setting the SRB in May 2016. This confirmed that banks with total assets of less than £175bn (which includes the Group) will be subject to a 0% SRB.

Monitoring

The capital plan is approved by the Board on an annual basis. The Group's ALCO monitors the capital plan and forecast positions on a monthly basis. This ensures that performance trends are appropriately reviewed and that there is transparency on the impact on capital ratios, risk appetite and the future outlook.

Recent Developments

Information on banking reform, ring fencing and resolution all of which may impact the Group's capital and funding structures, are provided in the regulatory and political environment update within the Strategic Report of the CYBG Annual Report and Accounts.

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

Capital position

The Group's capital position as at 30 September is summarised below.

Regulatory capital (unaudited) [1]	2017 £m	2016 £m
CET1 capital		
Capital instruments	**502**	324
Retained earnings and other reserves	**2,527**	2,472
Regulatory adjustments and deductions		
Defined benefit pension fund assets (net of deferred tax liabilities) [2]	**(135)**	(7)
Prudent valuation adjustment [3]	**(4)**	(256)
Intangible assets [4]	**(339)**	(71)
Deferred tax asset relying on future profitability [5]	**(110)**	(69)
Cash flow hedge reserve	**(1)**	-
	2,440	2,393
Tier 1 capital		
Additional Tier 1 (AT1) capital instruments	**425**	425
Total Tier 1 capital	**2,865**	2,818
Tier 2 capital		
Subordinated debt	**476**	479
Credit Risk adjustments	**154**	151
Total Tier 2 capital	**630**	630
Total capital	**3,495**	3,448

[1] This table shows the capital position on a CRD IV "fully loaded" basis.
[2] The defined benefit pension fund asset (net of deferred tax liabilities) does not qualify as capital for regulatory purposes.
[3] A prudent valuation adjustment is applied in respect of fair valued instruments as required under regulatory capital rules.
[4] Intangible assets shall be deducted from capital for regulatory purposes.
[5] Under CRD IV, deferred tax assets that rely on future profitability are deducted from CET1 capital.

Reconciliation of statutory total equity to regulatory capital (unaudited)	2017 £m	2016 £m
Statutory total equity	**3,464**	3,221
Deductions from capital	**(478)**	(263)
Deferred tax asset relying on future profitability	**(110)**	-
Cash flow hedge reserve	**(1)**	(71)
Foreseeable AT1 dividends and charges	**(10)**	(69)
Regulatory Tier 1 capital	**2,865**	2,818

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

Regulatory capital flow of funds (unaudited)	CRD IV 2017 £m	CRD IV 2016 £m
CET1 capital		
CET1 capital at 1 October	2,393	2,420
Share capital: ordinary share new issuance	178	426
Share premium	-	-
Retained earnings and other reserves (including structured entities)	55	2,279
Prudent valuation adjustment	3	(2)
Intangible assets	(83)	9
Deferred tax asset relying on future profitability	(39)	202
Defined benefit pension fund assets	(135)	42
Share capital redenomination	-	(2,914)
Cash flow hedge reserve	68	(69)
CET1 capital at 30 September	2,440	2,393
Tier 1 capital		
Tier 1 capital at 1 October	425	450
Capital instruments repurchased: Perpetual Capital Notes	-	(450)
Capital instruments issued: Perpetual Subordinated Contingent Convertible Notes	-	425
Capital instruments issued: AT1 Perpetual Capital Notes	-	-
Tier 1 capital at 30 September	425	425
Total Tier 1 capital	2,865	2,818
Tier 2 capital		
Tier 2 capital at 1 October	630	613
Credit Risk adjustments	3	13
Subordinated debt redemption	(3)	-
Capital instruments repurchased: Subordinated Debt	-	(475)
Capital instruments issued: Perpetual Subordinated Debt	-	479
Total Tier 2 capital at 30 September	630	630
Total capital	3,495	3,448

Minimum Pillar 1 capital requirements (unaudited)	2017 £m	2016 £m
Credit Risk	1,449	1,353
Operational risk	131	128
Counterparty risk	11	17
Credit valuation adjustment	13	23
Tier 1 regulatory capital requirements	1,604	1,521

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

RWA movements

RWA flow statement (unaudited)	**2017**	2016
	£m	£m
RWA at 1 October	**19,017**	18,207
Book size growth / (reduction)	**918**	628
Book quality (improvement) / deterioration	**(28)**	182
Methodology and policy	**148**	-
Other	**-**	-
RWAs at 30 September	**20,055**	19,017

(1) The improvement in book quality is primarily due to the continued diversification in the Liquid Asset Buffer, where we are investing in a number of high quality liquid assets from AAA rated issuance programmes;

(2) The definition of default was enhanced to capture a broader interpretation of the regulatory requirements as part of the Group's programme of activity to prepare for IRB accreditation, which led to an increase in RWAs. This change does not reflect any movement in the underlying risk profile of the portfolio and is only a reporting and Probability of Default model build enhancement.

Pillar 1 RWAs and Capital requirements by business line (unaudited)

Capital requirements for calculating RWA s	**At 30 September 2017**			At 30 September 2016		
	Capital required	**RWA**	**Exposure**	Capital required	RWA	Exposure (restated)
	£m	**£m**	**£m**	£m	£m	£m
Central Governments or Central Banks	**-**	**-**	**12,582**	-	-	6,986
Regional Governments or Local Authorities	**2**	**19**	**156**	2	20	192
Public Sector Entities	**-**	**5**	**155**	-	5	13
Multilateral development banks	**-**	**-**	**205**	-	-	195
Financial Institutions	**13**	**163**	**1,089**	19	234	1,337
Corporates[1]	**302**	**3,782**	**4,155**	283	3,540	3,853
Retail	**72**	**905**	**1,207**	72	897	1,196
Secured by mortgages on immovable property	**961**	**12,001**	**28,203**	899	11,242	26,482
Exposures in default	**47**	**590**	**483**	33	408	340
Collective investments undertakings	**-**	**1**	**1**	-	3	3
Equity exposures	**-**	**5**	**3**	1	11	9
Items associated with particularly high risk	**3**	**40**	**26**	1	15	10
Covered bonds	**4**	**48**	**477**	2	19	191
Other items	**45**	**557**	**585**	41	518	1,649
Total Credit Risk	**1,449**	**18,116**	**49,327**	1,353	16,912	42,456
Operational risk	**131**	**1,634**		128	1,606	
Counterparty risk	**11**	**138**		17	214	
Credit valuation adjustment	**13**	**167**		23	285	
	1,604	**20,055**		1,521	19,017	

The 'Exposure' amounts disclosed above are post credit conversion factors and pre credit mitigation.

[1] FY2016 comparatives have been restated for the following, with no impact to total RWA or capital requirement:

- £1.1bn of Bank of England backing assets reallocated from 'other items' to 'central government or central banks' asset class; and
- £114m exposure reallocated from 'corporates' to 'other items' asset class.

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

Capital position & CET1 movements (unaudited)	**2017**	2016
	£m	£m
RWAs [1]		
Retail mortgages	**8,646**	7,998
Business lending	**7,359**	7,087
Other retail lending	**932**	916
Other lending	**148**	152
Other [2]	**1,031**	759
Credit risk	**18,116**	16,912
Operational risk	**1,634**	1,606
Counterparty risk	**138**	214
Credit valuation adjustment	**167**	285
Total RWAs	**20,055**	19,017
Capital ratios		
CET1 ratio	**12.2%**	12.6%
Tier 1 ratio	**14.3%**	14.8%
Total capital ratio	**17.4%**	18.1%

[1] RWAs are calculated under the standardised approach.

[2] The items included in the 'other' exposure class that attract a capital charge include items in the course of collection, cash in hand, fixed assets and deferred tax assets that are not deducted.

Leverage ratio (unaudited)	**2017**	2016
	£m	£m
Total Tier 1 capital for the leverage ratio		
Total CET1 capital	**2,440**	2,393
AT1 capital	**425**	425
Total Tier 1	**2,865**	2,818
Exposures for the leverage ratio		
Total statutory assets	**43,314**	39,963
Adjustment for off-balance sheet items	**2,019**	1,982
Adjustment for derivative financial instruments	**(228)**	(399)
Adjustment for securities financing transactions (SFTs)	**1,461**	601
Other adjustments	**(589)**	(403)
Leverage ratio exposure	**45,977**	41,744
Modified Leverage ratio [1]	**6.2%**	6.8%

[1] The Group's leverage ratio on a modified basis, excluding qualifying central bank claims from the exposure measure in accordance with the policy statement issued by the PRA in October 2017. The Group is currently excluded from the full reporting requirements of the UK leverage ratio framework.

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

The leverage ratio is monitored against a Board set RAS with the responsibility for managing the ratio delegated to ALCO, which monitors it on a monthly basis.

The leverage ratio is the ratio of Tier 1 capital to total exposure, defined as:

- capital: Tier 1 capital defined according to CRD IV on an end point basis (assuming the full impact of CRD IV requirements on Tier 1 capital were in force with no transitional provisions); and
- exposures: total on and off balance sheet exposures (subject to credit conversion factors) as defined in the Delegated Act amending CRR article 429 (Calculation of the Leverage Ratio), which includes deductions applied to Tier 1 capital.

Other regulatory adjustments consist of adjustments that are required under CRD IV to be deducted from Tier 1 capital. The removal of these from the exposure measure ensures consistency is maintained between the capital and exposure components of the ratio. The Group's leverage ratio is 6.3% which exceeds the Basel Committee's proposed minimum of 3%, applicable from 2018.

The UK leverage ratio framework, which came in to force on 1 January 2016, is relevant to PRA regulated banks and building societies with consolidated retail deposits equal to or greater than £50 billion. The Group is currently excluded from these requirements. On 3 October 2017, the PRA published a Policy Statement - 'UK Leverage Ratio treatment of claims on central banks'.

The PRA Rulebook has been amended to:

(i) align with its July 2016 modification by consent to exclude central bank claims matched by deposits in the same currency and of identical or longer maturity from the definition of the total leverage exposure measure in the UK leverage ratio framework;

(ii) increase the minimum leverage ratio requirement from 3% to 3.25% of total exposures; and

(iii) align the UK leverage ratio reporting and disclosure requirements to the proposed definition of the total exposure measure and 3.25% minimum leverage ratio requirement.

If these modifications are applied to the Group this results in an increase in the leverage ratio from 6.3% under CRD IV to 7.4% on the PRA modified basis as a result of the Group's significant exposures to Central Banks within its Liquid Asset Portfolio and Note Cover.

Funding and liquidity risk

Funding risk relates to the impact on the Group's strategy of being unable to raise funds from customers and the wholesale markets of sufficient quantity and of appropriate mix and tenor. An inability to raise sufficient funds may lead to a reduction in lending growth or a requirement to raise the price paid for deposits, both outcomes having an adverse effect on shareholder value. Where funding risk manifests itself in an adverse effect on mix and tenor, for example a high proportion of short term wholesale deposits, there is an increased liquidity risk to the Group.

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.

Risk assessment
The framework for the Group's approach to funding risk leads to the development of a Group funding plan that is subject to approval by the Board and is consistent with risk appetite and the Group's strategic objectives. The development of the Group's funding plan is informed by the requirements of the Group's Balance Sheet Risk Policy Standards.

Liquidity risk exposures are subject to assessment under both regulatory and internal requirements. Exposures relate to the outflow of funds under a series of stress scenarios less the impact of inflows from assets, liquidation of high quality liquid assets or through other actions instigated by the Group.

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

Funding and liquidity risk (continued)

Risk assessment (continued)
Liquidity within the Group is managed in accordance with the ILAAP that is approved by the Board. The ILAAP documents the manner in which the Group meets its OLAR which covers all regulatory and internal liquidity requirements. In addition the Group has a liquidity standard which details, amongst other items, the control standards and risk measurement requirements for liquidity and authorities and responsibilities.

Oversight of liquidity risk is undertaken by ALCO. To meet the requirements of regulatory authorities the liquidity of the Group is managed on a daily basis 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. ALCO delegates daily management responsibilities to the Treasury function within agreed tolerances. All balance sheet risks are subject to independent oversight from the second line balance sheet and liquidity risk oversight function.

Stress testing of the Group's liquidity risk is undertaken on a frequent basis and results are provided to ALCO and the Board. The ILAAP is used to establish key risk drivers and assumptions for liquidity risk and these provide the framework for ongoing stress testing. Stress testing considers the impact of severe yet plausible scenarios to consider the potential impact on the Group's funding and liquidity profile. The Group holds a portfolio of high quality assets that acts as a buffer against the impact of liquidity risk. Funding plans take a long term view and these consider the impact of prolonged periods of market disruption in order to identify potential vulnerabilities in the profile of the Group's funding.

A Contingency Funding Plan has been established for management of an escalated liquidity requirement if the 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, counterparty, term structure and market.

The Group can source funding through a range of channels including the following:

- customer deposits;
- access to short-term money market funding;.
- Term structure funding through 'Lanark' residential mortgage securitisation programme (owner occupied);
- 'Lannraig' BTL mortgage securitisation programme;
- regulated Covered Bond (RCB) programme;
- Senior unsecured funding; and
- access to the facilities within the BoE Sterling Monetary Framework and the TFS (the TFS closes to new drawings in February 2018).

The Group's securitisation and covered bond programmes offer investors the opportunity to purchase mortgage backed debt. 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 mortgage backed debt.

Monitoring

The Treasury function is responsible for the development and execution of strategy subject to oversight from the risk management function. In relation to funding and liquidity risk, the primary management committee is ALCO. ALCO meets monthly and reports to the Executive Risk Committee.

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

Funding and liquidity risk (continued)

Key risks

An assessment of a number of key risk drivers for funding and liquidity risks has been completed as part of the ILAAP process and a summary of the most material key risks is shown in the table below.

Risk	Rationale for assessment
Wholesale Funding	While wholesale borrowing is largely medium term and the Group has proven access to term debt markets there is residual refinancing risk around the medium term funding transactions.
Funding Tenors	Funding Tenors are an additional component of wholesale funding risk. The Group must maintain an appropriate mix by tenor in order to manage maturity concentrations.
Retail Funding Risk	While the overall assessment of the retail funding key risk driver is low, the potential impact if this risk was to crystallise is high. This is reflective of the shape of the Group's balance sheet and an appropriate reliance on customer deposits as a retail driven bank. The Group holds a portfolio of high quality liquid assets in order to act as a buffer against the effects of liquidity risk.

The Group continues to have a strong funding and liquidity position and seeks to achieve an appropriate balance between profitability and liquidity risk. Funding is predominantly provided by Retail and SME customers and this is supported by medium term secured funding issuance from the Group's Lanark and Lannraig securitisation programmes, its RCB platform and TFS. These funding programmes are a source of strength for the Group and leverage the Group's high quality mortgage book as a source of collateral for secured funding.

The Group monitors liquidity and funding with reference to a number of measures including LCR, LDR and NSFR (see Financial Results section).

External credit ratings

The Group's credit ratings have remained unchanged over the past year. S&P assigns a long-term credit rating of "BBB-" to the Group, two notches below that of Clydesdale Bank PLC, reflecting their non-operating holding company methodology. Fitch assigns an issuer default rating of "BBB+", in line with that of Clydesdale Bank PLC again reflecting their holding company methodology.

Fitch announced the outcome of their annual review of Clydesdale Bank PLC and CYBG PLC ratings on 7 September 2017. All current ratings were affirmed, with a stable outlook. On 15 September 2017, Moody's placed the long-term ratings of Clydesdale Bank PLC on review for upgrade. The review will focus on progress in the execution of the Group's strategic plan as well as the extent to which enhancements in management, risk and control frameworks and processes have been embedded. On 15 November 2017, S&P moved the outlook on Clydesdale Bank PLC and CYBG PLC back to stable from negative as a result of an update to an industry-wide exercise following the EU referendum.

Clydesdale Bank PLC's long term credit ratings are summarised below:

	Outlook as at 20 November 2017 [1]	**30 September 2017**	30 September 2016
Fitch	**Stable**	**BBB+**	A
Standard & Poor's	**Stable**	**BBB+**	BBB+
Moody's [2]	**Stable**	**Baa2**	Baa1

[1] For detailed background on the latest credit opinions, including commentary on the impact of the demerger and IPO, by S&P and Fitch, please refer to the respective rating agency websites.

[2] Long Term Deposit Rating

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

Additional collateral to be provided in the event of a notch downgrade

The Group monitors the movements in its credit ratings and the related requirement to post collateral for payment systems and clearing houses. These figures are not considered material compared to the volume of unencumbered liquid assets.

Assets and liabilities by maturity

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

The Group has disclosed certain term facilities within loans and advances to customers with a revolving element at the maturity of the facility as this best reflects their contractual maturity.

Group 2017 (audited)	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	5,430	-	-	-	-	1,507	6,937
Due from related entities	-	366	-	-	-	-	366
Due from other banks	701	109	-	-	-	-	810
Financial assets available for sale	-	3	256	1,334	473	10	2,076
Other financial assets at fair value	-	4	16	225	232	-	477
Derivative financial instruments	-	19	72	116	75	-	282
Loans and advances to customers	1,783	292	764	5,048	23,010	396	31,293
Due from customers on acceptances	-	4	-	-	-	-	4
All other assets	-	202	48	-	-	819	1,069
Total assets	7,914	999	1,156	6,723	23,790	2,732	43,314
Liabilities							
Due to other banks	44	1,164	700	1,900	-	-	3,808
Other financial liabilities at fair value	-	-	-	26	-	-	26
Derivative financial instruments	-	21	31	132	192	-	376
Due to customers	22,185	917	2,220	2,396	-	-	27,718
Liabilities on acceptances	-	4	-	-	-	-	4
Due to related entities	28	-	3	475	303	-	809
Debt securities in issue	-	620	499	2,138	749	-	4,006
All other liabilities	2,197	174	-	-	-	732	3,103
Total liabilities	24,454	2,900	3,453	7,067	1,244	732	39,850
Off balance sheet items							
Contingent liabilities	-	19	40	7	3	42	111
Other credit commitments	8,408	-	-	-	-	-	8,408
Total off balance sheet items	8,408	19	40	7	3	42	8,519

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

Assets and liabilities by maturity (continued)

Group 2016 (audited)	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	4,642	-	-	-	-	1,313	5,955
Due from related entities	-	7	-	-	-	-	7
Due from other banks	862	83	-	-	-	-	945
Financial assets available for sale	-	7	20	1,019	649	36	1,731
Other financial assets at fair value	-	34	88	275	353	-	750
Derivative financial instruments	2	46	72	242	223	-	585
Loans and advances to customers	2,021	285	648	4,271	21,577	400	29,202
Due from customers on acceptances	-	4	-	-	-	-	4
All other assets	111	34	40	-	-	599	784
Total assets	7,638	500	868	5,807	22,802	2,348	39,963
Liabilities							
Due to other banks	81	417	311	500	-	-	1,309
Other financial liabilities at fair value	-	2	11	35	-	-	48
Derivative financial instruments	2	47	73	123	353	-	598
Due to customers	21,169	1,802	1,933	2,186	-	-	27,090
Liabilities on acceptances	-	4	-	-	-	-	4
Due to related entities	15	4	-	-	479	-	498
Debt securities in issue	-	18	214	2,992	797	-	4,021
All other liabilities	1,959	85	132	-	-	998	3,174
Total liabilities	23,226	2,379	2,674	5,836	1,629	998	36,742
Off balance sheet items							
Contingent liabilities	-	19	44	12	48	-	123
Other credit commitments	7,690	-	-	-	-	-	7,690
Total off balance sheet items	7,690	19	44	12	48	-	7,813

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

Assets and liabilities by maturity (continued)

Bank 2017 (audited)	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	5,430	-	-	-	-	1,507	6,937
Due from related entities	1,051	383	34	-	-	79	1,547
Due from other banks	407	-	-	-	-	-	407
Financial assets available for sale	-	3	255	1,335	473	4	2,070
Other financial assets at fair value	-	4	16	225	232	-	477
Derivative financial instruments	-	19	32	67	18	-	136
Loans and advances to customers	1,781	285	758	4,985	22,031	396	30,236
Due from customers on acceptances	-	4	-	-	-	-	4
All other assets	-	209	48	-	-	822	1,079
Total assets	8,669	907	1,143	6,612	22,754	2,808	42,893
Liabilities							
Due to other banks	44	1,164	700	1,900	-	-	3,808
Other financial liabilities at fair value	-	-	-	26	-	-	26
Derivative financial instruments	-	21	31	132	192	-	376
Due to customers	22,185	917	2,220	2,396	-	-	27,718
Liabilities on acceptances	-	4	-	-	-	-	4
Due to related entities	193	395	294	2,534	308	-	3,724
Debt securities in issue	-	-	10	-	698	-	708
All other liabilities	2,197	172	-	-	-	732	3,101
Total liabilities	24,619	2,673	3,255	6,988	1,198	732	39,465
Off balance sheet items							
Contingent liabilities	-	19	40	7	3	42	111
Other credit commitments	8,382	-	-	-	-	-	8,382
Total off balance sheet items	8,382	19	40	7	3	42	8,493

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

Assets and liabilities by maturity (continued)

Bank 2016 (audited)	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	4,642	-	-	-	-	1,313	5,955
Due from related entities	1,505	15	12	-	-	73	1,605
Due from other banks	425	-	-	-	-	-	425
Financial assets available for sale	-	7	20	1,019	649	29	1,724
Other financial assets at fair value	-	34	88	275	353	-	750
Derivative financial instruments	2	48	65	159	114	-	388
Loans and advances to customers	2,017	275	640	4,200	20,151	400	27,683
Due from customers on acceptances	-	4	-	-	-	-	4
All other assets	111	34	40	-	-	616	801
Total assets	8,702	417	865	5,653	21,267	2,431	39,335
Liabilities							
Due to other banks	81	417	311	500	-	-	1,309
Other financial liabilities at fair value	-	2	11	35	-	-	48
Derivative financial instruments	2	36	73	123	353	-	587
Due to customers	21,169	1,802	1,933	2,186	-	-	27,090
Liabilities on acceptances	-	4	-	-	-	-	4
Due to related entities	56	96	724	1,885	485	-	3,246
Debt securities in issue	-	-	8	-	700	-	708
All other liabilities	1,959	77	131	-	-	998	3,165
Total liabilities	23,267	2,434	3,191	4,729	1,538	998	36,157
Off balance sheet items							
Contingent liabilities	-	19	44	12	48	-	123
Other credit commitments	7,660	-	-	-	-	-	7,660
Total off balance sheet items	7,660	19	44	12	48	-	7,783

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

Cash flows payable under financial liabilities by contractual maturity

Group 2017 (audited)	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	44	1,164	708	1,912	-	-	3,828
Other financial liabilities at fair value	-	-	1	27	-	-	28
Trading derivative financial instruments	-	26	36	79	28	-	169
Due to customers	22,185	918	2,220	2,397	-	-	27,720
Liabilities on acceptances	-	4	-	-	-	-	4
Debt securities in issue	32	620	521	2,268	878	-	4,319
Due to related entities	27	5	32	573	317	-	954
All other financial liabilities	2,197	174	-	-	-	732	3,103
Hedging derivative liabilities							
Contractual amounts payable	-	6	39	225	194	-	464
Total financial liabilities	24,485	2,917	3,557	7,481	1,417	732	40,589

Group 2016 (audited)	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	81	420	318	505	-	-	1,324
Other financial liabilities at fair value	-	2	12	40	-	-	54
Trading derivative financial instruments	2	52	114	192	308	-	668
Due to customers	21,169	1,811	1,954	2,217	-	-	27,151
Liabilities on acceptances	-	4	-	-	-	-	4
Debt securities in issue	-	23	285	3,712	991	-	5,011
Due to related entities	15	10	18	80	479	-	602
All other financial liabilities	1,912	-	-	-	-	-	1,912
Hedging derivative liabilities							
Contractual amounts payable	-	8	71	141	100	-	320
Total financial liabilities	23,179	2,330	2,772	6,887	1,878	-	37,046

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

Cash flows payable under financial liabilities by contractual maturity (continued)

Bank 2017 (audited)	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	44	1,164	708	1,912	-	-	3,828
Other financial liabilities at fair value	-	-	1	27	-	-	28
Trading derivative financial instruments	-	26	36	79	28	-	169
Due to customers	22,185	918	2,220	2,397	-	-	27,720
Liabilities on acceptances	-	4	-	-	-	-	4
Debt securities in issue	32	-	32	130	828	-	1,022
Due to related entities	193	837	674	4,946	322	-	6,972
All other financial liabilities	2,197	172	-	-	-	732	3,101
Hedging derivative liabilities							
Contractual amounts payable	-	6	39	225	194	-	464
Total financial liabilities	24,651	3,127	3,710	9,716	1,372	732	43,308

Bank 2016 (audited)	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	81	420	318	505	-	-	1,324
Other financial liabilities at fair value	-	2	12	40	-	-	54
Trading derivative financial instruments	2	40	114	192	308	-	656
Due to customers	21,169	1,811	1,954	2,217	-	-	27,151
Liabilities on acceptances	-	4	-	-	-	-	4
Debt securities in issue	-	-	40	130	797	-	967
Due to related entities	56	183	1,306	3,443	484	-	5,472
All other financial liabilities	1,912	-	-	-	-	-	1,912
Hedging derivative liabilities							
Contractual amounts payable	-	8	7	141	100	-	256
Total financial liabilities	23,220	2,468	3,751	6,668	1,689	-	37,796

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.

Market risk

Market risk is the risk associated with adverse changes in the fair value, or accrual income and expense, of assets and liabilities held by the Group as a result of movements in market factors such as interest rates, foreign exchange rates, volatility and credit spreads. The Group's balance sheet is predominantly UK based and is denominated in GBP therefore foreign exchange risk is not a major part of the Group's risk profile.

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

Market risk (continued)

Structural interest rate risk comprises the sensitivity of the Group's current and future net interest income and economic value to movements in market interest rates. The major contributors to interest rate risk are:

- the investment of non-interest bearing deposits and equity into interest bearing assets;
- the mismatch between repricing dates of interest-bearing assets and liabilities;
- basis risk, for example, the inability of the pricing 'basis' for customer asset and liability products to be replicated in the financial markets or the risk arising from changing relationships between different interest rate yield curves; and
- customer optionality, e.g. the right to repay borrowing in advance of contract maturity dates.

Exposures

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 products 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. Controls include the hedging of these products as and when they arise.

Measurement

IRRBB is measured, monitored, and managed from both an internal management and regulatory perspective. The RMF incorporates both market valuation and earnings based approaches. In accordance with the Group IRRBB standard, risk measurement techniques include: basis point sensitivity; 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:

- the use of basis point sensitivity analysis;
- 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 statistical basis: 99% confidence level with appropriate holding periods depending on varying risk types;
- EaR utilises a twelve month forecast period;
- eight years of business day historical data is used in modelling;
- VaR methodology is based on proportional rather than absolute changes in historical interest rates;
- investment term for capital is modelled with a benchmark term agreed by the ALCO;
- investment term for core non interest bearing assets and liabilities is modelled on a behavioural basis with a benchmark term agreed by the ALCO; and
- assumptions covering the behavioural life of products and customer behaviour for optionality are reviewed and approved by ALCO.

Foreign Exchange Risk is assessed based on the absolute exposure in each currency.

Mitigation measures

Market risks are overseen by the ALCO with delegation for day to day management given to Treasury. Treasury use a number of techniques and products to manage market risks including interest rate swaps, cash flow netting and foreign exchange. Basis risk is managed through a combination of wholesale market basis risk management products, pricing strategies and product innovation. As part of an 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. The use of derivatives gives rise to the need to apportion transactions into hedge relationships.

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

Market risk (continued)

Fair value hedges

The Group hedges part of its existing interest rate risk, resulting from potential movements in the fair value of fixed rate assets and liabilities, using interest rate swaps. The fair value of these swaps is disclosed in note 3.4. 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 and foreign currency risk. The interest and foreign currency risk arise from variable interest rate assets and liabilities which are hedged using cross currency and interest rate swaps, and material non-GBP denominated transactions which are hedged using FX forward contracts. There were no transactions for which cash flow hedge accounting had to be discontinued in the period as a result of the highly probable cash flows no longer being expected to occur. The fair value of derivatives is disclosed in note 3.4.

Monitoring

Model parameters and assumptions are reviewed and updated on at least an annual basis. Material changes require the approval of the ALCO. Oversight of market risk is conducted by the Group's balance sheet & liquidity risk oversight team that is independent of the Treasury function. The Board and Executive Risk Committee, through ALCO's oversight, monitors risk to ensure it remains within approved policy, limits and Board requirements.

Interest rate risk (audited)

	Group			
	Value at risk		Earnings at risk	
	2017	2016	**2017**	2016
	£m	£m	**£m**	£m
As at 30 September	**25**	15	**4**	2
Average value during the year	**23**	25	**2**	5
Minimum value during the year	**15**	13	**1**	2
Maximum value during the year	**36**	36	**4**	11

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

Market risk (continued)

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

	2017 £m	Liquidity risk	Interest rate risk	Foreign exchange risk	Credit risk
Assets					
Cash and balances with central banks	6,937				✔
Financial assets available for sale	2,076	✔	✔		✔
Loans and advances to customers	31,293	✔	✔	✔	✔
Derivative financial instruments	282	✔	✔	✔	✔
Other financial assets at fair value	477	✔	✔		✔
Liabilities					
Due to customers	27,718	✔	✔	✔	
Due to other banks	3,808	✔	✔	✔	
Derivative financial instruments	376	✔	✔	✔	
Other financial liabilities at fair value	26	✔	✔		
Debt securities in issue	4,006	✔	✔	✔	

	2016 £m	Liquidity risk	Interest rate risk	Foreign exchange risk	Credit risk
Assets					
Cash and balances with central banks	5,955				✔
Financial assets available for sale	1,731	✔	✔		✔
Loans and advances to customers	29,202	✔	✔	✔	✔
Derivative financial instruments	585	✔	✔	✔	✔
Other financial assets at fair value	750	✔	✔		✔
Liabilities					
Due to customers	27,090	✔	✔	✔	
Due to other banks	1,309	✔	✔	✔	
Derivative financial instruments	598	✔	✔	✔	
Other financial liabilities at fair value	48	✔	✔		
Debt securities in issue	4,021	✔	✔	✔	

Foreign currency assets and liabilities split by type
The Group does not incur material foreign currency exposure.

Risk Report (continued)

PENSION RISK

The Group operates a defined benefit (DB) pension scheme, the Yorkshire and Clydesdale Bank Pension Scheme (the "Scheme"). Clydesdale Bank PLC is the Scheme's principal employer and there are no other participating employers. Following a consultation process the Scheme was closed to future accrual on 1 August 2017 for the majority of members. A small number of members elected to keep defined benefit accruals subject to making an increased contribution to the Scheme and to also forego other remuneration benefits.

DB pension schemes provide a promise to pay members a pre-determined level of income at retirement which is independent of the contributions and investment returns (assets) used to fund these benefit promises (collectively the 'liabilities'). As such, there are significant risks associated with managing a DB scheme. These risks will continue until the Scheme is formally wound up, either in the event that all the liabilities are transferred to a third party (for example an insurer) or once all individual member benefits are paid.

The Scheme's assets are held under a separate trust and the Scheme is managed by a corporate Trustee Board independently of the Group, per the Scheme Trust Deed and Rules. Therefore, the Group's ability to directly manage the Scheme is limited to certain powers within the governing documentation. Aside from the Group's role to sponsor the Scheme to ensure there are sufficient assets to meet benefit payments as they fall due, the Group's focus is directed on mitigating the impact on capital and earnings through working with the trustee to implement risk reduction initiatives. Several activities have been implemented since 2003 with the specific aim of reducing risk in the Scheme, including a de-risking journey plan, benefit reforms and the outcome of the 2017 consultation on future accruals.

The principal cause of risk within the Scheme is the difference between the assets and the liabilities. The assets are exposed to market valuation movements, within and between asset classes, while the liabilities are more sensitive to interest rate and inflation rate changes, and changes in other actuarial assumptions which may not be borne out in experience, for example life expectancy. There are various bases, with differing assumptions, for measuring the Scheme liabilities whereas Scheme assets are consistently valued at current market values. The two key bases used to value DB scheme liabilities are IAS 19, a standardised accounting measure which is the basis for income statement, balance sheet and capital reporting, and the Trustee's Technical Provisions basis which determines the cash funding contributions to the Scheme to repair any deficit agreed as part of a triennial valuation.

The triennial valuation (the valuation) uses the Trustee's actuarial assumptions and a liability discount rate based on gilt yields. The last formal valuation indicated a deficit of £290m as at 30 September 2016 (after allowing for changes to future accrual from 1 August 2017), a reduction from the 30 September 2013 reported deficit of £450m. There has been no change to the deficit reduction schedule agreed with the Trustees in June 2014, with a further payment of £50m in May 2017, to be followed by payments of £50m in each year ending 31 March 2019, 31 March 2020, 31 March 2021 and 31 March 2022. A payment of £55m is due in the year ending 31 March 2023.

REGULATORY, COMPLIANCE & CONDUCT RISK

Regulatory and Compliance risk is the risk of failing to identify and comply with relevant laws, regulations, licence conditions, supervisory requirements, self-regulatory industry codes of conduct and voluntary initiatives; failing to identify, monitor and respond to changes in the regulatory environment; damaging the Group's relationship with its regulators through non-compliance with requirements, not keeping regulators informed of relevant issues that affect (or which may affect) the Group, not responding effectively to the information requests and review findings of the regulators, by providing incorrect or inadequate information, not meeting regulatory deadlines or obstructing the regulator from fulfilling its role.

Risk appetite

The Group has no appetite for actions resulting in breaches of regulation or for inaction to address systemic process and control failures leading to material non-compliance.

Risk Report (continued)

REGULATORY, COMPLIANCE & CONDUCT RISK (continued)

Mitigation measures

- The Group has a regulatory engagement policy designed to ensure an open and cooperative relationship is maintained with regulators at all times, ensuring that all key interactions with regulators are managed, recorded and escalated as appropriate.
- All colleagues are required to achieve mandated standards to meet their 'compliance gateway' obligations.
- Material changes to regulatory policies and protocols are approved by either the Executive Leadership Team or the Board.
- The Group CRO and Risk Leadership Team consider compliance risk topics when setting risk appetite and through ongoing risk assessment, profiling and reporting.

Monitoring

A risk management oversight and compliance monitoring plan is approved by Board's Risk Committee on an annual basis which independently assesses the control framework underpinning compliance with laws and regulations.

Conduct Risk

Conduct Risk is the risk of treating customers unfairly and / or delivering inappropriate outcomes resulting in customer detriment, regulatory fines, compensation, redress costs and reputational damage.

Risk appetite

The Group is committed to acting in the interests of its customers, and has no appetite for conduct risk.

Mitigation measures

The Group has a conduct framework which recognises the key conduct risks inherent in the Group's strategy, through which it seeks to apply the highest standards in the design and sale of products, and the treatment of its customers. The framework ensures fair customer outcomes supported by a good customer experience. This is achieved in a number of ways including continuous monitoring and responding to customer feedback and complaints. In addition, if things do go wrong, action is taken to ensure we put things right for our customers.

Products are subject to a product governance framework methodology and are designed and sold to meet customer needs and expectations with governance processes embedded to ensure those objectives are met.

Consideration of customer outcomes is embedded within the Group's operating processes, and metrics are regularly monitored to help ensure outcomes are appropriate.

Exposures

As part of the demerger in 2016, the group's parent entity, CYBG and NAB have entered into a Conduct Indemnity Deed where NAB has agreed to provide CYBG with a capped indemnity in respect of certain historic liabilities relating to conduct in the period prior to the demerger date. Details of this Conduct Indemnity and its impact on CYBG PLC and the Group are included in note 26 – Provisions.

There continues to be a great deal of uncertainty and significant judgement is required in determining the quantum of conduct risk related liabilities with note 3.14 reflecting the Group's current position in relation to redress provisions for PPI, IRHPs and other smaller historic conduct matters. The final amount required to settle the Group's potential liabilities for these matters is materially uncertain. The Group will continue to reassess the adequacy of provisions for these matters and the assumptions underlying the calculations at each reporting date based upon experience and other relevant factors at that time.

Monitoring

This is a principal focus of the Board, senior management and regulators, and the Group seeks to ensure customers are treated fairly and products are designed and sold to meet their needs. The Group also works to ensure that customer expectations are met and complaints are dealt with effectively and fairly. All three lines of defence consider conduct risk as part of their oversight and assurance activities.

Risk Report (continued)

OPERATIONAL RISK (including people risks)

Operational risk (including people risk) is the risk of loss resulting from inadequate or failed internal processes, people strategies and systems or from external events including, for example, the prospect of a cyber attack. It is a core component of the RMF and is embedded in day to day business activities. Responsibilities are set out in a structured operational risk framework that seeks to identify, assess, mitigate, monitor, and report the operational risks and events that could impact the achievement of business objectives or impact core business processes.

Business units are responsible for the day to day management of operational risk, with oversight from the risk management function and independent assurance activities undertaken by Internal Audit.

The requirements of the operational risk management framework are defined in an overarching operational risk policy and related minimum standards, and reflect the Group's operational risk appetite.

Risk Appetite

The Group is prepared to tolerate a level of operational risk exposure within agreed thresholds and limits. Operational risks arise from day to day business activities, which may result in direct or indirect losses and could adversely impact the Group's financial performance, levels of customer care and reputation.

Approach to Monitoring and Mitigating Exposures

Losses may result from both internal and external events, and are categorised using risk categories aligned to Basel II. The Basel II categories are used to ensure that data can be reported externally and compared with other industry data.

The Group has identified, assessed and is currently monitoring all key operational risks across the above noted categories, including undertaking an assessment of control effectiveness, monitoring trends in key risk indicators and escalating events, in accordance with policy requirements.

Stress testing

The Group undertakes scenario analysis to gain insights into the stresses the business could be subject to in the event of this type of operational risk materialising. The Group maintains a suite of operational risk scenarios covering top operational risks relevant to its business. As part of the scenario analysis approach, the suite of operational risk scenarios are reviewed and updated on a regular basis for existing potential impacts and identification of potential new risk events. Management then document a proposed response to identify how the scenarios would be managed and monitored if they occurred.

Risk Category	
Operational resilience risk	The risks associated with the ability of the Group to quickly adapt to disruptions while maintaining continuous business operations and safeguarding people, assets and overall brand equity, even in the face of adverse events, shocks and chronic or incremental changes.
Information Technology risk	The risks associated with inadequate and failed information technology processes and components (including hardware, software and networking components).
Third Party risk	The risks associated with ensuring the Group's outsourced and offshoring arrangements are controlled effectively, including the risk of failure to service existing and new Customers, and the potential cessation of specific activities, or the risk of personally identifiable information or Group sensitive data being exposed or exploited, or the risk of financial, reputational and regulatory censure if the third party enters into any illegal or unethical activities.
Data risk	The risks associated with the accuracy, management and use of data that underpins decision making at every level across the organisation.

Risk Report (continued)

FINANCIAL CRIME RISK

Financial Crime Risk is the risk that the Group's products and services will be used to facilitate financial crime against the Group, its customers or third parties. It encompasses the risk of failing to understand and comply with relevant laws, regulations and supervisory requirements relating to money laundering, terrorism financing, bribery and corruption and sanctions and embargoes. It also includes risks associated with external or internal acts intended to defraud, misappropriate, and circumvent; policy, funds, information, regulations and property. The Group maintains an overarching financial crime policy and four policy standards aligned to each material financial crime risk. These are:

Sanctions – The Group has no appetite for non-compliance with the legal and regulatory obligations relating to Sanctions and Embargoes. To reflect the Group's risk appetite and to protect the Group from financial and reputational damage, including regulatory censure, fines and enforcement action, the Sanctions & Embargoes Policy articulates a set of minimum standards and requirements which must be complied with.

Anti-Money Laundering – The Group applies a prescribed high risk customer model which sets out the types of customer it has no risk appetite to onboard as well as customers with whom the Group is prohibited from entering into or maintaining a customer relationship. All other customers who are not prescribed shall be subject to controls commensurate with their risk.

Anti-Bribery and Corruption – The Group does not tolerate the direct or indirect offer, payment, solicitation or acceptance of bribes in any form. The Group has in place risk assessments, policies and guidelines on interacting with customers, suppliers and agents, including specific policies for gifts and hospitality. Senior managers across the business are required to complete an evaluation of risk areas as part of the risk assessment process.

Fraud – The Group accepts that in order to conduct business in a commercially viable manner, it is willing to sustain fraud losses within an agreed set of parameters. The application of fraud risk management considers customer impacts, industry trends and financial impacts of fraud which on occasion provide conflicting priorities. Emerging risks are identified and assessed with action taken to mitigate them. An agreed loss plan is set and performance against this is overseen by the Policy owner and reported through the appropriate Governance Committees. With regard to internal fraud, the Group recognises the risk of internal fraud but has no appetite for it. Consequently there is a control framework in place to mitigate that risk.

Exposures

There are currently no significant exposures to report. The Group continues to review the external environment for any change in regulatory or legislative direction, taking action as appropriate.

Mitigation measures

Risk assessments against the four financial crime policy standards take place on an annual basis. Over and above these assessments, regular oversight of higher-risk activities takes place as part of the formal oversight plan and embedded activity takes place throughout the year. Key performance metrics relative to critical financial crime systems are kept under review to ensure ongoing effectiveness. Third party tools are used to test system effectiveness where available and appropriate. Training completion and compliance is subject to annual oversight.

All standards are reflected in the Group policy and standards and financial crime prevention manual, the content of which is provided by financial crime risk and updated as appropriate.

Monitoring

The financial crime team is responsible for strategy, governance, standard setting, oversight, training and reporting to the competent authorities and governance committees / Board.

The control framework is owned by financial crime risk but management and execution of customer identity and verification, customer due diligence, enhanced due diligence, identifying high risk customers, including correspondent banking relationships and record keeping is the responsibility of first line business units.

Account opening pass rates are overseen as part of a regular process undertaken by financial crime risk and reported monthly.

Higher risk customers are referred to financial crime risk and senior management within Customer Banking for agreement and sign off that business is within appetite and then continue to be monitored on an ongoing basis.

Screening customers for sanctions or politically exposed persons and transaction monitoring is carried out by financial crime risk. Sanctions screening for payments is carried out by the Payments team in the first line. Critical financial crime systems oversight is independently tested by Internal Audit.

Risk Report (continued)

STRATEGIC, BUSINESS & FINANCIAL PERFORMANCE RISK

Strategic, Business & Financial Performance risk is the risk of significant loss, loss of earnings or damage arising from business decisions that impact the long-term interests of the Group's stakeholders or from an inability to adapt to external developments.

Risk appetite

The Group intends to grow and increase share in target markets, and has clear strategies for its business model and for target Customers and products, but it has no appetite to achieve its targets in an unsustainable fashion, or one which may result in damaging outcomes for the Group, its customers or other stakeholders.

Exposures

The Group operates amid intense, increasing competition. Peer and challenger banks, some with innovative business models and low cost bases, such as fast-growing peer-to-peer lenders and crowd funders, allied with rapid technological change, notably in payments and mobile banking, present a fast evolving, challenging environment. These trends and new regulations also necessitate a large change agenda, which diverts management attention, imposes costs and which may not deliver expected benefits.

At the same time, the low interest rate environment constrains income, reduces margins and, by inhibiting capital generation, reduces strategic room for manoeuvre. As such, income growth and margin expectations over the Group's planning horizon are balanced, highlighting that this environment contributes to significant Business Risk, the risk that Group net income fails to grow as targeted, or falls.

Mitigation measures

CYBG was divested from National Australia Bank and listed in February 2016, but strategic changes necessary for success when independent were assessed over a prolonged prior period to this. Moreover, CYBG has a long history as a full service UK bank and benefits from an experienced Board and Executive Leadership Team, such that the overall strategy has evolved through a mature and robust process.

The Group's Risk Appetite represents a 'risk envelope' against which chosen strategies and financial plans are assessed and within which chosen strategies must operate. The RAS, and associated Risk Appetite Framework, is therefore a key means of controlling strategic risk. The Risk Appetite Framework comprises an extensive system of measures, thresholds and other controls, which together ensure that the Group operates within the Board's approved appetite for strategic risk

Monitoring

A range of financial and non-financial metrics, including RoTE, lending growth, Customer acquisition, NIM and others, are Key Performance Indicators used to monitor performance relative to strategic objectives. They are monitored against the Financial Plan by the Group's Board and Leadership Team, who react to deviations from targets and modify strategy accordingly.

Report of the Directors

The Directors of the Bank and its subsidiary undertakings (which together comprise the 'Group') submit their report and consolidated financial statements for the year ended 30 September 2017.

Corporate Governance

Details of the corporate governance framework applying to the Bank is set out in the Corporate Governance Report within the CYBG PLC Annual Report & Accounts.

Profits and appropriations

The Group loss before tax for the year ended 30 September 2017 was £261m (2016: loss of £352m). The loss attributable to the shareholders for the year ended 30 September 2017 amounted to £294m (2016: loss of £558m). A dividend of £Nil was paid in respect of the ordinary shares for this financial year (2016: £51m). The Group's strategic highlights and business developments are set out in the Strategic Report.

Future developments and financial risk management objectives and policies

Information regarding future developments and financial risk management objectives and policies of the Group in relation to the use of financial instruments that would otherwise be required to be disclosed in the Report of the Directors, and which is incorporated into this report by reference, can be found in the Strategic Report and the Risk Report.

Directors and Directors' interests

The current Directors are shown on page 1. There were no appointments during the year or subsequently to the date of this report. Richard Gregory resigned on 10 January 2017. 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 Bank or its subsidiaries at any time during the year

Directors' liabilities

During the year, CYBG PLC paid a premium for a contract insuring the Directors and officers of CYBG PLC, 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.

Directors' Indemnities

The Directors have each entered into individual deeds of access, insurance and indemnity with the CYBG Group which, amongst other things and subject to certain exceptions, indemnify the Directors to the maximum extent permitted by law and regulation against liabilities to a person other than the Company or an associated company that they may incur as an officer of the Company and any other subsidiary of CYBG Group. Each such provision constitutes a 'third party indemnity provision' and a 'qualifying indemnity provision' for the purposes of section 234 to 236 of the Companies Act 2006. These provisions are in force for the benefit of the Directors at the date of this Report, and were in force when this Report was approved and during the financial year to which this Report relates. Such deeds are available for inspection at the Company's registered office.

Report of the Directors (continued)

Directors' Indemnities (continued)

The CYBG Group has an insurance policy in place for the benefit of all trustees, colleagues, Directors, officers, members and partners of the Company whilst acting in the capacity of a trustee or administrator of employee benefit or pension plans. This policy therefore indemnifies the Directors of Yorkshire and Clydesdale Bank Pension Trustee Limited and YCB DC Trustee Limited (each a 'Trustee Company'), the trustees of two occupational pension schemes operated by the CYBG Group, against liability incurred by them in connection with the management and administration of the pension schemes. This insurance policy constitutes a 'pension scheme indemnity provision' and a 'qualifying indemnity provision' for the purposes of section 235 to 236 of the Companies Act 2006. These provisions are in force for the benefit of the Directors of Trustee Companies at the date of this Report, and were in force when this Report was approved and during the financial year to which this Report relates. Such policy is available for inspection at the Company's registered office.

In addition, the CYBG Group had appropriate Directors' and Officers' Liability Insurance cover in place throughout the financial year.

Colleagues

Policies and practices in respect of colleague issues are managed on a consistent basis across the CYBG Group.

Engagement and communication

This has been a year of transformational change, and ensuring that our colleagues remain engaged is critical. MyVoice (our annual colleague feedback survey) provides us with insight in relation to our values and behaviours, alignment with our strategy and focus on serving our customers. 88% are clear on how their work impacts our customers, and think we actively seek to understand how their work contributes to the achievement of the Group's goals. Day-to-day engagement with the Group is driven through Our World (our intranet). In its first year (to August 2017) there was an average of c.6k unique visitors per day, with over 370 articles published relating to our leadership, strategy, culture, business success and community activity. This site is increasingly used for two-way engagement through the use of polls, discussion threads and invitations to get involved in activities. This interactivity has been extended by our myComms app, which won the award for the 'Best Use of Interactive Media' at the IoIC Scotland Awards.

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 colleagues 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 colleagues.

Additional information can be found in the Strategic Report section of the CYBG PLC Annual Report & Accounts.

Political donations

No political donations were made during the year (2016: £Nil).

Management of risk

Risk and capital related disclosures for the Group are included within the Strategic Report and Risk Report. The information contained within these disclosures has not been audited by the Group's external auditor, except where labelled accordingly.

Risk and capital related disclosures for the CYBG Group can be found in the CYBG PLC Pillar 3 Report, www.cybg.com/investor-centre/financial-results, and also within the Risk Report section of the CYBG PLC Annual Report & Accounts.

Significant contracts

Details of related party transactions are set out in note 5.3 of the financial statements.

Report of the Directors (continued)

Share capital

Information about share capital is shown in note 4.1 of the financial statements.

Research and Development Activities

The Group does not undertake formal research and development activities although it does invest in new platforms and products in each of its business lines in the ordinary course of business. In addition to new products and services the Group also invests in internally generated intangible assets including software and computers systems. Further details can be found in Note 3.10 of the Group's consolidated financial statements.

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 1.4 of the Group's consolidated financial statements.

Events after the balance sheet date

There have been no material post balance sheet events.

Auditors

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

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

Lorna McMillan
Company Secretary
20 November 2017

Statement of Directors' responsibilities

The Directors are responsible for preparing the Strategic Report, 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') as adopted by the EU 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 year. 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.

Lorna McMillan
Company Secretary
20 November 2017

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

Opinion

In our opinion:

- Clydesdale Bank PLC's Group financial statements and parent company financial statements (the "financial statements") give a true and fair view of the state of the Group's and of the parent company's affairs as at 30 September 2017 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 parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union 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, and, as regards the Group financial statements, Article 4 of the IAS Regulation.

We have audited the financial statements of Clydesdale Bank PLC which comprise:

Group	Parent company
Consolidated Income Statement for the year ended 30 September 2017	
Consolidated Statement of Comprehensive Income for the year ended 30 September 2017	
Consolidated Balance Sheet as at 30 September 2017	Company Balance Sheet as at 30 September 2017
Consolidated Statement of Changes in Equity for the year ended 30 September 2017	Company Statement of Changes in Equity for the year ended 30 September 2017
Consolidated Statement of Cash Flows for the year ended 30 September 2017	Company Statement of Cash Flows for the year ended 30 September 2017
Related notes 1.1 to 5.4 to the financial statements	Related notes 1.1 to 6.2 of the financial statements
Certain required disclosures have been presented elsewhere in the Annual Report and Accounts, rather than in the notes to the financial statements. These have been cross-referenced from the financial statements and are identified as audited.	

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 and; as regards to the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report below. We are independent of the Group and parent company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard as applied to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

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

Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which the ISAs (UK) require us to report to you where:

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

Overview of our audit approach

Key audit matters	• Payment Protection Insurance ("PPI") and other conduct related provisioning • SME lending impairment provisions • Revenue recognition – Effective Interest method accounting
Audit scope	• We performed an audit of the complete financial information of the Group and parent company. • Our Group audit scope included all Clydesdale Bank PLC subsidiaries.
Materiality	• Overall Group materiality was £17m which represents 0.5% of shareholders' equity.

Key audit matters

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

Key audit matters	Our response to the risk	Key observations communicated to the Board's Audit Committee
Payment Protection Insurance ("PPI") and other conduct related provisioning Please refer to pages 112 to 116 (Provisions for liabilities and charges note), pages 135 to 136 (Contingent liabilities and commitments note). The Group has material provisions relating to its conduct towards its past and present customers relating to past PPI sales and other conduct related matters. The Group benefits from a conduct indemnity deed granted by its former parent, under which 90.3% of remediation costs for past conduct issues can be reimbursed up to a capped total amount. The	We considered the results of the testing of key controls operating within the PPI and other conduct case handling and recording processes which supported the data used in the determination of key provision assumptions. We found that we could place reliance on these controls. We examined the models used by the Directors to determine a best estimate of the provisions for mis-sold payment protection insurance ("PPI") and other products. We assessed the appropriateness of PPI provision model assumptions, including case volumes, redress per claim, uphold rates and case processing costs, which were informed by the Group's historic experience.	We communicated to the Audit Committee that provisions for PPI redress and other conduct related matters held by the Group were reasonably estimated. We noted that the Bank's disclosures describe the uncertainties and risks associated with determining the provisions, and the sensitivity of the provisions to changes in key assumptions. As disclosed on page 116 in Note 3.14, we also noted that £148m of the Capped Indemnity remains undrawn, and that this provides a level of protection to the Group should future costs relating to PPI claims exceed the Directors' estimate. The estimations of provisions for PPI claims and other conduct related matters are inherently uncertain and

Key audit matters	Our response to the risk	Key observations communicated to the Board's Audit Committee
Group contributes 9.7% of such costs. While this limits the impact on the Group's equity, unutilised amounts remaining under the indemnity are an important factor in the assessment of the Group's overall financial position. In March 2017, the FCA published Policy Statement 17/3 containing its final rules and guidance on PPI complaints. The Policy Statement confirmed a new rule that sets a deadline of 29 August 2019 for consumers to complain about the way they were sold PPI. During the year, the Group has also made progress with its past business review for other conduct related matters. Significant judgements and assumptions are required to be made by the Directors in relation to the timing, volume and quantum of future redress payments and associated administration costs that will be required. The most significant assumption is total anticipated future PPI complaint volumes. The effects of these judgements are material, so this was considered to be a significant audit risk.	We tested the clerical accuracy of the Directors' provision calculations and sensitivity analysis. In evaluating the Directors' provision assumptions, we examined correspondence during the year between the Group and the FCA, and regulatory pronouncements, such as PS 17/3. We compared the Directors' assumptions to our own expectations based on the Group's historical experience, current trends and our industry knowledge.	required significant judgements to be made by the Directors. The Directors' best estimate for future PPI claims and associated costs involved probability weighting a number of possible outcomes. The most significant assumption is the volume of future, new PPI complaints, details of which are reported on page 113 in Note 3.14. We determined an independent range of reasonable future PPI cost outcomes using the Group's historical experience of PPI claims, and we compared this range to the Directors' estimate. We found no material differences in this comparison. We communicated to the Audit Committee that provisions for other conduct related matters, had been determined based on appropriate evidence and were fairly stated at 30 September 2017.
SME lending impairment provisions Please refer to pages 100 to 102 (Impairment provisions on credit exposures note). The majority of the Group's non-retail lending portfolio relates to small and medium sized enterprises ('SMEs') which can be vulnerable to both domestic and foreign market volatility. Estimating the Group's collective and specific provisioning is subjective, requires the Directors to exercise significant judgement, and incorporates the use of various assumptions. Due to the materiality of the	We tested controls over impairment calculations and the generation of portfolio data for use in these calculations. These controls included those covering the identification and assessment of potentially impaired loans, the transfer of data from source systems to impairment models, and the calculation of specific impairment provisions. We determined that we could rely on these controls for the purposes of our audit. We performed loan file testing on a sample of impaired loans to determine whether the specific provisions held by the Group were, in our judgement, sufficient and appropriate. Our approach included the use of our own valuation specialists to independently test key	We communicated to the Audit Committee that the impairment models, calculations and assumptions employed by the Group were reasonable as at 30 September 2017 and that these resulted in impairment provisions that were appropriately estimated. We also concluded that the disclosures presented were in compliance with IFRSs. We independently determined a range of appropriate outcomes for the level of incurred but not reported losses existing in the Group's loan portfolio. The Directors' post model adjustments resided within our range of acceptable outcomes. We assessed and challenged the

Key audit matters	Our response to the risk	Key observations communicated to the Board's Audit Committee
provisions and level of judgment involved, this was considered to be a significant audit risk.	assumptions underpinning a sample of collateral values used in provision calculations. We evaluated the completeness of SME loans assessed for impairment by the Directors and examined key loans where no impairment provisions were held. We tested the collective impairment provision model by examining the logic of the model calculations, the accuracy of data inputs, and the appropriateness of key assumptions and loan ratings used within the model. We tested the Directors' judgements in determining overlays to the collective impairment models for appropriateness of methodology and accuracy of calculation.	calculations and related judgements for a sample of specific impairment provisions and did not identify any material differences to the provisions determined by the Directors.
Revenue recognition – Effective Interest method Please refer to page 84 (net interest income accounting policy). For certain product fees, the Group operates a model to recognise fee income (included within interest income) under the effective interest method. The effective interest method spreads the recognition of product fee income over the life of a financial instrument, as these are in substance an integral part of the overall yield. Effective interest models are sensitive to judgements about the expected lives of the product portfolios to which they relate. Due to the complexity of calculations, the degree of judgement exercised by the Directors in respect of the expected lives of the product portfolios and the different products for which fees are recognised, this is considered a significant audit risk.	We gained an understanding of key controls and assessed the appropriateness of key assumptions used within the Group's effective interest model, primarily the average loan life assumption, which we corroborated against underlying loan data, our knowledge of market conditions and observed practice in the UK mortgage sector. We performed data integrity testing on the key sources of information feeding the effective interest calculation. This involved sample testing data from business systems to the loan data used in the model and vice-versa. We examined the journals recording the deferral and amortisation of fee income to verify that the revenue deferred and amortised over the life of the underlying loans was appropriate and aligned with the effective interest model output.	As set out on page 98 in Note 3.5, the Group has recorded £32m of net deferred income in relation to fee income and expenses deferred under the Group's effective interest method of accounting. We communicated to the Audit Committee that the effective interest adjustments recognised in interest income had been appropriately derived. We also communicated that the assumptions made by the Directors were reasonable in the context of the Group's lending portfolios and current observable customer behaviours.

Our application of materiality

We apply the concept of materiality in planning and performing the audit, in evaluating the effect of identified misstatements on the audit and in forming our audit opinion.

Audit materiality

Audit materiality is the magnitude of an omission or misstatement that, individually or in the aggregate, could reasonably be expected to influence the economic decisions of the users of the financial statements. Audit materiality provides a basis for determining the nature and extent of our audit procedures.

We determined audit materiality for the Group to be £17m (2016: £17m) which approximates 0.5% of the total equity attributable to owners of the parent company ('Group equity'). The reason for selecting this measure as the basis for our audit materiality consideration is that the Group was loss making in recent financial periods. Given the importance of equity to the Group's solvency and regulatory capital resources, we judged equity to be the most relevant basis for setting audit materiality.

Performance materiality

Performance materiality is the application of materiality at the individual account or balance level. It is set at an amount to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality.

On the basis of our risk assessments, together with our assessment of the Group's overall control environment, our judgement was that performance materiality should be set at 75% (2016: 50%) of our audit materiality, namely £12.75m (2016: £8.5m). We have set performance materiality at this percentage due to our previous experience as auditors of the Group, from which we concluded that there is a lower expectation of material financial statement inaccuracies due to the effective control environment and only minor audit differences resulting from our prior and current year work. We set performance materiality at a more conservative percentage of 50% in the prior year as 2016 was the first year that the Group, through its parent CYBG PLC, reported as a publicly listed company.

Reporting threshold

This is the amount below which identified misstatements are considered as being clearly trivial.

We agreed with the Audit Committee that we would report to them all uncorrected audit differences in excess of £0.85m (2016: £0.85m), which is set at 5% of our audit materiality, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds.

We evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations in forming our opinion.

Other information

The other information comprises the information included in the annual report set out on pages 1 to 56, and the additional information set out on pages 146 to 156 other than the financial statements and our auditor's report thereon. The Directors are responsible for the other information.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in this report, we do not express any form of assurance conclusion thereon.

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

We have nothing to report in this regard.

Opinions on other matters prescribed by the Companies Act 2006

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

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

Matters on which we are required to report by exception

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

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

- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company financial statements are not in agreement with the accounting records and returns; 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

Responsibilities of Directors

As explained more fully in the Directors' responsibilities statement set out on page 60, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the Directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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

Auditor's responsibilities for the audit of the financial statements

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

Explanation as to what extent the audit was considered capable of detecting irregularities, including fraud

The objectives of our audit, in respect of fraud, are: to identify and assess the risks of material misstatement of the financial statements due to fraud; to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and to respond appropriately to fraud or suspected fraud identified during the audit. However, the primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management. Our audit approach in respect of irregularities, including fraud, was as follows:

- We obtained an understanding of the legal and regulatory frameworks that are applicable to the Group and determined that the most significant were the regulations, licence conditions and supervisory requirements of the Prudential Regulation Authority ('PRA') and the Financial Conduct Authority ('FCA').
- We understood how the Group complies with these legal and regulatory frameworks by making enquiries of management, internal audit, and those responsible for legal and compliance matters. We also: reviewed correspondence between the Group and UK regulatory bodies; reviewed minutes of the Board and Executive Risk Committee; and gained an understanding of the Group's approach to governance, demonstrated by the Board's approval of the Group's governance framework and the Board's review of the Group's risk management framework ('RMF') and internal control processes.
- We assessed the susceptibility of the Group's financial statements to material misstatement, including how fraud might occur, by considering the controls that the Group has established to address risks identified by the entity, or that otherwise seek to prevent, deter or detect fraud. We also considered performance and incentive plan targets and their potential to influence management to manage earnings or influence the perceptions of investors.
- Based on this understanding we designed our audit procedures to identify non-compliance with such laws and regulations identified in the paragraphs above. Our procedures involved inquiries of legal counsel, executive management, internal audit, and focused testing, as referred to in the Key Audit Matters section above.
- The Group operates in the banking industry which is a highly regulated environment. As such the Senior Statutory Auditor considered the experience and expertise of the engagement team to ensure that the team had the appropriate competence and capabilities, which included the use of specialists where appropriate.

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

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

Other matters we are required to address

- Following the recommendation of the National Australia Bank ('NAB') Group Audit Committee, we were appointed as External Auditor at the AGM on 31 January 2005 to audit the financial statements for the year ending 30 September 2005 of the National Australia Bank Group of companies, which at the time included Clydesdale Bank PLC. The period of total uninterrupted engagement as auditors of Clydesdale Bank PLC including previous renewals and reappointments, is 12 years, covering the years ending 30 September 2005 to 30 September 2017.
- The non-audit services prohibited by the FRC's Ethical Standard were not provided to the Group or the Company and we remain independent of the Group and the Company in conducting the audit.
- The audit opinion is consistent with the additional report to the audit committee.

Steven Robb (Senior Statutory Auditor)

for and on behalf of Ernst & Young LLP, Statutory Auditor

Leeds

20 November 2017

Notes:

1. The maintenance and integrity of the Clydesdale Bank PLC website 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 website.

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

Consolidated income statement
for the year ended 30 September

	Note	2017 £m	2016 £m
Interest income and similar income		1,075	1,101
Interest expense and similar charges		(230)	(294)
Net interest income	2.2	845	807
Gains less losses on financial instruments at fair value		6	9
Other operating income		186	182
Non-interest income	2.3	192	191
Total operating income		1,037	998
Personnel expenses		(166)	(280)
Restructuring expenses		(67)	(45)
Depreciation and amortisation expense		(87)	(88)
Other operating and administrative expenses		(930)	(898)
Total operating and administrative expenses before impairment losses	2.4	(1,250)	(1,311)
Operating loss before impairment losses		(213)	(313)
Impairment losses on credit exposures	3.6	(48)	(39)
Loss on ordinary activities before tax		(261)	(352)
Tax expense	2.5	(33)	(206)
Loss for the year attributable to equity holders		(294)	(558)

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

The notes on pages 75 to 145 form an integral part of these financial statements.

Statements of comprehensive income for the year ended 30 September

	Group		Bank	
	2017	2016	**2017**	2016
	£m	£m	**£m**	£m
Loss for the year	**(294)**	(558)	**(288)**	(574)
Items that may be reclassified to the income statement				
Change in cash flow hedge reserve				
(Losses)/gains during the year	**(84)**	108	**(82)**	109
Transfers to the income statement	**(5)**	(1)	**(5)**	(1)
Taxation thereon	**21**	(25)	**21**	(25)
	(68)	82	**(66)**	83
Change in available for sale reserve				
(Losses)/gains during the year	**(7)**	29	**(8)**	29
Transfers to the income statement	**(20)**	(8)	**(20)**	(8)
Taxation thereon	**7**	(6)	**7**	(6)
	(20)	15	**(21)**	15
Total items that may be reclassified to the income statement	**(88)**	97	**(87)**	98
Items that will not be reclassified to the income statement				
Remeasurement of defined benefit pension plans	**154**	(179)	**154**	(179)
Taxation thereon	**(35)**	43	**(35)**	43
Total items that will not be reclassified to the income statement	**119**	(136)	**119**	(136)
Other comprehensive income/(losses) net of tax	**31**	(39)	**32**	(38)
Total comprehensive losses for the year, net of tax	**(263)**	(597)	**(256)**	(612)
Total comprehensive losses attributable to equity holders of the parent	**(263)**	(597)	**(256)**	(612)

The notes on pages 75 to 145 form an integral part of these financial statements.

Balance sheets
as at 30 September

	Note	Group 2017 £m	Group 2016 £m	Bank 2017 £m	Bank 2016 £m Restated
Assets					
Cash and balances with central banks	3.1	**6,937**	5,955	**6,937**	5,955
Due from related entities	5.3	**366**	7	**1,547**	1,605
Due from other banks		**810**	945	**407**	425
Financial assets available for sale	3.2	**2,076**	1,731	**2,070**	1,724
Other financial assets at fair value	3.3	**477**	750	**477**	750
Derivative financial instruments	3.4	**282**	585	**136**	388
Loans and advances to customers	3.5	**31,293**	29,202	**30,236**	27,683
Due from customers on acceptances		**4**	4	**4**	4
Current tax assets		**-**	-	**5**	6
Property, plant and equipment	3.8	**86**	99	**86**	99
Investment properties	3.9	**14**	22	**14**	22
Investments in controlled entities and associates	6.2	**-**	-	**10**	16
Intangible assets	3.10	**339**	256	**339**	256
Deferred tax assets	3.11	**236**	219	**231**	214
Defined benefit pension assets	3.16	**207**	-	**207**	-
Other assets		**187**	188	**187**	188
Total assets		**43,314**	39,963	**42,893**	39,335
Liabilities					
Due to other banks	3.12	**3,808**	1,309	**3,808**	1,309
Other financial liabilities at fair value	3.3	**26**	48	**26**	48
Derivative financial instruments	3.4	**376**	598	**376**	587
Due to customers	3.13	**27,718**	27,090	**27,718**	27,090
Liabilities on acceptances		**4**	4	**4**	4
Current taxes		**1**	8	**-**	-
Provisions for liabilities and charges	3.14	**554**	852	**554**	852
Due to related entities	5.3	**809**	498	**3,724**	3,246
Debt securities in issue	3.15	**4,006**	4,021	**708**	708
Retirement benefit obligations	3.16	**3**	79	**3**	79
Deferred tax liabilities	3.11	**75**	27	**75**	27
Other liabilities	3.17	**2,470**	2,208	**2,469**	2,207
Total liabilities		**39,850**	36,742	**39,465**	36,157
Equity (parent entity interest)					
Share capital	4.1	**502**	324	**502**	324
Other equity instruments	4.1	**425**	425	**425**	425
Other reserves	4.1	**373**	104	**372**	102
Retained earnings		**2,164**	2,368	**2,129**	2,327
Total equity		**3,464**	3,221	**3,428**	3,178
Total liabilities and equity		**43,314**	39,963	**42,893**	39,335

The notes on pages 75 to 145 form an integral part of these financial statements.
These financial statements were approved by the Board of Directors on 20 November 2017 and were signed on its behalf by:

David Duffy
Chief Executive Officer

Ian Smith
Chief Financial Officer

Company name: Clydesdale Bank PLC
Company number: SC001111

Statements of changes in equity

Group	Notes	Share capital £m	Other equity instruments £m	Other reserves: Equity based compensation reserve £m	Other reserves: Asset revaluation reserve £m	Other reserves: Available for sale reserve £m	Other reserves: Cash flow hedge reserve £m	Other reserves: Capital contribution reserve £m	Retained earnings £m	Total equity £m
As at 1 October 2015		2,812	450	3	2	12	(13)	-	192	3,458
Loss for the year		-	-	-	-	-	-	-	(558)	(558)
Other comprehensive income/(losses)		-	-	-	-	15	82	-	(136)	(39)
Total comprehensive income/(losses), net of tax		-	-	-	-	15	82	-	(694)	(597)
AT1 distribution paid (net of tax)		-	-	-	-	-	-	-	(15)	(15)
Dividend paid		-	-	-	-	-	-	-	(51)	(51)
Shares issued - ordinary shares		426	-	-	-	-	-	-	-	426
Share capital reduction		(2,914)	-	-	-	-	-	-	2,914	-
Capital contribution		-	-	-	-	-	-	7	-	7
Other equity instruments issued		-	425	-	-	-	-	-	-	425
Capital note repurchase (net of tax)		-	(450)	-	-	-	-	-	21	(429)
Transfer from asset revaluation reserve		-	-	-	(1)	-	-	-	1	-
Equity based compensation expensed		-	-	5	-	-	-	-	-	5
Equity based compensation settled		-	-	(8)	-	-	-	-	-	(8)
As at 30 September 2016	4.1	324	425	-	1	27	69	7	2,368	3,221
Loss for the year		-	-	-	-	-	-	-	(294)	(294)
Other comprehensive (losses)/income		-	-	-	-	(20)	(68)	-	119	31
Total comprehensive losses, net of tax		-	-	-	-	(20)	(68)	-	(175)	(263)
AT1 distribution paid (net of tax)		-	-	-	-	-	-	-	(29)	(29)
Dividend paid		-	-	-	-	-	-	-	-	-
Shares issued - ordinary	4.1	178	-	-	-	-	-	-	-	178
Capital contribution	4.1	-	-	-	-	-	-	357	-	357
As at 30 September 2017	4.1	**502**	**425**	**-**	**1**	**7**	**1**	**364**	**2,164**	**3,464**

The notes on pages 75 to 145 form an integral part of these financial statements.

Statements of changes in equity

Bank				Other reserves						
		Share capital £m	Other equity instruments £m	Equity based compensation reserve £m	Asset revaluation reserve £m	Available for sale reserve £m	Cash flow hedge reserve £m	Capital contribution reserve £m	Retained earnings £m	Total equity £m
As at 1 October 2015		2,812	450	3	2	12	(16)	-	167	3,430
Loss for the year		-	-	-	-	-	-	-	(574)	(574)
Other comprehensive income/(losses)		-	-	-	-	15	83	-	(136)	(38)
Total comprehensive income/(losses), net of tax		-	-	-	-	15	83	-	(710)	(612)
AT1 distribution paid (net of tax)		-	-	-	-	-	-	-	(15)	(15)
Dividend paid		-	-	-	-	-	-	-	(51)	(51)
Shares issued - ordinary shares		426	-	-	-	-	-	-	-	426
Nominal share value reduction		(2,914)	-	-	-	-	-	-	2,914	-
Capital contribution		-	-	-	-	-	-	7	-	7
Other equity instruments issued		-	425	-	-	-	-	-	-	425
Capital note repurchase (net of tax)		-	(450)	-	-	-	-	-	21	(429)
Transfer from asset revaluation reserve		-	-	-	(1)	-	-	-	1	-
Equity based compensation expensed		-	-	5	-	-	-	-	-	5
Equity based compensation settled		-	-	(8)	-	-	-	-	-	(8)
As at 30 September 2016	4.1	324	425	-	1	27	67	7	2,327	3,178
Loss for the year		-	-	-	-	-	-	-	(288)	(288)
Other comprehensive (losses)/income		-	-	-	-	(21)	(66)	-	119	32
Total comprehensive losses, net of tax		-	-	-	-	(21)	(66)	-	(169)	(256)
AT1 distribution paid (net of tax)		-	-	-	-	-	-	-	(29)	(29)
Shares issued - ordinary	4.1	178	-	-	-	-	-	-	-	178
Capital contribution	4.1	-	-	-	-	-	-	357	-	357
As at 30 September 2017	4.1	502	425	-	1	6	1	364	2,129	3,428

The notes on pages 75 to 145 form an integral part of these financial statements.

Statement of cash flows for the year ended 30 September

	Notes	Group 2017 £m	Group 2016 £m	Bank 2017 £m	Bank 2016 £m Restated
Operating activities					
Loss on ordinary activities before tax		(261)	(352)	(260)	(376)
Adjustments for:					
Non cash or non operating items included in loss before tax	5.2	(735)	(644)	(711)	(628)
Changes in operating assets	5.2	(1,497)	(2,279)	(2,098)	(1,626)
Changes in operating liabilities	5.2	917	1,585	930	1,653
Interest received		1,124	1,101	1,077	1,053
Interest paid		(260)	(198)	(259)	(198)
Tax (paid)/received - Group relief		(8)	5	5	4
Net cash used in operating activities		(720)	(782)	(1,316)	(118)
Cash flows from investing activities					
Interest received		12	11	10	4
Proceeds from maturity of investments		20	101	20	101
Proceeds from sale of investments		60	56	60	56
Proceeds from sale of tangible fixed assets (1)		19	17	19	17
Purchase of tangible fixed assets (1)		(21)	(22)	(21)	(22)
Purchase and development of intangible fixed assets		(148)	(99)	(148)	(51)
Purchase of investments		(492)	(357)	(492)	(357)
Net cash used in investing activities		(550)	(293)	(552)	(252)
Cash flows from financing activities					
Interest received		-	1	25	65
Interest paid		(89)	(97)	(95)	(161)
Proceeds from ordinary shares issued		178	426	178	426
Proceeds from other equity instruments issued		-	425	-	425
Repurchase of other equity instruments		-	(429)	-	(429)
Repurchase of subordinated debt		-	(474)	-	(474)
Redemption and principal repayment on residential mortgage backed securities	3.7	(740)	(1,029)	-	-
Issuance of residential mortgage backed securities and covered bonds	3.7	750	750	-	-
Amounts drawn down under the TFS		1,900	-	1,900	-
Net (increase)/decrease in amounts due from related entities		(2)	786	420	541
Net increase/(decrease) in amounts due to related entities		311	407	478	(332)
Equity based compensation settled		-	(8)	-	(8)
AT1 distributions paid		(36)	(19)	(36)	(19)
Dividends paid		-	(51)	-	(51)
Net cash provided by/(used in) financing activities		2,272	688	2,870	(17)
Net increase/(decrease) in cash and cash equivalents		1,002	(387)	1,002	(387)
Cash and cash equivalents at the beginning of the year		5,950	6,337	5,950	6,337
Cash and cash equivalents at the end of the year (2)	5.2	6,952	5,950	6,952	5,950

(1) Tangible fixed assets include property, plant and equipment, investment properties and property inventory.

(2) Cash and cash equivalents is cash and balances with central banks less mandatory deposits plus cash equivalents within other assets, less due to other banks, due to related entities and other liabilities.

The notes on pages 75 to 145 form an integral part of these financial statements.

Notes to the consolidated financial statements
Section 1: Basis of preparation

Overview

This section sets out the Group's accounting policies that relate to the consolidated financial statements as a whole. Where an accounting policy is specific to one note, the policy is described in the note to which it relates. This section also shows new accounting standards, amendments and interpretations relevant to the Group, and whether they are effective in 2017 or later years. We explain how these changes are expected to impact the financial position and performance of the Group.

1.1 General information

The Bank is incorporated in the United Kingdom under the Companies Act and registered in Scotland. The consolidated financial statements comprise the Bank and its controlled entities, together the 'Group'.

The Bank's immediate and ultimate parent is CYBG PLC, a company registered in England and Wales. CYBG PLC also heads the largest and smallest group in which the results of the Group are consolidated. The financial statements of CYBG PLC may be obtained from CYBG PLC's registered office at 20 Merrion Way, Leeds, West Yorkshire, LS2 8NZ.

1.2 Basis of accounting

The consolidated financial statements have been prepared in accordance with IFRS as adopted by the EU and in accordance with the provisions of the Companies Act 2006. No individual income statement is presented for the Bank, as permitted by Section 408 of the Companies Act 2006.

The financial information has been prepared under the historical cost convention, as modified by the revaluation of land and buildings, investment properties, financial assets available for sale and certain other financial assets and liabilities at fair value through profit or loss. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

1.3 Presentation of risk offsetting and maturity disclosures

Certain disclosures required under IFRS 7 'Financial instruments: disclosures' and IAS 1 'Presentation of financial statements' have been included within the audited sections of the Risk report. Where information is marked as audited, it is incorporated into these financial statements by this cross reference and it is covered by the Independent auditor's report.

1.4 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, the Risk report includes the Group's risk management objectives and the Group's objectives, policies and processes for managing its capital.

In assessing the Group's going concern position as at 30 September 2017, the Directors have considered a number of factors, including the current balance sheet position, the principal and emerging risks which could impact the performance of the Group and the Group's strategic and financial plan which includes future projections of profitability, capital adequacy, liquidity and funding. The assessment concluded that, for the foreseeable future, the Group has sufficient capital to support its operations; has a funding and liquidity base which is strong, robust and well managed with future capacity; and has expectations that performance will continue to improve as the Group's strategy is executed.

As a result of the assessment, 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 risks successfully in line with its business model and strategic aims. Accordingly, they continue to adopt the going concern basis in preparing the consolidated financial statements.

Notes to the consolidated financial statements (continued)
Section 1: Basis of preparation (continued)

1.5 Basis of consolidation

Controlled entities are all entities (including structured entities) to which the Bank is exposed, or has rights, to variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. An assessment of control is performed on an ongoing basis.

Controlled entities are consolidated from the date on which control is established by the Group until the date that control ceases. The acquisition method of accounting is used to account for business combinations other than those under common control. A non-controlling interest is recognised by the Group in respect of any portion of the total assets less total liabilities of an acquired entity or entities that is not owned by the Group. Post-acquisition, income received and expenses incurred by the entity or entities acquired are included in the consolidated income statement on a line by line basis in accordance with the accounting policies set out herein. 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 that of Clydesdale Bank PLC.

1.6 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 also the Group's presentation currency, rounded to the nearest million pounds sterling (£m) unless otherwise stated.

Transactions and balances
The Group records an asset, liability, expense or revenue arising from a transaction using the closing exchange rate between the functional and foreign currency on the transaction date. At each subsequent 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, with those measured at fair value 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 are recognised in the income statement, are also recognised in the income statement.

1.7 Financial assets and liabilities

Recognition and derecognition
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. Purchases and sales of financial assets classified within fair value through profit or loss are recognised on trade date.
The Bank derecognises a financial asset when the contractual cash flows from the asset expire 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. Financial liabilities are derecognised when the Bank has discharged its obligation to the contract, or the contract is cancelled or expires.

Offsetting
This can only occur, and the net amount be presented on the balance sheet, when the Group currently has a legally enforceable right to set off the recognised amounts and intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

Notes to the consolidated financial statements (continued)
Section 1: Basis of preparation (continued)

1.8 Critical accounting estimates and judgements

The preparation of financial statements requires the use of certain critical accounting estimates and judgements 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 Bank has internal control systems in place to ensure that estimates can be reliably measured, actual amounts may differ from those estimates. The Bank considers the most significant use of accounting estimates and judgements relate to the following areas:

- financial assets and liabilities at fair value through profit or loss (note 3.3);
- impairment provisions on credit exposures (note 3.6);
- deferred tax (note 3.11);
- PPI redress provision and other conduct related matters (note 3.14); and
- retirement benefit obligations (note 3.16).

1.9 Presentation changes in respect of Clydesdale Bank PLC

A review of the presentation of the deemed loan repayable to the structured entities has been conducted to ensure a consistent, clear view is presented which avoids grossing up the balance sheet by the Bank and enhances the understanding of the end user of the financial statements. As described in note 3.7, the CB PLC Company has assigned mortgage loans to structured entities under the Lanark and Lannraig securitisation programme and to the Clydesdale Covered Bond 2 LLP under the Covered Bond programme. These mortgage loans do not qualify for derecognition, with a deemed loan liability being recognised for the proceeds of the funding transaction. The components of the deemed loan were presented as at 30 September 2016 primarily on a gross basis in either in "amounts due from related entities" (2016: £905m), "amounts due to related entities" (2016: £5,060m) or "other liabilities" (2016 :£(7)m). Similarly a review of the presentation of the internally held A and Z notes has been conducted. The CB PLC Group has entered into self-issuances of debt as part of the Lanark and Lannraig securitisation programme with A notes to be used as collateral for repurchase ('repo') and similar transactions and Z notes to be held as a credit enhancement of the securitisation programme. Previously these internally held A and Z notes were recognised as held to maturity assets on the Company's balance sheet (2016: £1,447m) and on consolidation were eliminated to nil on the CB PLC Group balance sheet.

Reclassification amendments have been made such that the separate components of the deemed loan have now been presented on an aggregate basis in "amounts due to related entities" on the Company balance sheet. The loan to the Clydesdale Covered Bond 2 LLP structured entity and the equivalent deemed loan representing the consideration for the transfer of mortgage loans has not been recognised separately as an additional asset and liability, to avoid grossing up the balance sheet. Similarly the investments in A and Z notes and the equivalent deemed loan, together with the related income and expenditure, are not recognised in the Company's or Group's financial statements.

In order to aid understanding of this presentation change the prior year comparatives have been restated below for the Bank balance sheet. The Group balance sheet is unaffected by the reclassification as all impacted balances eliminate on consolidation.

		Bank	
	Original 2016 £m	Reclassification 2016 £m	Restated 2016 £m
Assets			
Due from related entities [1]	2,510	(905)	1,605
Financial assets held to maturity	1,447	(1,447)	-
All other assets	37,730	-	37,730
Total assets	41,687	(2,352)	39,335
Liabilities			
Due to related entities [2]	5,605	(2,359)	3,246
Other liabilities	2,200	7	2,207
All other liabilities	30,704	-	30,704
Total liabilities	38,509	(2,352)	36,157
Total equity	3,178	-	3,178
Total liabilities and equity	41,687	(2,352)	39,335

(1) The residual £1,605m represents funding balances due from other controlled entities.
(2) The reclassification of £3,246m primarily represents the deemed loan liability and debt issued to the parent entity.

Notes to the consolidated financial statements (continued)
Section 1: Basis of preparation (continued)

1.10 New accounting standards and interpretations

The Group has adopted the following International Accounting Standards Board (IASB) pronouncements in the current financial year. Except where otherwise stated, these did not have a material impact on the Group's consolidated financial statements:

- amendments to IAS 16 and IAS 38: 'Clarification of Acceptable Methods of Depreciation and Amortisation', issued May 2014 and effective for financial years beginning on or after 1 January 2016. IAS 16 and IAS 38 both establish the principle for the basis of depreciation and amortisation being the expected pattern of consumption of the future economic benefits of an asset. This amendment provides clarification that the use of certain revenue based methods to calculate depreciation is not appropriate.
- 'Annual Improvements to IFRS Standards 2012-2014 Cycle', issued September 2014 and effective for financial years beginning on or after 1 January 2016. The IASB has made amendments to the following standards that are relevant to the Group: IFRS 5: 'Non-current Assets Held for Sale and Discontinued Operations'; IFRS 7: 'Financial Instruments: Disclosures'; IAS 19: 'Employee Benefits'; and IAS 34: 'Interim Financial Reporting'.
- amendments to IAS 1: 'Disclosure Initiative', issued December 2014 and effective for financial years beginning on or after 1 January 2016. This includes a narrow scope amendment providing clarification to existing IAS 1: 'Presentation of Financial Statements' requirements.

New accounting standards and interpretations not yet adopted

IFRS 9 'Financial Instruments' (issued July 2014) and IFRS 15 'Revenue from Contracts with Customers' (issued September 2015) are both effective for financial years beginning on or after 1 January 2018 and have been endorsed by the EU. IFRS 16 'Leases' was issued in January 2016 and is effective for financial years beginning on or after 1 January 2019 and has been endorsed by the EU. Separate updates on the Group's implementation of these new standards can be found at the end of this section.

There are a number of other standards and amendments that are either not available for adoption in the EU or are otherwise not mandatory at 30 September 2017 and have not been applied by the Group in preparing these financial statements. The pronouncements, while relevant to the Group, are not anticipated to have a material impact and include:

- amendments to IAS 12: 'Recognition of Deferred Tax Assets for Unrealised Losses'[(1)], issued in January 2016 and effective for financial years beginning on or after 1 January 2017. The amendments clarify the requirements on the recognition of deferred tax assets for unrealised losses;
- amendments to IAS 7: 'Disclosure initiative'[(1)], issued in January 2016 and effective for financial years beginning on or after 1 January 2017. The amendments to IAS 7: 'Statement of Cash Flows' require disclosures that enable users of the financial statements to evaluate changes in liabilities arising from an entity's financing activities;
- amendments to IFRS 2: 'Classification and Measurement of Share-based Payment Transactions'[(2)], issued in June 2016 and effective for financial years beginning on or after 1 January 2017. The amendments provide guidance on the effects of vesting and non-vesting conditions on the measurement of cash-settled share-based payments; classification of share-based payments with a net settlement feature for withholding tax obligations; and accounting for modifications to a share-based payment that change the classification from cash-settled to equity-settled;
- amendments to IFRS 9: 'Prepayment Features with Negative Compensation'[(2)], issued in October 2017 and effective for financial years beginning on or after 1 January 2019. The amendments allow companies to measure particular prepayable financial assets with so-called negative compensation at amortised cost or at fair value through other comprehensive income if a specified condition is met, instead of at fair value through profit or loss;

[(1)] Endorsed by the EU.
[(2)] Not yet endorsed by the EU.

Notes to the consolidated financial statements (continued)
Section 1: Basis of preparation (continued)

1.10 New accounting standards and interpretations (continued)

New accounting standards and interpretations not yet adopted (continued)

- 'Annual Improvements to IFRS Standards 2014-2016 Cycle'[(2)], issued December 2016 and effective for financial years beginning on or after 1 January 2017 or 1 January 2018. The IASB has made amendments to the following standards: IFRS 12: 'Disclosure of Interests in Other Entities' (clarification of the scope of the standard – effective 1 January 2017), and IAS 28: 'Investments in Associates and Joint Ventures' (measuring an associate or joint venture at fair value – effective 1 January 2018);
- IFRIC interpretation 22: 'Foreign Currency Transactions and Advance Consideration'[(2)], issued December 2016 and effective for financial years beginning on or after 1 January 2018. The new interpretation provides requirements on which exchange rate to use in reporting foreign currency transactions (such as revenue transactions) when payment is made or received in advance; and
- IFRIC interpretation 23: 'Uncertainty over Income Tax Treatments'[(2)], issued June 2017 and effective for financial years beginning on or after 1 January 2019. The new interpretation applies to any situation in which there is uncertainty as to whether an income tax treatment is acceptable under tax law and is not limited to actual ongoing disputes.

Updates on the implementation of IFRS 9: 'Financial Instruments', IFRS 15: 'Revenue from Contracts with Customers' and IFRS 16: 'Leases'

The Group continues to assess the requirements of these Standards as it seeks to ensure that the methodology and approach to the key impacts and challenges of the Standards result in a high quality implementation, while continuing to recognise emerging and evolving industry practice.

IFRS 9
CYBG implementation strategy and approach
IFRS 9 was endorsed for adoption in the EU in November 2016 and will be adopted by the Group with effect from 1 October 2018.

Classification and measurement
IFRS 9 changes the classification of financial assets by reducing the number of categories to just three (amortised cost, fair value through other comprehensive income (FVOCI) and fair value through profit or loss (FVTPL)). The final classification is based on a combination of the Group's business model and the contractual cash flow characteristics of the instruments. The option to designate a financial asset at FVTPL in IAS 39 is largely retained in IFRS 9, with IFRS 9 also affording a further option to designate certain equity instruments at FVOCI instead of accounting for these as FVTPL. The Group has undertaken an assessment to determine the potential impact of these changes. These are unlikely to result in significant changes to existing measurement bases; however, the final impact will be dependent on the circumstances prevailing on 1 October 2018.

Impairment overview
The Group's IFRS 9 implementation programme is progressing as planned with models built and an end-to-end parallel run exercise to commence during the year beginning 1 October 2017. As expected, there will be a period of refinement required where the series of complex decisions, judgements and assumptions made, particularly in relation to the Group's model methodology, are reviewed, sufficiently tested and benchmarked. It is only after a period where the testing environment has stabilised, that the results of the parallel run will provide an indication of the likely impact.

[(2)] Not yet endorsed by the EU.

Notes to the consolidated financial statements (continued)
Section 1: Basis of preparation (continued)

1.10 New accounting standards and interpretations (continued)

Updates on the implementation of IFRS 9: 'Financial Instruments', IFRS 15: 'Revenue from Contracts with Customers' and IFRS 16: 'Leases' (continued)

The Group's approach to the new expected credit loss (ECL) methodology in IFRS 9 will leverage, as far as possible, off the model development work that has been undertaken to support the Group's IRB accreditation application. A lifetime ECL calculation will be required for scenarios where the credit quality of a financial asset has been identified through the Group's staging criteria as having significantly deteriorated since original recognition.

The Group's 12 month and lifetime ECL calculation will be based around a 'PD x EAD x LGD' formula:

Term	Defined as	To be IFRS 9 compliant
PD	Probability of default (PD) is an estimate of the probability that a customer will default	Forward-looking 12 month and lifetime PD, which needs to be capable of reflecting changes in the economic environment
EAD	Exposure at default (EAD) is an estimate of the amount the customer will owe at the time of default	Forward-looking and based on contractual limits with certain exceptions for revolving products (such as credit cards) that may contain both a drawn and undrawn element
LGD	Loss given default (LGD) is an estimate of the loss that the Group will suffer if the customer defaults (incorporating any collateral held)	Forward-looking with no prescribed floors

There are a number of specific key elements to the IFRS 9 ECL calculation which require the Group to define and articulate the direction it will take in meeting these – that is ensuring that the ECL calculation is *forward-looking* and encompasses a *probability weighted multiple scenario* approach.

The Group currently adopts economic scenario methodology for capital planning and credit stress testing purposes and views the introduction of the IFRS 9 requirements as an extension to these established processes. The Group will align the specific requirements of IFRS 9 to these to ensure a consistent approach is adopted.

The exact nature and number of the economic scenarios (including the necessary economic inputs required for the scenarios), along with their relevant probability weightings, were finalised following experienced credit judgement, discussion and agreement with stakeholders. This will be subject to refinement as the parallel run period progresses.

The adoption of IFRS 9 may result in an increase in the Group's balance sheet provisions for credit losses and may therefore have a negative impact on the Group's regulatory capital position.

Hedge accounting
Macro hedge accounting is being considered in a separate IASB project. There is an option available to retain the existing IAS 39 hedge accounting requirements until the completion of the macro hedge accounting project. The Group proposes to continue applying the hedge accounting requirements of IAS 39 in accordance with this option.

Regulatory capital
The Group notes the pronouncements regarding transitional relief for the likely regulatory capital impact of adopting IFRS 9 from the Basel Committee and also the European Parliament and Commission and will continue to monitor the regulatory landscape over the year ahead in the lead up to the Group's adoption of IFRS 9 for final details on the regulatory capital treatment of the change to an ECL methodology.

The Group will consider the option of spreading the effect of the change to an ECL methodology for regulatory capital purposes should this feature in the finalised version of the rules.

Notes to the consolidated financial statements (continued)
Section 1: Basis of preparation (continued)

1.10 New accounting standards and interpretations (continued)

Updates on the implementation of IFRS 9: 'Financial Instruments', IFRS 15: 'Revenue from Contracts with Customers' and IFRS 16: 'Leases' (continued)

IFRS 15
IFRS 15 was issued in May 2014 and endorsed for use in the EU in September 2016. It is effective for financial years beginning on or after 1 January 2018, and it will be adopted by the Group with effect from 1 October 2018.

The Standard is unlikely to have a significant impact as the majority of the Group's income is generated from financial instruments and is therefore not in scope of the Standard. For those revenues that are in scope (typically fees and other commissions), the Group continues to assess the related performance obligations to identify any fees or other commissions that may require a change in recognition. The Group continues to assess the new disclosure requirements of the Standard.

IFRS 16
IFRS 16 was issued in January 2016 and endorsed for use in the EU. It is effective for financial years beginning on or after 1 January 2019 and will be adopted by the Group with effect from 1 October 2019.

The Group continues to work on and assess the new estimates and judgements required by the Standard and their implications. Operating leases will be brought onto the Group balance sheet with an asset recognised for the contractual 'right of use' and a liability recognised for the contractual payments. The Group expects this work to progress throughout the 2018 reporting period.

Notes to the consolidated financial statements (continued)
Section 2: Results for the year

2.1 Segment information

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

The Group's business is organised into two principal operating segments: SME banking and Retail banking. In addition, Central Functions consist of the Group's back office support functions.

SME banking

The Group's established regional SME franchise offers a full range of banking products and services to meet business customers' banking needs across its small business, commercial, corporate and specialist and acquisition finance segments.

The Group's SME franchise comprises small businesses (which the Group defines as businesses with lending of up to £0.5m but less than £2.0m in turnover) and commercial businesses (which the Group defines as businesses with lending of more than £0.5m and greater than £2.0m in turnover).

Through its SME franchise, the Group offers a full range of lending products and services across a portfolio consisting of term lending, overdrafts and working capital solutions:

- term lending: the Group offers a wide variety of term loans, both secured and unsecured, and offers customers a range of repayment and interest rate options. The majority of the Group's business term lending is LIBOR based;
- overdrafts: business overdrafts are the primary type of revolving variable rate credit facility offered by the Group to business customers;
- invoice finance: the Group advances funds against the customer's trade receivables;
- asset finance: these products provide a method of financing capital equipment purchases;
- international trade services: these products facilitate transactions between a buyer and seller located in different countries. The Group offers import loans, export loans, documentary collections and currency guarantees, together with letters of credit for securing trade; and
- business current accounts: the Group provides business customers day to day banking, current account facilities (including debit cards, cheque books, regular statements, direct debits and standing orders), and online banking.

Retail banking

The Group has a comprehensive regional and national retail banking product proposition with a personal deposit portfolio comprising personal current accounts (PCA), savings accounts and term deposits. The Group's Retail lending portfolio comprises mortgages, personal loans, credit cards, overdrafts and introductions to insurance and investment products through its branch network:

- PCA: the Group offers a full range of PCAs, including, for example, B, a newly launched digital proposition, together with a packaged bank account and a basic bank account;
- savings accounts: the Group offers a variety of savings accounts that pay a variable rate of interest. It also offers cash ISAs that provide depositors tax free returns;
- term deposits: offer a fixed interest rate for a fixed term;
- mortgages: the Group provides mortgage loans on a capital repayment basis, where the loan is required to be repaid during its life, and on an interest-only basis, where the customer pays interest during the term of the mortgage loan with the principal balance required to be repaid in full at maturity. The Group offers both owner occupied mortgage loans and BTL loans;
- personal loans: the Group provides unsecured personal loans through its branch network and through its digital and telephone distribution channels;
- credit cards: the Group currently offers four credit card products: Private MasterCard, Business MasterCard, Gold MasterCard and B MasterCard; and
- overdrafts: the Group provides overdraft lending across a variety of PCA products, subject to the account holder's status;

Notes to the consolidated financial statements (continued)
Section 2: Results for the year (continued)

2.1 Segment information (continued)

Geographical areas

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

Operating Segments 2017	SME banking £m	Retail banking £m	Central functions £m	Other [1] £m	Total £m
Net interest income	251	644	(50)	-	845
Non-interest income	83	100	(11)	20	192
Operating income	334	744	(61)	20	1,037
Operating and administrative expenses	(61)	(97)	(512)	(580)	(1,250)
Impairment losses on credit exposures [2]	(33)	(15)	-	-	(48)
Segment operating profit/(loss) before tax	240	632	(573)	(560)	(261)
Average interest earning assets [3]	10,154	20,578	6,965	-	37,697

Operating segments [4] 2016	SME banking £m	Retail banking £m	Central functions £m	Other[1] £m	Total £m
Net interest income	242	627	(62)	-	807
Non-interest income	87	100	(4)	8	191
Operating income	329	727	(66)	8	998
Operating and administrative expenses	(70)	(119)	(537)	(585)	(1,311)
Impairment losses on credit exposures [2]	(30)	(9)	-	-	(39)
Segment operating profit/(loss) before tax	229	599	(603)	(577)	(352)
Average interest-earning assets [3]	10,404	19,063	6,790	-	36,257

(1) 'Other' reflects underlying adjustments to the statutory view of performance and is therefore not recharged to the Group's two principal operating segments, such as conduct related provisions and restructuring costs. For a breakdown of the items included in this category, refer to 'Measuring financial performance – glossary'.

(2) The impairment losses on credit exposures of £15m (2016: £9m) for Retail banking includes losses on certain retail products attributable to SME (private banking) customers.

(3) Average interest earning assets for SME banking segment includes £2.9bn (2016: £3.3bn) of mortgages originated by private banking.

(4) Comparative disclosures have been amended to conform with the current period's presentation.

Liabilities are managed on a centralised basis and therefore are not disclosed by segment.

Notes to the consolidated financial statements (continued)
Section 2: Results for the year (continued)

2.2 Net interest income

Accounting policy

Interest income is reflected in the income statement using the effective interest method which discounts the estimated future cash payments or receipts over the expected life of the financial instrument to the net carrying amount of the financial asset or liability.

When calculating the effective interest rate, 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 includes all fees and points paid or received that are an integral part of the effective interest rate such as transaction costs and all other premiums or discounts. Where it is not possible to reliably estimate 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 within the effective interest rate calculation. Non-utilisation of a commitment fee is recognised as revenue upon expiry of the agreed commitment period. Loan related administration and service fees are recognised as revenue over the period of service.

Interest income and interest expense on hedged assets and liabilities and financial assets and liabilities designated as fair value through profit or loss are also recognised as part of net interest income. Where a trading derivative is economically hedging an interest bearing 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.

	2017 £m	2016 £m
Interest income and similar income		
Loans and advances to other banks	11	22
Financial assets available for sale	11	11
Loans and advances to customers	1,030	1,037
Financial assets at fair value through profit or loss	18	27
Due from related entities	-	1
Other interest income	5	3
Total interest income and similar income	1,075	1,101
Less: interest expense and similar charges		
Due to other banks	15	8
Financial liabilities at fair value through profit or loss	-	1
Due to customers	126	188
Debt securities in issue	63	72
Due to related entities	26	25
Total interest expense and similar charges	230	294
Net interest income	845	807

Notes to the consolidated financial statements (continued)
Section 2: Results for the year (continued)

2.3 Non-interest income

Accounting policy

Gains less losses on financial instruments at fair value

This includes fair value gains and losses from three distinct activities:

- derivatives classified as held for trading - the full change in fair value of trading derivatives is recognised inclusive of interest income and expense arising on those derivatives except when economically hedging other assets and liabilities at fair value outlined in note 2.2;
- other financial assets and liabilities designated at fair value through profit or loss – these relate to the Group's fixed interest rate loan portfolio and related term deposits (note 3.3), which were designated at inception as fair value through profit or loss. The fair value of these loans is derived from the future loan cash flows using appropriate discount rates and includes adjustments for credit risk and credit losses. The valuation technique used is reflective of current market practice; and
- hedged assets, liabilities and derivatives designated in hedge relationships - fair value movements are recognised on both the hedged item and hedging derivative in a fair value hedge relationship (the net of which represents hedge ineffectiveness), and hedge ineffectiveness on cash flow hedge relationships (note 3.4).

Fees and commissions

Where not integral to the effective interest rate, these are recognised on an accruals basis as the services are provided or on completion of the underlying transaction.

	2017 £m	2016 £m
Gains less losses on financial instruments at fair value		
Interest rate derivatives	45	3
Other assets and liabilities at fair value [1]	(35)	7
Ineffectiveness arising from fair value hedges (note 3.4)	(4)	-
Ineffectiveness arising from cash flow hedges (note 3.4)	-	(1)
	6	9
Other operating income		
Fees and commissions	146	151
Margin on foreign exchange derivative brokerage	18	19
Gains on disposal of available for sale financial assets	20	8
Net fair value movement on investment properties	(1)	(1)
Other income	3	5
	186	182
Total non-interest income	192	191

[1] A credit risk gain on other assets and liabilities at fair value of £6m, offset by a fair value loss of £41m, has been recognised in the current year (2016: £11m gain and £4m loss, respectively).

On 28 April 2017, MasterCard completed its acquisition of 94.2% of VocaLink. By virtue of its 3.24% shareholding in VocaLink, the Group received cash consideration of £25m. The resulting gain of £20m, which was recognised in the available for sale reserve following the acquisition announcement in 2016, was recycled to the income statement and is included within 'Gains on disposal of available for sale financial assets' in the current year.

Notes to the consolidated financial statements (continued)
Section 2: Results for the year (continued)

2.4 Operating and administrative expenses

Accounting policy

Personnel expenses primarily consist of wages and salaries, accrued bonus and social security costs arising from services rendered by employees during the financial year.

The Group recognises bonus costs where it has a present obligation that can be reliably measured. Bonus costs are recognised over the relevant service period required to entitle the employee to the reward.

The Group's accounting policies on pension expenses and equity based compensation are included in notes 3.16 and 4.2 respectively.

	2017	2016
	£m	£m
Personnel expenses	**166**	280
Restructuring expenses (note 3.14)	**67**	45
Depreciation and amortisation expense (notes 3.8, 3.10)	**87**	88
Other operating and administrative expenses	**930**	898
	1,250	1,311

Personnel expenses comprises the following items:

	2017	2016
	£m	£m
Salaries, wages and non-cash benefits and social security costs	**171**	211
Defined contribution pension expense	**19**	20
Defined benefit pension (income)/expense (note 3.16)	**(54)**	28
Equity based compensation (note 4.2)	**6**	5
Other personnel expenses	**24**	16
Personnel expenses	**166**	280

The Group recognised gains in relation to its defined benefit pension scheme in the year. A past service credit of £88m is included in personnel expenses as a result of the closure of the Scheme to future accrual for the majority of members. In addition, a curtailment gain of £13m was recognised in respect of redundancies which did not attract an enhancement entitlement and offsets against the related restructuring costs.

The average number of FTE employees of the Group during the year was made up as follows:

	2017	2016
	Number	Number
Managers	**2,234**	2,460
Clerical staff	**3,806**	4,258
	6,040	6,718

The average monthly number of employees was 6,818 (2016: 7,567)

All staff are contracted employees of the Group and its subsidiary undertakings. The average figures above do not include contractors.

Other items of significance to the Group which are included within other operating and administrative expenses are:

	2017	2016
	£m	£m
Operating lease charges	**29**	30
Impairment losses on software (note 3.10)	**-**	45
PPI redress expense (note 3.14)	**494**	450
Other conduct expenses (note 3.14)	**98**	34
Separation costs	**8**	3
Auditor's remuneration	**2**	2

Notes to the consolidated financial statements (continued)
Section 2: Results for the year (continued)

2.4 Operating and administrative expenses (continued)

Auditor's remuneration included within other operating and administrative expenses:

	2017	2016
	£'000	£'000
Fees payable to the Bank's auditor for the audit of the Bank's financial statements	1,182	1,284
Fees payable to the Bank's auditor for the audit of the Bank's subsidiaries	69	103
Total audit fees	1,251	1,387
Audit related assurance services	30	50
Other assurance services	278	35
Total non-audit fees	308	85
Fees payable to the Bank's auditor in respect of associated pension schemes	63	75
Total fees payable to the Bank's auditor	1,622	1,547

Non-audit services performed by the auditor during the year included agreed upon procedures under the Conduct Indemnity arrangement with NAB; regular profit attestations; preparation of a comfort letter for the global medium term note programme issuance; and a client asset regulatory review. In addition to the above, out of pocket expenses of £16k (2016: £58k) were borne by the Group, principally related to reimbursement of travel expenses incurred by staff when performing the above services.

Notes to the consolidated financial statements (continued)

Section 2: Results for the year (continued)

2.5 Taxation

Accounting policy

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 directly in equity, in which case the tax is also recognised in equity.

Current tax is the expected tax payable or receivable 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 assets and liabilities are recognised on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the 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.

	2017 £m	2016 £m
Current tax		
UK corporation tax		
Current year	9	13
Adjustment in respect of prior years	1	(3)
	10	10
Deferred tax (note 3.11)		
Current year	17	200
Adjustment in respect of prior years	6	(4)
	23	196
Tax expense for the year	33	206

The tax assessed for the year differs from that arising from applying the standard rate of corporation tax in the UK. A reconciliation from the credit implied by the standard rate to the actual tax expense is as follows:

	2017 £m	2016 £m
Loss on ordinary activities before tax	(261)	(352)
Tax credit based on the standard rate of corporation tax in the UK of 19.5% (2016: 20%)	(51)	(70)
Effects of:		
Disallowable expenses	64	57
Deferred tax assets (recognised)/written off	(21)	237
Impact of rate changes	34	(11)
Adjustments in respect of prior years	7	(7)
Tax expense for the year	33	206

The total amount of tax, current and deferred, recognised directly in equity during the year was a credit of £1m (2016: credit £16m).

Disallowable expenses represent, in the main, the Group's share of incremental conduct charges that are not deductible in computing taxable profits.

The rate at which deferred tax is recognised in respect of the defined benefit pension scheme has changed due to the closure of the Scheme. The surplus is accounted for as a potential refund to the employer, not a reduction in future contributions. In accordance with tax legislation this "authorised surplus payment" is recognised as a deferred tax liability at 35%. There is an overall rate change in respect of the pension of £37m with £30m taken to the Income Statement and £7m to the statement of other comprehensive income.

Notes to the consolidated financial statements (continued)
Section 3: Assets and liabilities

3.1 Cash and balances with central banks

	Group		Bank	
	2017	2016	**2017**	2016
	£m	£m	**£m**	£m
Cash assets	**1,507**	1,313	**1,507**	1,313
Balances with central banks (including EU payment systems)	**5,430**	4,642	**5,430**	4,642
	6,937	5,955	**6,937**	5,955
Less mandatory deposits with central banks [1]	**(44)**	(43)	**(44)**	(43)
Included in cash and cash equivalents (note 5.2)	**6,893**	5,912	**6,893**	5,912

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

3.2 Financial assets available for sale

Accounting policy

Available for sale financial assets are recognised on trade date and comprise listed and unlisted non-derivative financial assets not classified into any other financial asset category. They are initially recognised at fair value including direct and incremental transaction costs, and subsequently measured at fair value. Gains and losses arising from changes in fair value are included as a separate component of equity until sale or impairment, at which point the cumulative gain or loss is transferred to the income statement.

All available for sale financial assets are continually monitored for evidence of any impairment, which would typically be deemed to have arisen where there is evidence of a significant or prolonged reduction in the fair value of the security below its cost. Where such evidence of impairment exists, the cumulative net loss previously recognised directly in equity is transferred to the income statement.

In situations where evidence suggests a subsequent increase in value, reversals of impairment of previously impaired equity instruments are recognised directly in equity; reversals of impairment of debt instruments are recognised in the income statement.

Interest income, determined using the effective interest method, is recognised in the income statement. Impairment losses and translation differences on monetary items are recognised in the income statement within the year in which they arise.

	Group		Bank	
	2017	2016	**2017**	2016
	£m	£m	**£m**	£m
Listed securities	**2,066**	1,695	**2,066**	1,695
Unlisted securities	**4**	29	**4**	29
Other financial assets	**6**	7	**-**	-
Total financial assets available for sale	**2,076**	1,731	**2,070**	1,724

3.2 Financial assets available for sale (continued)

Refer to note 3.18 for further information on the valuation methodology applied to available for sale assets and their classification within the fair value hierarchy.

Credit quality of investments	Group		Bank	
	2017	2016	**2017**	2016
	£m	£m	**£m**	£m
Available for sale				
Senior investment grade	**2,066**	1,695	**2,066**	1,695
Other	**10**	36	**4**	29
	2,076	1,731	**2,070**	1,724

Senior investment grade securities

These include £1,221m (2016: £1,286m) of UK Government Gilts. The remainder relates to highly liquid, AAA-rated corporate bonds.

3.3 Financial assets and liabilities at fair value through profit or loss

Accounting policy

Financial assets and liabilities are designated at fair value through profit or loss, with gains and losses recognised in the income statement as they arise (note 2.3), when this reduces an accounting mismatch or where the performance is evaluated on a fair value basis. In such cases, transaction costs are recognised immediately in the income statement upon initial recognition of the financial asset and liability.

The derivatives related to the assets and liabilities at fair value through profit or loss do not meet the requirements for hedge accounting and are accounted for as held for trading derivative financial instruments (note 3.4).

Critical accounting estimates and judgements

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 such data is not available, judgement is required to establish fair values. The judgements include considerations of liquidity and model inputs.

The most significant judgement is in relation to the Group's fair value loan portfolio. The most significant input impacting the carrying value of the loans other than interest rates is the future expectation of credit losses. Sensitivity analysis indicating the impact of reasonably possible changes in this input on the fair value is provided in note 3.18.

	Group		Bank	
	2017	2016	**2017**	2016
	£m	£m	**£m**	£m
Financial assets at fair value through profit or loss				
Loans and advances	**477**	750	**477**	750
Financial liabilities at fair value through profit or loss				
Due to customers – term deposits	**26**	48	**26**	48

Loans and advances

Included in financial assets at fair value through profit or loss is a historical portfolio of loans (sales ceased in 2012). 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 £477m (2016: £750m) including accrued interest receivable of £2m (2016: £4m). The cumulative loss in the fair value of the loans attributable to changes in credit risk amounts to £11m (2016: £24m) and the change for the current year is a decrease of £13m (2016: decrease of £14m), of which £6m (2016: £11m) has been recognised in the income statement.

The loans are classified as Level 3 in the fair value hierarchy (note 3.18).

3.3 Financial assets and liabilities at fair value through profit or loss (continued)

Due to customers – term deposits

Included in other financial liabilities at fair value are fixed rate deposits, the interest rate risk on which is hedged using interest rate derivative contracts. The deposits are recorded at fair value to avoid an accounting mismatch.

The change in fair value attributable to changes in the Group's credit risk is £Nil (2016: £Nil). The Group is contractually obligated to pay £1m (2016: £3m) less than the carrying amount at maturity to the deposit holder.

The term deposits are classified as Level 3 in the fair value hierarchy (note 3.18).

3.4 Derivative financial instruments

Accounting policy

All derivative instruments manage exposures to interest rates and foreign currency and are recognised on the balance sheet at fair value on trade date. 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 notional amount of a derivative contract is not recorded on the balance sheet but disclosed as part of this note.

The method of recognising the resulting fair value gain or loss on a derivative depends on whether it is designated as a hedging instrument and, if so, the nature of the item being hedged. Certain derivatives are designated as either hedges of highly probable future cash flows attributable to a recognised asset or liability, or a highly probable forecast transaction (a cash flow hedge); or hedges of the fair value of recognised assets or liabilities or firm commitments (a fair value hedge).

Cash flow hedge

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in equity. Specifically, the separate component of equity (note 4.1) is adjusted to the lesser of the cumulative gain or loss on the hedging instrument, and the cumulative change in fair value of the expected future cash flows on the hedged item from the inception of the hedge. Any remaining gain or loss on the hedging instrument is recognised 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 period in which the hedged item affects 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.

Fair value hedge

The carrying value of the hedged item on initial designation is adjusted for the fair value attributable to the hedged risk. Subsequently, 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 interest basis over the remaining life of the asset or liability.

Hedge effectiveness

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 documentation covers how effectiveness will be measured throughout the life of the hedge relationship and its assessment, both at hedge inception and on an ongoing 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%.

Derivatives held for trading

The Group uses derivatives for risk management purposes and does not have a trading book. However, derivatives that do not meet the hedging criteria within IAS 39, or for which hedge accounting is not applied, are classified as held for trading. Changes in value of held for trading derivatives are immediately recognised in the income statement (note 2.3).

Notes to the consolidated financial statements (continued)
Section 3: Assets and liabilities (continued)

3.4 Derivative financial instruments (continued)

The tables below analyse derivatives between those designated as hedging instruments and those classified as held for trading:

	Group		Bank	
	2017	2016	**2017**	2016
	£m	£m	**£m**	£m
Fair value of derivative financial assets				
Designated as hedging instruments	**202**	351	**56**	154
Designated as held for trading	**80**	234	**80**	234
	282	585	**136**	388
Fair value of derivative financial liabilities				
Designated as hedging instruments	**229**	257	**229**	257
Designated as held for trading	**147**	341	**147**	330
	376	598	**376**	587

Cash collateral on derivatives placed with banks totalled £338m (2016: £337m). Cash collateral received on derivatives totalled £31m (2016: £57m). These amounts are included within due from other banks and due to other banks respectively.

The derivative financial instruments held by the Group and Bank are further analysed below. The notional contract amount is the amount from which the cash flows are derived and is not an indication of the amounts at risk relating to these contracts.

Group **Total derivative contracts as at 30 September 2017**	Notional contract amount £m	Fair value of assets £m	Fair value of liabilities £m
Derivatives designated as hedging instruments			
Cash flow hedges			
Interest rate swaps	17,952	56	104
Cross currency swaps	527	89	-
Forward foreign exchange	6	-	-
	18,485	145	104
Fair value hedges			
Interest rate swaps	1,452	57	125
Derivatives designated as held for trading			
Foreign exchange rate related contracts			
Spot and forward foreign exchange	2,689	45	47
Cross currency swaps	150	9	9
Options	103	2	2
	2,942	56	58
Interest rate related contracts			
Swaps	983	18	82
Swaptions	33	-	-
Options	477	2	3
	1,493	20	85
Commodity related contracts	93	4	4
Total derivative contracts	24,465	282	376

Notes to the consolidated financial statements (continued)
Section 3: Assets and liabilities (continued)

3.4 Derivative financial instruments (continued)

Group Total derivative contracts as at 30 September 2016	Notional Contract amount £m	Fair value of assets £m	Fair value of liabilities £m
Derivatives designated as hedging instruments			
Cash flow hedges			
Interest rate swaps	15,526	154	79
Cross currency swaps	760	88	-
Forward foreign exchange	5	-	-
	16,291	242	79
Fair value hedges			
Interest rate swaps	1,452	109	178
Derivatives designated as held for trading			
Foreign exchange rate related contracts			
Spot and forward foreign exchange	2,202	84	78
Swaps	150	11	11
Options	216	5	5
	2,568	100	94
Interest rate related contracts			
Swaps	1,512	123	233
Swaptions	47	-	1
Options	569	2	4
	2,128	125	238
Commodity related contracts	127	9	9
Total derivative contracts	22,566	585	598

3.4 Derivative financial instruments (continued)

Bank	Notional contract amount	Fair value of assets	Fair value of liabilities
Total derivative contracts as at 30 September 2017	£m	£m	£m
Derivatives designated as hedging instruments			
Cash flow hedges			
Interest rate swaps	17,952	56	104
Forward foreign exchange	6	-	-
	17,958	56	104
Fair value hedges			
Interest rate swaps	752	-	125
Derivatives designated as held for trading			
Foreign exchange rate related contracts			
Spot and forward foreign exchange	2,689	45	47
Cross currency swaps	150	9	9
Options	103	2	2
	2,942	56	58
Interest rate related contracts			
Swaps	983	18	82
Swaptions	33	-	-
Options	477	2	3
	1,493	20	85
Commodity related contracts	93	4	4
Total derivative contracts	23,238	136	376

3.4 Derivative financial instruments (continued)

Bank Total derivative contracts as at 30 September 2016	Notional contract amount £m	Fair value of assets £m	Fair value of liabilities £m
Derivatives designated as hedging instruments			
Cash flow hedges			
Interest rate swaps	15,526	154	79
Forward foreign exchange	5	-	-
	15,531	154	79
Fair value hedges			
Interest rate swaps	752	-	178
Derivatives designated as held for trading			
Foreign exchange rate related contracts			
Spot and forward foreign exchange	2,202	84	78
Swaps	150	11	11
Options	216	5	5
	2,568	100	94
Interest rate related contracts			
Swaps	1,512	123	222
Swaptions	47	-	1
Options	569	2	4
	2,128	125	227
Commodity related contracts	127	9	9
Total derivative contracts	21,106	388	587

Derivatives traded to manage the Group's interest rate exposure on a net portfolio basis are accounted for as cash flow hedges. Derivatives traded to manage interest rate risk on certain fixed rate assets, such as UK Government Gilts, are accounted for as fair value hedges. The Group also cash flow hedges its foreign currency exposure on material, highly probable non-GBP denominated transactions.

The Group hedging positions also include those designated as foreign currency and interest rate hedges of debt issued from the Group's securitisation and covered bond programmes respectively. As such certain derivative financial assets and liabilities have been booked in structured entities and consolidated within these financial statements.

Cash flow hedged derivatives include vanilla interest rate swaps within macro hedges and cross currency swaps within a structured entity. The Group has notional commitments in the following periods:

	Group		Bank	
	2017	2016	**2017**	2016
Nominal values per time period	**£m**	£m	**£m**	£m
Within 0 to 3 months	**92**	1,452	**83**	1,433
Between 3 and 12 months	**2,986**	6,710	**2,665**	6,495
1 to 5 years	**14,817**	8,063	**14,620**	7,537
Greater than five years	**590**	66	**590**	66
	18,485	16,291	**17,958**	15,531

Notes to the consolidated financial statements (continued)
Section 3: Assets and liabilities (continued)

3.4 Derivative financial instruments (continued)

The Group and Bank have hedged forecast future cash flows, which vary primarily with interest or foreign exchange rates. These cash flows are expected to impact the income statement in the following periods:

Group	Forecast receivable cash flows 2017 £m	Forecast payable cash flows 2017 £m	Forecast receivable cash flows 2016 £m	Forecast payable cash flows 2016 £m
Within 1 year	52	399	29	261
Between 1 and 2 years	70	86	16	368
Between 2 and 3 years	70	86	15	59
Between 3 and 4 years	44	122	14	77
Between 4 and 5 years	19	6	8	112
Greater than 5 years	26	18	-	6
	281	717	82	883

Bank	Forecast receivable cash flows 2017 £m	Forecast payable cash flows 2017 £m	Forecast receivable cash flows 2016 £m	Forecast payable cash flows 2016 £m
Within 1 year	52	29	29	17
Between 1 and 2 years	70	29	16	6
Between 2 and 3 years	70	9	15	3
Between 3 and 4 years	44	7	14	2
Between 4 and 5 years	19	6	8	-
Greater than 5 years	26	18	-	6
	281	98	82	34

	2017 £m	2016 £m
Gain/(loss) arising from fair value hedges (note 2.3)		
Hedging instrument	1	15
Hedged item attributable to the hedged risk	(5)	(15)
	(4)	-

	2017 £m	2016 £m
Loss from cash flow hedges due to hedge ineffectiveness (note 2.3)	-	(1)

Notes to the consolidated financial statements (continued)
Section 3: Assets and liabilities (continued)

3.5 Loans and advances to customers

Accounting policy

Loans and advances to customers arise when the Group provides money directly to a customer and include overdrafts, credit card lending, lease finance, mortgages, invoice financing and term lending.

Loans and advances to customers are initially recognised at fair value including direct and incremental transaction costs. They are subsequently measured at amortised cost, using the effective interest method, adjusted for impairment losses. 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.

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 leased asset is not held on the Group balance sheet; instead, a finance lease is recognised representing the minimum lease payments receivable under the terms of the lease, discounted at the rate of interest implicit in the lease. Interest income is recognised in interest receivable, allocated to accounting periods to reflect a constant periodic rate of return.

	Group		Bank	
	2017	2016	**2017**	2016
	£m	£m	**£m**	£m
Overdrafts	**1,524**	1,536	**1,524**	1,536
Credit cards	**396**	400	**396**	400
Lease finance	**594**	515	**575**	504
Mortgages	**23,480**	21,836	**22,442**	20,331
Other term lending – SME	**4,762**	4,393	**4,762**	4,393
Other term lending – Retail	**709**	690	**709**	690
Trade finance	**23**	26	**23**	26
Gross loans and advances to customers	**31,488**	29,396	**30,431**	27,880
Accrued interest receivable	**75**	76	**72**	70
Unearned income	**(28)**	(26)	**(27)**	(25)
Deferred and unamortised fee income	**(32)**	(29)	**(33)**	(30)
Impairment provisions on credit exposures (note 3.6)	**(210)**	(215)	**(207)**	(212)
	31,293	29,202	**30,236**	27,683

The Group and Bank have transferred a proportion of mortgages to the securitisation and covered bond programmes (note 3.7).

The Group and Bank also have a portfolio of fair valued business loans of £477m (2016: £750m) which are held separately as Other financial assets at fair value on the balance sheet (note 3.3). Combined with the above this is equivalent to total loans and advances of £31,770m (2016: £29,952m) in respect of Group and £30,713m (2016: £28,433m) in respect of Bank.

Notes to the consolidated financial statements (continued)
Section 3: Assets and liabilities (continued)

3.5 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 cost 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 £13m (2016: £5m) and £408m (2016: £381m) respectively. The total receivables from finance leases for the Group and Bank were £17m and £Nil (2016: £8m and £Nil) respectively. The total receivables from hire purchase contracts in the Group and Bank were £550m and £549m (2016: £482m and £480m) respectively.

	Group		Bank	
	2017 £m	2016 £m	2017 £m	2016 £m
Finance lease and hire purchase receivables				
Gross investment in finance lease and hire purchase receivables:				
Due within 1 year	241	224	236	221
Due within 1 to 5 years	346	288	334	281
Due after more than 5 years	7	3	5	2
	594	515	575	504
Unearned income	(27)	(25)	(26)	(24)
Net investment finance lease and hire purchase receivables	567	490	549	480

Notes to the consolidated financial statements (continued)
Section 3: Assets and liabilities (continued)

3.6 Impairment provisions on credit exposures

Accounting policy

Assets carried at amortised cost
At each reporting date the Group assesses if there is objective evidence of impairment on a financial asset or group of financial assets due to one or more loss events that occurred after initial recognition but prior to the balance sheet date. Examples of loss events are (i) where there has been an actual breach of contract by the borrower such as a default or delinquency in payment of interest or principal; or (ii) the granting of a concession to the borrower that the Group would not otherwise consider.

The Group first assesses whether objective evidence of impairment exists either individually for assets that are separately significant; or collectively for assets that are not separately significant. If it is determined that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, the asset is included in a group of financial assets with similar credit risk characteristics and collectively assessed for impairment ('collective provisions').

Collective provisions
Collective provisions are generally established for homogenous portfolios such as the Retail portfolios and the small business portfolio within the SME franchise.

Within the Group's Retail environment, past loss experience is a key factor in determining an appropriate collective provision level and takes into account a number of different elements including:

- the number of days past due;
- the realisable value of any security held; and
- the timing of any such security sale.

These and other factors will influence the probability that the customer defaults on the loan (the PD). In the event of a default occurrence, the Retail collective provision calculator provides the amount the Group expects to be irrecoverable from that customer (the LGD). The level and impact of LGD varies significantly between the Group's secured and unsecured lending portfolios.

Collective provisioning for the Group's SME portfolio is also based on the use of PD and LGD. The assets are is included in a group of financial assets with similar risk characteristics and collectively assessed for impairment. The modelled collective assessment considers factors such as:

- credit quality;
- levels of arrears;
- credit utilisation;
- loan to collateral ratios; and
- other factors including the Group's internal customer rating system (eCRS).

These characteristics are relevant to the estimation of future cash flows for groups of such assets as they are indicative of the borrower's ability to pay all amounts due according to the contractual terms of the assets being evaluated.

Reliance is placed on the eCRS rating when assessing PD as these are directly mapped within the model. Manual interventions to the eCRS rating, such as the placement on a watch list, will directly lead to an increase in PD and consequently the level of collective provision required. LGD assumptions are driven by the level of security assigned to the customer within the collective provisioning model. These are regularly monitored to ensure comparability with recent actual loss experience.

In addition, for both the Group's Retail and SME portfolios, experienced judgement is used to estimate the amount of an impairment loss. This reflects a limited number of refinements that have been assessed as necessary to reflect specific and evolving circumstances that, by their nature, cannot be adequately captured in the models. The use of judgements and supportable estimates is considered by management to be an essential part of the credit impairment process. The methodology and assumptions used for estimating future cash flows are reviewed regularly to identify and reduce any significant differences between loss estimates and actual loss experience.

Specific provision
If there is objective evidence that an impairment loss has been incurred on a loan, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows (including the estimated realisable value of any security) discounted at the asset's original effective interest rate (a 'specific provision').

Notes to the consolidated financial statements (continued)
Section 3: Assets and liabilities (continued)

3.6 Impairment provisions on credit exposures (continued)

Accounting policy (continued)

Specific provision allowances are primarily established against the Group's commercial business within the SME franchise. Assets are reviewed on a regular basis and those showing potential or actual vulnerability are placed onto a watch list where enhanced monitoring is undertaken.

Impairment
When first recognised, the impairment allowance, which is a combination of both the collective and specific provision, is recognised in the income statement.

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. 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. The amount of the reversal is recognised in the income statement.

When a loan is uncollectible, and all necessary internal procedures have been completed, it is written off against the related impairment loss. Subsequent recoveries of amounts previously written off reduce the expense in the income statement.

The Group's impairment policy for available for sale financial assets is included in note 3.2.

Critical accounting estimates and judgements

In determining the required level of collective impairment provisions, the Group uses the output from various statistical models, with management judgement required to assess the modelled outputs and, where necessary, make appropriate adjustments.

The key assumptions within the Group's collective provisioning models which give rise to significant estimation uncertainty are the PD and the LGD. Both measures are predicated on expectations of customer behaviour and performance, which requires management to form a judgement based on a wide range of historic and current evidence. The actual amount of the future cash flows and their timing may differ significantly from the assumptions made for the purposes of determining the impairment allowances and consequently these allowances can be subject to variation as time progresses and the circumstances of the customer become clearer.

From an SME perspective, changes made to eCRS will have a direct impact as these are mapped to PDs. Assumption changes on retail customer behaviour will also have an impact on the PDs used.

Within the Retail portfolio, the Group's collective provision is reflective of the fact that the majority of lending is concentrated on customer mortgages, where the available security is generally sufficient to cover the exposure. This differs from the SME portfolio where the availability and strength of the security will have less of an impact on overall recoveries, leading to a potentially higher collective provision charge relative to the overall exposure.

Sensitivities within the collective provision

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 below assume all other assumptions remain unchanged.

If the PDs were to move by +/- 5% from those presently used within the Group's provisioning models, the impairment provision would increase/decrease accordingly by £5m.

An important element to the PD is the loss emergence period (LEP) which represents the Group's assessment of the period from when a loss event occurs to eventual default. The impact of the LEP differs between the Group's Retail and SME portfolios. A two-month increase in the LEP would result in a further £2m impairment provision within the SME portfolio; and a further £1m being added to the Retail impairment provision.

Notes to the consolidated financial statements (continued)
Section 3: Assets and liabilities (continued)

3.6 Impairment provisions on credit exposures (continued)

Accounting policy (continued)

Critical accounting estimates and judgements (continued)

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 £14m. Alternatively, if recovery rates deteriorate by 5%, the impairment provision on loans and advances would increase by £24m.

Provision in the SME portfolio is sensitive not only to default rates and severity of losses, but also to the assessment of risk and security. If 10% of the SME portfolio were to fall by one notch, the impairment provision would increase by £2m.

In addition to modelled outputs, the impairment provision is further impacted by management judgements. These include judgements that reflect elements which are not sufficiently sensitive to the current economic conditions, model risk reserves that are held to cover against a range of potential model limitations, and judgements made in respect of potential recoveries for specific provisions which also involve customer and economic specific conditions. These management judgements do not allow for any meaningful sensitivity comparison.

	Group		Bank	
	2017	2016	**2017**	2016
	£m	£m	**£m**	£m
Opening balance	**215**	230	**212**	226
Charge for the year	**48**	39	**48**	38
Amounts written off	**(75)**	(68)	**(75)**	(68)
Recoveries of amounts written off in previous years	**18**	18	**18**	18
Other [1]	**4**	(4)	**4**	(2)
Closing balance (note 3.5)	**210**	215	**207**	212
Specific	**56**	64	**54**	62
Collective	**154**	151	**153**	150
	210	215	**207**	212

[1] Other includes the unwind of net present value elements of specific provisions and other minor movements.

Notes to the consolidated financial statements (continued)
Section 3: Assets and liabilities (continued)

3.7 Securitisation and covered bond programmes

Accounting policy

The Group sponsors the formation of structured entities, primarily for the purpose of facilitation of asset securitisation and covered bond transactions to accomplish certain narrow and well-defined objectives. Although the Group has no shareholding in these entities, where it is exposed, or has rights, to variable returns from its involvement with the entities and it has the ability to affect those returns through its power over the entity, they are regarded as controlled entities as described in note 1.5 and are consolidated in the Group's financial statements.

Securitisation

The Group has securitised a proportion of its retail mortgage loan portfolio under the Group's master trust securitisation programmes. The securitised mortgage loans have been assigned at principal value to bankruptcy remote structured entities. These structured entities have been funded through the issue of residential mortgage backed debt to third-party institutional debt investors. The Group and Bank is entitled to any residual income from the vehicles after the debt obligations and senior expenses of the programmes have been met. The securitised debt holders have no recourse to the Group other than the principal and interest (including fees) generated from the securitised mortgage loan portfolio. The Group and Bank continue servicing these mortgage loans in return for an administration fee.

The mortgage loans do not qualify for derecognition because the Group and Bank remain exposed to the majority of the risks and rewards of the mortgage loan portfolio, principally the associated credit risk. The securitisation structured entities are consolidated and the securitised mortgage loans retained on the Group's and Bank's balance sheets. A liability is recognised for the proceeds of the funding transaction. The externally held securitised notes in issue are included within debt securities in issue (note 3.15). There are a number of notes held internally by the Group and Bank, not recognised on the balance sheet, which are used as collateral for repurchases and similar transactions or for credit enhancement purposes.

Covered bond

A subset of the Group and Bank's retail mortgage loan portfolio has been ring fenced and assigned to a bankruptcy remote limited liability partnership, Clydesdale Covered Bond 2 LLP, associated with the covered bond programme, to provide a guarantee for the obligations payable on the covered bonds issued by the Group and Bank. Similar to the securitisation programmes, the Group and Bank are entitled to any residual income after all payment obligations due under the terms of the covered bonds and senior programmes expenses have been met. The Bank continues servicing these mortgage loans in return for an administration fee.

The mortgage loans do not qualify for derecognition because the Group and Bank retain all of the risks and rewards of the mortgage loan portfolio. The covered bond partnership is consolidated with the mortgage loans retained on the Group and Bank balance sheets and the covered bonds issued included within debt securities in issue. The covered bond holders have dual recourse; firstly to the Bank on an unsecured basis; and secondly to the LLP under the Covered Bond Guarantee secured against the mortgage loans.

Significant restrictions

Where the Group uses its financial assets to raise finance through securitisations and the sale of securities subject to repurchase agreements, this leads to the assets becoming encumbered. Once encumbered, the assets are not available for transfer around the Group.

Notes to the consolidated financial statements (continued)
Section 3: Assets and liabilities (continued)

3.7 Securitisations and covered bond programmes (continued)

The assets and liabilities in relation to securitisation and covered bonds in issue at 30 September are as follows:

2017	**Group**			**Bank**		
		Covered			**Covered**	
	Securitisation	**bonds**	**Total**	**Securitisation**	**bonds**	**Total**
Liabilities	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
At 1 October 2016	3,208	797	4,005	-	698	698
Issuance of debt	750	-	750	-	-	-
Repayments	(740)	-	(740)	-	-	-
Other movements	24	(49)	(25)	-	-	-
At 30 September 2017	3,242	748	3,990	-	698	698
Assets						
Securitised mortgage loans	6,182	1,344	7,526	6,182	1,344	7,526

2016	Group			Bank		
		Covered			Covered	
	Securitisation	bonds	Total	Securitisation	bonds	Total
Liabilities	£m	£m	£m	£m	£m	£m
At 1 October 2015	3,031	721	3,752	-	697	697
Issuance of debt	750	-	750	-	-	-
Reclassification of notes previously held internally	380	-	380	-	-	-
Repayments	(1,029)	-	(1,029)	-	-	-
Other movements	76	76	152	-	1	1
At 30 September 2016	3,208	797	4,005	-	698	698
Assets						
Securitised mortgage loans	5,435	1,149	6,584	5,435	1,149	6,584

3.7 Securitisations and covered bond programmes (continued)

The carrying amounts of covered bonds differ between Group and Bank due to fair value hedging adjustments which form part of the Group but not the Bank. Further information on the liabilities relating to the Group's securitisation and covered bond programmes can be found in note 3.15.

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

The Bank securitises mortgages which includes those originated by Yorkshire Bank Home Loans Limited ('YBHL'), a subsidiary of the Group. A legal sale agreement between the Bank and YBHL has been put in place to ensure that the titles of such mortgages are transferred to the Bank prior to the completion of any securitisation transactions and these mortgages are included in the securitised asset balances disclosed in the table above and are recognised on the Bank balance sheet.

The following table sets out the net position of the fair value of financial assets, relating to the securitisation programmes where the counterparty to the associated liabilities has recourse only to the financial assets:

	2017	2016
	£m	£m
Fair value of transferred assets	**6,074**	5,417
Fair value of associated liabilities	**3,262**	3,233
	2,812	2,184

There were no events during the year that resulted in any Group or Bank financial assets being derecognised.

The Group and Bank have contractual and non-contractual arrangements which may require them to provide financial support as follows:

Securitisation programmes

The Bank provides credit support to the structured entities via reserve funds, which are partly funded through subordinated debt arrangements and by holding junior notes. Exposures totalled £47m in subordinated debt (2016: £20m) and £856m in junior notes held (2016: £610m). The Bank has a beneficial interest in the securitised mortgage portfolio held by the structured entities of £711m (2016: £997m).

Furthermore, the Bank has an obligation to repurchase mortgage exposures if certain mortgage loans no longer meet the programme criteria.

Looking forward through future reporting periods there are a number of date based options on the notes issued by the structured entities which could be actioned by them as issuer. These could require the Bank, as sponsor, to provide additional liquidity support.

Covered bond programme

The nominal level of over-collateralisation was £681m (2016: £599m) of the outstanding covered bonds. From time to time the obligations of the Bank to provide over-collateralisation may increase due to the formal requirements of the programme.

Furthermore, the Bank has an obligation to repurchase mortgage exposures if certain mortgage loans no longer meet the programme criteria.

3.8 Property, plant and equipment

Accounting policy

The Group's freehold and long-term leasehold land and buildings are carried at their fair value as determined by the Directors, taking account of advice received from independent valuers. Fair values are determined in accordance with guidance published by the Royal Institution of Chartered Surveyors, including adjustments to observable market inputs reflecting any specific characteristics of the land and buildings. Directors' valuations are performed annually in July, with the independent valuations carried out on a three-year cycle on an open market basis. The valuations are classified in Level 3 of the fair value hierarchy as defined in note 3.18.

All other items of property, plant and equipment are carried at cost, less accumulated depreciation and impairment losses. Cost includes expenditure that is directly attributable to acquisition of the asset. Impairment is assessed whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

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. The annual rates of depreciation or amortisation are:

Buildings	50 years
Leases (leasehold improvements)	the lower of the expected lease term or the asset's remaining useful life
Fixtures and equipment	3-10 years

Residual values and useful lives of assets are reviewed at each reporting date. Depreciation is recognised within depreciation expense in the income statement.

Group

	Freehold land and buildings £m	Long term leasehold land and buildings £m	Building improvements £m	Fixtures and equipment £m	Total £m
Cost or valuation					
At 1 October 2015	10	3	171	105	289
Additions	-	-	15	7	22
Disposals	(4)	-	(32)	(12)	(48)
At 30 September 2016	6	3	154	100	263
Additions	-	-	14	7	21
Disposals	(1)	-	(25)	(5)	(31)
At 30 September 2017	**5**	**3**	**143**	**102**	**253**
Accumulated depreciation					
At 1 October 2015	1	-	105	74	180
Charge for the year	-	-	15	10	25
Disposals	-	-	(30)	(11)	(41)
At 30 September 2016	1	-	90	73	164
Charge for the year (note 2.4)	-	-	14	8	22
Disposals	-	-	(16)	(3)	(19)
At 30 September 2017	**1**	**-**	**88**	**78**	**167**
Net book value					
At 30 September 2017	**4**	**3**	**55**	**24**	**86**
At 30 September 2016	5	3	64	27	99

Notes to the consolidated financial statements (continued)
Section 3: Assets and liabilities (continued)

3.8 Property, plant and equipment (continued)

Bank

	Freehold land and buildings £m	Long-term leasehold land and buildings £m	Building improvements £m	Fixtures and equipment £m	Total £m
Cost or valuation					
At 1 October 2015	10	3	171	74	258
Additions	-	-	15	38	53
Disposals	(4)	-	(32)	(12)	(48)
At 30 September 2016	6	3	154	100	263
Additions	-	-	14	7	21
Disposals	(1)	-	(25)	(5)	(31)
At 30 September 2017	**5**	**3**	**143**	**102**	**253**
Accumulated depreciation					
At 1 October 2015	1	-	105	56	162
Charge for the year	-	-	15	7	22
Accumulated depreciation on purchase	-	-	-	19	19
Disposals	-	-	(30)	(9)	(39)
At 30 September 2016	1	-	90	73	164
Charge for the year	-	-	14	8	22
Disposals	-	-	(16)	(3)	(19)
At 30 September 2017	**1**	**-**	**88**	**78**	**167**
Net book value					
At 30 September 2017	**4**	**3**	**55**	**24**	**86**
At 30 September 2016	5	3	64	27	99

Valuations

A comparison of the carrying value between the revaluation basis and the historical cost basis, for freehold and long-term leasehold land and buildings, is shown below:

Group and Bank	2017 £m	2016 £m
Carrying value as included under the revaluation basis	**7**	8
Carrying value if the historical cost basis had been used	**6**	7

Notes to the consolidated financial statements (continued)
Section 3: Assets and liabilities (continued)

3.9 Investment properties

Accounting policy

Investment properties are measured at fair value and are revalued annually by the Directors. The valuations are based upon advice received from independent valuers and performed on an open market basis. Adjustments are made to observable market data for comparable properties for specific characteristics such as the nature, location or condition of the asset. Fair value movements are recognised in the income statement in the period in which they arise.

Investment properties are classified in Level 3 of the fair value hierarchy as defined in note 3.18.

Group and Bank	2017	2016
	£m	£m
At 1 October	22	32
Disposals	(7)	(10)
Revaluation	(1)	-
At 30 September 2017	**14**	22

During the year 86% (2016: 97%) of the investment properties generated total rental income of £1m (2016: £1m) and incurred operating and administrative expenses of £1m (2016: £1m). The operating and administrative expenses of the investment properties that did not generate rental income were £Nil (2016: £Nil).

3.10 Intangible assets

Accounting policy

Capitalised software costs are stated at cost, less amortisation and any provision for impairment.

Identifiable and directly associated external and internal costs of acquiring and developing software are capitalised where the software is controlled by the Group, and where it is probable that future economic benefits that exceed its cost will flow from its use over more than one year. Costs associated with maintaining software are recognised as an expense as incurred. Capitalised computer software costs are amortised on a straight line basis over their expected useful lives, usually between three and 10 years. Impairment losses are recognised in the income statement as incurred.

Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable, which typically arises when the benefits associated with the software were substantially reduced from what had originally been anticipated or the asset has been superseded by a subsequent investment. In such situations, an impairment loss is recognised for the amount by which the carrying amount of an asset exceeds its recoverable amount. The recoverable amount of an asset is the higher of its fair value less costs of disposal or its value in use.

Intangible assets which are fully amortised are reviewed annually to consider whether the assets remain in use.

Notes to the consolidated financial statements (continued)
Section 3: Assets and liabilities (continued)

3.10 Intangible assets (continued)

Group

Capitalised software costs	2017 £m	2016 £m
Cost		
At 1 October	463	427
Additions	148	99
Write-off	(22)	(63)
At 30 September	589	463
Accumulated amortisation		
At 1 October	207	162
Charge for the year (note 2.4)	65	63
Write-off	(22)	(63)
Impairment (note 2.4)	-	45
At 30 September	250	207
Net book value at 30 September	339	256

£3m (2016: £13m) of the £148m (2016: £99m) software additions do not form part of internally generated software projects.

Bank

Capitalised software costs	2017 £m	2016 £m
Cost		
At 1 October	463	-
Additions	148	526
Write-off	(22)	(63)
At 30 September	589	463
Accumulated amortisation		
At 1 October	207	-
Accumulated amortisation on purchase	-	192
Charge for the year	65	33
Write-off	(22)	(63)
Impairment	-	45
At 30 September	250	207
Net book value at 30 September	339	256

Additions of £475m and accumulated amortisation of £192m were included as part of the transfer of CYB Services Limited to Clydesdale Bank PLC in the year ended 30 September 2016.

3.11 Deferred tax

Accounting policy

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. A deferred tax asset is recognised for unused tax losses and unused tax credits only if it is probable that future taxable amounts will arise against which those temporary differences and losses may be utilised.

Critical accounting estimates and judgements

The Group has deferred tax assets of £236m (2016: £219m); increased by £17m being additional trading losses created in the period. The Group has assessed the recoverability of these deferred tax assets at 30 September 2017 and considers it probable that sufficient future taxable profits will be available against which the underlying deductible temporary differences can be utilised over the corporate planning horizon.

At 30 September 2017, the Group had an unrecognised deferred tax asset of £180m (2016: £202m) representing trading losses with a gross value of £1,058m (2016: £1,186m). Although there is no prescribed period after which losses expire, a deferred tax asset has not been recognised in respect of these losses as the directors have insufficient certainty over their recoverability in the foreseeable future.

Movement in net deferred tax asset

	Group		Bank	
	2017	2016	**2017**	2016
	£m	£m	**£m**	£m
At 1 October	**192**	379	**187**	298
Transferred in on purchase of other group entities	**-**	-	**-**	76
Recognised in the income statement (note 2.5)	**(23)**	(196)	**(23)**	(196)
Recognised directly in equity	**(8)**	9	**(8)**	9
	161	192	**156**	187

The Group has recognised deferred tax in relation to the following items:

	Group		Bank	
	2017	2016	**2017**	2016
Deferred tax assets	**£m**	£m	**£m**	£m
Tax losses carried forward	**111**	71	**110**	71
Capital allowances	**120**	127	**116**	122
Transitional adjustment - available for sale reserve	**3**	-	**3**	-
Employee equity based compensation	**2**	2	**2**	2
Defined benefit pension scheme deficit	**-**	18	**-**	18
Other	**-**	1	**-**	1
	236	219	**231**	214
Deferred tax liabilities				
Defined benefit pension scheme surplus	**(72)**	-	**(72)**	-
Cash flow hedge reserve	**-**	(21)	**-**	(21)
Gains on unlisted available for sale investments	**(3)**	(6)	**(3)**	(6)
	(75)	(27)	**(75)**	(27)
Net deferred tax asset	**161**	192	**156**	187

Notes to the consolidated financial statements (continued)
Section 3: Assets and liabilities (continued)

3.11 Deferred tax (continued)

The statutory rate of UK corporation tax is 19% from 1 April 2017 and as enacted in Finance Act 2016 will fall to 17% from 1 April 2020. In accordance with IAS 12, these rates are taken into account in assessing the value at which assets are expected to be realised and liabilities settled.

Finance Bill (No. 2) 2017 contains draft legislation in respect of the Corporate Tax Loss Restriction and the Corporate Interest Restriction which was due to apply from 1 April 2017. As the legislation was not substantively enacted at the balance sheet date it has not been applied in the calculation of the tax position at 30 September 2017. Management expects that given the Group's particular asset profile in respect of losses, application of the new rules would have resulted in an immaterial increase in the deferred tax asset recognised on the balance sheet. This is expected given that the new rules are designed to accelerate the payment of corporation tax.

The rate at which deferred tax is recognised in respect of the defined benefit pension scheme has changed due to the closure of the Scheme to the majority of members (note 3.16). The surplus is accounted for as a potential refund to the employer, rather than a reduction in future contributions. In accordance with tax legislation this 'authorised surplus payment' is recognised as a deferred tax liability at 35%. There is an overall rate change in respect of the pension of £37m with £30m charged in the income statement and £7m charged directly to equity.

3.12 Due to other banks

Accounting policy

Repurchase agreements

Securities sold subject to repurchase agreements ('repos') are retained in their respective balance sheet categories. The associated liabilities are included in amounts due to other banks based upon the counterparties to the transactions.

The difference between the sale and repurchase price of repos is treated as interest and accrued over the life of the agreements using the effective interest method.

	Group		Bank	
	2017	2016	**2017**	2016
	£m	£m	**£m**	£m
Secured loans	**1,901**	-	**1,901**	-
Transaction balances with other banks	**12**	23	**12**	23
Securities sold under agreements to repurchase [1]	**1,864**	1,226	**1,864**	1,226
Deposits from other banks	**31**	60	**31**	60
	3,808	1,309	**3,808**	1,309

[1] The underlying securities sold under agreements to repurchase have a carrying value of £2,660m (2016: £1,657m).

Secured loans comprise amounts drawn under the TFS.

Notes to the consolidated financial statements (continued)
Section 3: Assets and liabilities (continued)

3.13 Due to customers

	Group		Bank	
	2017	2016	**2017**	2016
	£m	£m	**£m**	£m
Non-interest bearing demand deposits	**2,548**	2,160	**2,548**	2,160
Interest bearing demand deposits	**19,130**	19,328	**19,130**	19,328
Term deposits	**5,957**	5,454	**5,957**	5,454
Other wholesale deposits	**18**	12	**18**	12
	27,653	26,954	**27,653**	26,954
Accrued interest payable	**65**	136	**65**	136
	27,718	27,090	**27,718**	27,090

3.14 Provision for liabilities and charges

Accounting policy

Provisions for liabilities and charges 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 for liabilities and charges are not discounted to the present value of their expected net future cash flows except where the time value of money is considered material.

Critical accounting estimates and judgements

PPI redress provision and other conduct related **matters**

Management has exercised significant judgement around the key assumptions that underpin the estimates and used estimation techniques to quantify them. Ongoing regulatory review and input, as well as rulings from the Financial Ombudsman Service over time, and the Group's internal reviews and assessments 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 in future periods.

Significant judgement is required in determining the key assumptions used to estimate the quantum of the provision, including the level of future 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). Also factored into the estimate is the effect of the judgements required around the outcome of the remediation activity. The provision is therefore subject to inherent uncertainties as a result of the subjective nature of the assumptions used in quantifying the overall estimated position at 30 September 2017, consequently, the provision calculated may be subject to change in future years if outcomes differ to those currently assumed. Sensitivity analysis indicating the impact of reasonably possible changes in key assumptions on the PPI provision is presented within this note.

There are similar uncertainties and judgements for other conduct risk related matters however the level of liability is materially lower.

3.14 Provision for liabilities and charges (continued)

	Group		Bank	
	2017	2016	**2017**	2016
	£m	£m	**£m**	£m
PPI redress provisions				
Opening balance	**725**	774	**725**	774
Charge to the income statement (note 2.4)	**494**	450	**494**	450
Utilised	**(797)**	(499)	**(797)**	(499)
Closing balance	**422**	725	**422**	725
Customer redress and other provisions				
Opening balance	**101**	214	**101**	214
Charge to the income statement (note 2.4)	**98**	35	**98**	35
Utilised	**(90)**	(148)	**(90)**	(148)
Closing balance	**109**	101	**109**	101
Restructuring provision (1)				
Opening balance	**26**	18	**26**	18
Charge to the income statement	**58**	39	**58**	39
Utilised	**(61)**	(31)	**(61)**	(31)
Closing balance	**23**	26	**23**	26
Total provisions	**554**	852	**554**	852

(1) Restructuring provision includes surplus lease space provision.

PPI redress

In common with the wider UK retail banking sector, the Group continues to deal with complaints and redress issues arising out of historic sales of PPI. During the year, the Group reassessed the level of provision that was considered appropriate to meet current and future expectations in relation to the mis-selling of PPI policies and concluded that a further charge of £494m was required incorporating the Group's estimate of the impact of PS 17/3 issued on 2 March 2017 relating to a proposed time bar for complaints in August 2019. It also incorporated a reassessment of the costs of processing cases and the impact of experience adjustments. The total provision raised to date in respect of PPI is £2,140m (2016: £1,646m), with £422m of this remaining (2016: £725m) comprising £201m for customer initiated complaints and proactive customer contact (2016: £299m); £80m for the remediation of complaints closed prior to August 2014 (2016: £257m); and £142m for costs of administering the redress programme (2016: £169m).

To 30 September 2017, the Group has received 361,000 (2016: 282,000) complaints and has allowed for 73,000 further walk in complaints. This reflects an expectation that the volume of walk in complaints will reduce compared to most recent experience as the time bar approaches. Future complaint volumes could differ from the Group's assumption, which could result in a further provision being required.

The Group implemented a comprehensive new PPI complaint handling process from August 2014 which involved making a number of significant changes to the PPI operations, which resulted in an increase in operational and administrative costs. As reported previously, the Group is in the process of re-opening approximately 180,000 complaints and reviewing the original decision reached in light of the new PPI complaint handling processes. As at 30 September 2017, this exercise is approximately 83% complete.

In addition to the remediation activity described above, the Group has completed a past business review (PBR) of certain PPI sales to determine if there was actual or potential customer detriment in the sales process leading to a risk of mis-sale and the potential for proactive redress. The review indicated a more favourable outcome than allowed for in the assumptions underpinning the provision as at 30 September 2016.

Notes to the consolidated financial statements (continued)
Section 3: Assets and liabilities (continued)

3.14 Provision for liabilities and charges (continued)

PPI redress (continued)

The increase in provision has taken into account all of the above factors as well as a revision in the Group's expectation of new customer initiated complaints in light of current experience with the overall provision based on a number of assumptions derived from a combination of past experience, estimated future experience, industry comparison and the exercise of judgement in the key areas identified. There remain risks and uncertainties in relation to these assumptions and consequently in relation to the ultimate costs of redress and related costs, including: (i) the number of PPI claims (and the extent to which this is influenced by the activity of claims management companies, the application of a time bar, Plevin, and FCA advertising); (ii) the number of those claims that ultimately will be upheld; (iii) the amount that will be paid in respect of those claims; (iv) any additional amounts that may need to be paid in respect to previously handled claims; (v) the response rates to the proactive customer contact; and (vi) the costs of administering the remediation programme.

As such, the factors discussed above mean there is a risk that existing provisions for PPI customer redress may not cover all potential costs. In light of this, the eventual costs of PPI redress and complaint handling may therefore differ materially from that estimated and further provision could be required.

The table below sets out the key assumptions and the effect on the provision at 30 September 2017 of future, potential, changes in key assumptions:

Assumptions	Change in assumption	Sensitivity [1]
Number of expected future customer initiated complaints (73,000 cases)	+/-10%	£22m
Uphold rates:		
Future complaints	+/-1%	£3m
Pre August 2014 complaints review	+/-1%	£1m
Average redress costs [2]	+/-1%	£2m

[1] There are inter-dependencies between several of the key assumptions which add to the complexity of the judgements the Group has to make. This means that no single factor is likely to move independently of others, however, the sensitivities disclosed above assume all other assumptions remain unchanged. The sensitivities disclosed do not incorporate the impact, if any, on the administrative cost element of the provision.

[2] Sensitivity to a change in average redress across customer initiated complaints, pre August 2014 complaints review and PBR customer populations.

3.14 Provision for liabilities and charges (continued)

PPI redress (continued)

The number of complaints received is monitored against past experience and future expectations and the Group will continue to reassess the adequacy of the provision for this matter and the assumptions underlying the provision calculation based upon experience and other relevant factors as matters develop.

Customer redress and other provisions

In addition to PPI redress set out above, 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 can incorporate the costs of skilled persons, independent reviewers, and where appropriate other elements of administration.

The Group has reassessed the level of provision considered necessary in light of the current and future expected claims for all of these matters and concluded that no additional provisions are required to cover the expected tail of new complaints received at this stage.

Other provisions also include amounts in respect of a number of other non-PPI conduct related matters, legal proceedings, and claims arising in the ordinary course of the Group's business. Over the course of the year, the Group has raised further provisions of £98m for these matters. The ultimate cost to the Group of other customer redress matters is driven by a number of factors relating to offers of redress, compensation, offers of alternative products, consequential loss claims and administrative costs. The matters are at varying stages of their life cycle and in certain circumstances, usually early in the life of a potential issue, elements of the potential exposure are contingent. These factors could result in the total cost of review and redress varying materially from the Group's estimate. The final amount required to settle the Group's potential liabilities in these matters is therefore uncertain and further provision could be required. During the year £Nil (30 September 2016: £1m) was also recognised for provisions not related to customer redress/conduct risk.

Conduct Indemnity Deed

The Bank's parent entity, CYBG, and NAB have an agreement under which NAB has provided CYBG with a Capped Indemnity to meet the costs of dealing with conduct matters related to products sold in the period prior to the date of the Group's demerger from NAB (the Conduct Indemnity Deed). The legacy conduct matters covered by the Capped Indemnity are referred to as Relevant Conduct Matters. The Capped Indemnity provides the Group with economic protection against certain costs and liabilities (including financial penalties imposed by a regulator) resulting from conduct issues relating to:

a) PPI, standalone interest rate hedging products, voluntary scope tailored business loans and fixed rate tailored business loans; and

b) other conduct matters, subject to certain limitations and minimum financial thresholds.

Amounts payable under the Capped Indemnity include, subject to certain limitations, payments to customers to satisfy, settle or discharge a Relevant Conduct Matter and the direct costs and expenses of satisfying, settling, discharging or administering such Relevant Conduct Matter.

It has been agreed that NAB will meet 90.3% of Qualifying Conduct Costs claimed by CYBG, up to the amount of the Capped Indemnity.

Claims under the Conduct Indemnity Deed are made by CYBG, whilst the provisions in respect of the qualifying conduct costs are raised and incurred by the Bank. It is intended that the capital impact of providing for Relevant Conduct Matters in the Bank is then mitigated by CYBG using the proceeds of the claim to subscribe for share capital of the Bank. During the year CYBG subscribed for share capital on three occasions (note 4.1.1).

3.14 Provision for liabilities and charges (continued)

Conduct Indemnity (continued)

Where provisions for Relevant Conduct Matters are increased in respect of a reporting period, but proceeds from that claim are not received from NAB prior to the period close, CYBG has put in place an agreement with the Bank in order to mitigate the effect of capital losses at the end of the reporting period. Upon raising a provision for a Relevant Conduct Matter, CYBG indemnifies the Bank for the Qualifying Conduct Costs (excluding the CYBG Group's loss share) until CYBG subscribes for an equivalent amount of capital in the Bank. The Bank recognises and measures amounts receivable from CYBG under this indemnity as a separate asset (see note 5.4) in accordance with IAS 37: *Provisions, Contingent Liabilities and Contingent Assets* and recognises an associated capital contribution within equity (see note 4.1.3.5). No reimbursement is recognised in the income statement.

The utilisation and undrawn balance of the Capped Indemnity held by the Group's ultimate parent CYBG is set out below:

	Conduct protection £m
Conduct protection provided by NAB	1,700
Capital injected into CYBI prior to demerger [1]	(120)
Drawn in the year to 30 September 2016[2]	(898)
Undrawn Conduct Indemnity as at 30 September 2016	682
Drawn in the year to 30 September 2017	(171)
Amount to be drawn relating to the year to 30 September 2017	(363)
Undrawn balance as at 30 September 2017	**148**

(1) £120m of the £670m of capital injected in CYBI Investments Limited (CYBI) on 24 September 2015 related to the Conduct Indemnity Deed.

(2) £465m of the £898 represents the pre-covered provision amount.

Restructuring provision

Restructuring of the business is currently ongoing and a provision is held to cover redundancy payments, property vacation costs and associated enablement costs. During the year £67m (2016: £45m) was charged to the income statement, of which £9m (2016: £6m) was charged directly to the income statement and £58m (2016: £39m) was provided for in accordance with the requirements of IAS 37. £61m (2016: £31m) of the total provision was utilised in the year.

Included within the restructuring provision is an amount for committed rental expense on surplus lease space consistent with the expected exposure on individual leases where the property is unoccupied. This element of the provision will be utilised over the remaining life of the leases or until the leases are assigned and is measured at present values by discounting anticipated future cash flows.

Notes to the consolidated financial statements (continued)
Section 3: Assets and liabilities (continued)

3.15 Debt securities in issue

Accounting policy

Debt securities comprise short- and long-term debt issued by the Group including commercial paper, medium-term notes, term loans, covered bonds and residential mortgage backed securities (RMBS).

Debt securities are initially recognised at fair value, being the issue proceeds, net of transaction costs incurred. These instruments are subsequently measured at amortised cost using the effective interest method resulting in premiums, discounts and associated issue costs being recognised in the income statement over the life of the instrument.

The breakdown of debt securities in issue is shown below:

2017

Group	Securitisation	Covered bonds	Total
	£m	£m	£m
Amortised cost	3,242	698	3,940
Fair value hedge adjustments	-	50	50
Total debt securities	3,242	748	3,990
Accrued interest payable	6	10	16
	3,248	758	4,006

Bank	Securitisation	Covered bonds	Total
	£m	£m	£m
Amortised cost	-	698	698
Fair value hedge adjustments	-	-	-
Total debt securities	-	698	698
Accrued interest payable	-	10	10
	-	708	708

2016

Group	Securitisation	Covered bonds	Total
	£m	£m	£m
Amortised cost	3,208	698	3,906
Fair value hedge adjustments	-	99	99
Total debt securities	3,208	797	4,005
Accrued interest payable	6	10	16
	3,214	807	4,021

Bank	Securitisation	Covered bonds	Total
	£m	£m	£m
Amortised cost	-	698	698
Fair value hedge adjustments	-	-	-
Total debt securities	-	698	698
Accrued interest payable	-	10	10
	-	708	708

Notes to the consolidated financial statements (continued)
Section 3: Assets and liabilities (continued)

3.15 Debt securities in issue (continued)

There were no new issuances of covered bonds during the year. The following new issuance of securitised debt occurred:

- 5 July 2017 - GBP 350m Lanark 2017-1 1A.
- 5 July 2017 - GBP 400m Lanark 2017-1 2A.

The following securitised debt redemptions occurred during the year in line with the scheduled programme terms:

- 22 August 2017 - EUR 300m Lanark 2014-1 1A.

Details of the terms and conditions of the notes issued under the securitisation and covered bond programmes as at 30 September are as follows:

Issue date	Currency	Carrying value £m	Coupon rate	Call date
Class A Lanark RMBS				
27 July 2012	GBP	288	3M GBP LIBOR + 1.63%	22 November 2017
20 March 2014	GBP	265	3M GBP LIBOR + 0.50%	22 November 2018
11 December 2014	EUR	368	3M EURIBOR + 0.40%	22 August 2018
11 December 2014	GBP	274	3M GBP LIBOR + 0.60%	22 February 2020
6 August 2015	GBP	120	3M GBP LIBOR + 0.50%	22 August 2018
6 August 2015	EUR	247	3M EURIBOR + 0.45%	22 May 2021
4 August 2016	GBP	606	3M GBP LIBOR + 1.00%	22 February 2019
5 July 2017	GBP	349	3M GBP LIBOR + 0.42%	22 November 2020
5 July 2017	GBP	399	3M GBP LIBOR + 0.55%	22 August 2022
Class A Lannraig RMBS				
30 September 2011	GBP	326		
		3,242	3M GBP LIBOR + 2.20%	19 November 2017
Covered bonds				
31 May 2012	GBP	748	4.63%	8 June 2026
		748		
Total securitised notes and covered bonds (note 3.7)		3,990		

Notes to the consolidated financial statements (continued)
Section 3: Assets and liabilities (continued)

3.16 Retirement benefit obligations

Accounting policy
The Group makes contributions to both defined benefit and defined contribution pension schemes which entitle employees to benefits on retirement or disability.

Defined contribution pension scheme
The Group recognises the obligation for contributions to the scheme 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
A liability or asset in respect of the defined benefit scheme is recognised on the balance sheet and is measured as the present value of the defined benefit obligation less the fair value of the defined benefit scheme assets at the reporting date. 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. Surpluses are only recognised to the extent that they are recoverable through reduced contributions in the future or through refunds from the Scheme. In assessing whether a surplus is recoverable, the Group considers its current right to obtain a refund or a reduction in future contributions and does not anticipate any future acts by other parties that could change the amount of the surplus that may be ultimately recovered.

Pension expense attributable to the Group's defined benefit scheme comprises current service cost, net interest on the net defined benefit obligation/asset, past service cost resulting from a scheme amendment or curtailment, gains or losses on settlement and administrative costs incurred. Where actuarial remeasurements arise, the Group recognises such amounts directly in equity through the statement of comprehensive income in the period in which they occur. Actuarial remeasurements arise from experience adjustments (the effects of differences between previous actuarial assumptions and what has actually occurred) and changes in actuarial assumptions.

The Group operates both defined benefit and defined contribution arrangements. The Bank is the sponsoring employer in one funded defined benefit pension scheme, the Yorkshire and Clydesdale Bank Pension Scheme ('the Scheme'). The Scheme was established under trust on 30 September 2009 as a result of the merger of the Clydesdale Bank Pension Scheme and the Yorkshire Bank Pension Fund. The assets of the Scheme are held in a trustee administered fund, with the Trustee responsible for the operation and governance of the Scheme, including making decisions regarding the Scheme's funding and investment strategy.

The Scheme is subject to the funding legislation outlined in the Pensions Act 2004 which came into force on 30 December 2005. This, together with documents issued by the Pensions Regulator, sets out the framework for funding defined benefit occupational pension plans in the UK.

The Group also provides post-retirement health care under a defined benefit scheme for pensioners and their dependant relatives for which provision has been made on a basis consistent with the methodology applied to the defined benefit pension scheme. This is a closed scheme and the provision will be utilised over the life of the remaining Scheme members.

The following table provides a summary of the present value of the defined benefit obligation and fair value of plan assets for the Scheme:

Group and Bank	2017 £m	2016 £m
Active members' defined benefit obligation [1]	(807)	(1,264)
Deferred members' defined benefit obligation	(1,549)	(1,776)
Pensioner and dependant members' defined benefit obligation	(1,618)	(1,497)
Total defined benefit obligation	(3,974)	(4,537)
Fair value of Scheme assets	4,181	4,462
Net defined benefit pension asset/(liability)	207	(75)
Post-retirement medical benefits obligations	(3)	(4)

[1] Active members include current employees who became deferred members on 1 August 2017 as part of the Scheme closure exercise.

Notes to the consolidated financial statements (continued)
Section 3: Assets and liabilities (continued)

3.16 Retirement benefit obligations (continued)

The Group has implemented a number of reforms to the Scheme to manage the liability. It closed the Scheme to new members in 2004 and since April 2006 has determined benefits accruing on a career average revalued earnings basis. On 1 August 2017, the Scheme was closed to future benefit accrual for the majority of current employees, with affected employees' future pension benefits being provided through the existing defined contribution scheme, 'Total Pension'. The Total Pension income statement charge for the year is shown in note 2.4. The closure of the Scheme for the majority of current employees has resulted in a reduction in the defined benefit obligation, recognised as a past service credit in the year.

During the year, the Bank reached agreement with the Trustee on the Scheme funding valuation at 30 September 2016, with a calculated deficit of £290m. In the recovery plan dated 31 July 2017 the Group agreed to contribute £50m per annum until 31 March 2022 and £55m in the year to 31 March 2023 to eliminate this deficit.

Group and Bank **Reconciliation of the net defined benefit pension asset/(liability)**	**2017** **£m**	2016 £m
Opening net defined benefit pension scheme (liability)/asset	**(75)**	52
Service credit/(cost)	**54**	(31)
Interest on net defined benefit (liability)/asset	**(1)**	3
Remeasurement effects recognised in SOCI	**154**	(179)
Employer contributions	**69**	84
Administrative expenses	**(7)**	(4)
Curtailments and settlements	**13**	-
Closing fair value of net defined benefit pension scheme asset/(liability)	**207**	(75)

Group and Bank **Reconciliation of the defined benefit pension scheme assets**	**2017** **£m**	2016 £m
Opening fair value of defined benefit pension scheme assets	**4,462**	3,565
Interest income on Scheme assets at discount rate	**104**	135
Return on Scheme assets (less)/greater than discount rate	**(195)**	791
Employer contributions (note 5.3)	**69**	84
Benefits paid	**(102)**	(90)
Transfer payments	**(150)**	(19)
Administrative costs paid	**(7)**	(4)
Closing fair value of defined benefit pension scheme assets	**4,181**	4,462

Group and Bank **Reconciliation of the defined benefit pension scheme obligations**	**2017** **£m**	2016 £m
Opening defined benefit pension scheme obligations	**(4,537)**	(3,513)
Current service cost	**(26)**	(27)
Past service credit/(cost)	**80**	(4)
Interest expense on the defined benefit obligation	**(105)**	(132)
Actuarial gain - experience adjustments	**76**	51
Actuarial gain - demographic assumptions	**88**	-
Actuarial gain/(loss) - financial assumptions	**185**	(1,021)
Benefits paid from pension Scheme assets	**102**	90
Transfer payments	**150**	19
Curtailments and settlements	**13**	-
Closing defined benefit pension scheme obligations	**(3,974)**	(4,537)

3.16 Retirement benefit obligations (continued)

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

Main categories of plan assets for the Scheme, stated at fair value, are as follows:	2017 £m	2016 £m
Quoted:		
Equities	804	784
Government bonds	1,495	1,640
Global sovereign bonds	33	38
Corporate bonds	829	968
Alternative credit	97	-
Infrastructure	272	254
Secure income alternatives	209	124
Derivatives [1]	169	440
Other	4	6
Cash	124	93
Unquoted:		
Property	145	115
Fair value of defined benefit pension scheme assets	4,181	4,462

[1] Derivative financial instruments are used to modify the profile of the assets of the Scheme to better match the Scheme's liabilities. Derivate holdings may lead to increased or decreased exposures to the physical asset categories disclosed above.

The Scheme is not invested in any of the Group's own financial instruments.

Through its defined benefit pension plan and post-employment medical plan, the Group is exposed to a number of risks. The main risk to the Group is that additional contributions are required if the Scheme's assets are not sufficient to pay for the benefits (which will be influenced mainly by inflation and the longevity of members). The level of asset returns will be a key factor in the overall investment return. The investment portfolio is also subject to a range of risks typical of the assets held, in particular equity risk, credit risk on bonds and exposure to the property market.

The Trustee has implemented an investment structure (including physical assets and derivatives) that seeks to reduce the Scheme's exposure to inflation and interest rate risks. The current hedge ratio is around 60% of liabilities when measured on a self-sufficiency basis. This strategy reflects the Scheme's liability profile and the Trustee's and the Group's attitude to risk. The Trustee monitors the investment objectives and asset allocation policy on a regular basis.

Amounts recognised in the income statement	2017 £m	2016 £m
Current service cost	26	27
Past service cost	8	4
Past service credit on closure of Scheme	(88)	-
Curtailment and settlement gains	(13)	-
Net interest on net defined benefit liability/(asset)	1	(3)
Defined benefit pension (income)/expense for the year	(66)	28
Administration costs incurred	7	4
(Credit)/cost recognised in the income statement (note 2.4)	(59)	32

The Group incurred a past service cost of £8m (2016: £4m) in relation to enhanced early retirement entitlements on redundancy; in both years these were fully offset in the income statement by a corresponding release from the restructuring provision. In contrast, the income statement benefited from a curtailment gain of £13m (2016: £Nil) due to a higher than normal level of redundancies in the current year with no enhancement entitlement; this gain has been offset against the related restructuring costs.

Notes to the consolidated financial statements (continued)
Section 3: Assets and liabilities (continued)

3.16 Retirement benefit obligations (continued)

Amounts recognised in the statement of comprehensive income	2017 £m	2016 £m
Opening cumulative actuarial losses	(849)	(670)
Actuarial gain due to liability experience adjustments	76	51
Actuarial gain/(loss) due to liability assumption changes	185	(1,021)
Actuarial gain due to demographic assumptions	88	-
Return on Scheme assets (less)/greater than discount rate	(195)	791
Cumulative actuarial losses recognised in the statement of comprehensive income	(695)	(849)

Actuarial assumptions	2017 % p.a.	2016 % p.a.
Financial assumptions		
Discount rate	2.74	2.38
Inflation (RPI)	3.24	3.02
Inflation (CPI)	2.24	2.02
Career average revalued earnings (CARE) revaluations:		
Pre 31 March 2012 benefits (RPI)	3.24	3.02
Post 31 March 2012 benefits (CPI capped at 5% per annum)	2.24	2.02
Pension increases (capped at 2.5% per annum)	2.12	2.05
Pension increases (capped at 5% per annum)	3.10	2.94
Rate of increase for pensions in deferment	2.24	2.02

Demographic assumptions	2017	2016
Post retirement mortality:	Years	Years
Current pensioners at 60 - male	28.2	27.7
Current pensioners at 60 - female	29.7	29.6
Future pensioners at 60 - male	29.3	29.2
Future pensioners at 60 - female	30.9	31.1

Notes to the consolidated financial statements (continued)
Section 3: Assets and liabilities (continued)

3.16 Retirement benefit obligations (continued)

Critical accounting estimates and judgements

The value of the Group's defined benefit pension scheme requires management to make several assumptions. The key areas of estimation uncertainty are:

- *The discount rate applied.* The discount rate is required to be set with reference to market yields at the end of the reporting period on high quality corporate bonds in the currency and with a term consistent with the Scheme's obligations. The average duration of the Scheme's obligations is approximately 20 years. The market for bonds with a similar duration is illiquid and, as a result, significant management judgement is required to determine an appropriate yield curve on which to base the discount rate.
- *Inflation assumptions.* Inflation is set with reference to market expectations of the RPI measure of inflation for a term consistent with the Scheme's obligations, based on data published by the BoE. Other measures of inflation (such as CPI, or inflation measures subject to an annual cap) are derived from this assumption.
- *Mortality assumptions.* The cost of the benefits payable by the Schemes will also depend upon the life expectancy of the members. The assumptions for mortality rates are based on standard mortality tables which allow for future improvements in life expectancies.

The table below sets out the sensitivity of the defined benefit obligation and pension cost to realistic changes in the key actuarial assumptions:

Assumption change	Impact on defined benefit obligation £m	Impact on pension cost £m
Discount rate		
+ 0.25%	(186)	(6)
- 0.25%	199	6
Inflation		
+ 0.25%	140	4
- 0.25%	(135)	(4)
Life expectancy		
+1 year	136	4
-1 year	(139)	(4)

The above sensitivity analyses are based on a change in an assumption while holding all other assumptions constant. In practice, changes in some of the assumptions may be correlated.

The discounted mean term of the defined benefit obligation at 30 September 2017 is 20 years (2016: 22 years). The expected contributions for the year ending 30 September 2018 are £33m (2017: £Nil) and expected benefit payments for the year ending 30 September 2018 are £100m (2017: £85m).

During the current year, the Group and Trustee entered into a contingent security arrangement (the 'Security Arrangement') (note 5.3).

Notes to the consolidated financial statements (continued)
Section 3: Assets and liabilities (continued)

3.17 Other liabilities

	Group		Bank	
	2017	2016	**2017**	2016
	£m	£m	**£m**	£m
Notes in circulation	**2,197**	1,912	**2,197**	1,912
Accruals and deferred income	**162**	152	**161**	150
Other	**111**	144	**111**	145
	2,470	2,208	**2,469**	2,207

3.18 Fair value of financial instruments

Accounting Policy

Fair value is the price that would be received to sell an asset, or paid to transfer a liability in an orderly transaction between market participants at the valuation date. When available, the Group measures the fair value of an instrument using quoted prices in an active market for that instrument. 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, which represents 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 the transaction date.

In certain limited circumstances the Group applies the fair value measurement option to financial assets including loans and advances, where the inherent market risks (principally interest rate and option risk) are individually hedged using appropriate interest rate derivatives. 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 and therefore avoid accounting mismatch. 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 and recognised in the income statement.

Analysis of the fair value disclosures uses a hierarchy that reflects the significance of inputs used in measuring fair value. The level in the fair value hierarchy within which a fair value measurement is categorised is determined on the basis of the lowest level input that is significant to the fair value measurement in its entirety. The fair value hierarchy is as follows:

- Level 1 fair value measurements - quoted prices (unadjusted) in active markets for an identical financial asset or liability;
- Level 2 fair value measurements - inputs other than quoted prices within Level 1 that are observable for the financial asset or liability, either directly (as prices) or indirectly (derived from prices); and
- Level 3 fair value measurements - inputs for the financial asset or liability that are not based on observable market data (unobservable inputs).

For the purpose of reporting movements between levels of the fair value hierarchy, transfers are recognised at the beginning of the reporting period in which they occur.

(a) Fair value of financial instruments recognised on the balance sheet at amortised cost

The tables overleaf show a comparison of the carrying amounts of financial assets and liabilities measured at amortised cost, as reported on the balance sheet, and their fair values where these are not approximately equal.

Notes to the consolidated financial statements (continued)
Section 3: Assets and liabilities (continued)

3.18 Fair value of financial instruments (continued)

(a) Fair value of financial instruments recognised on the balance sheet at amortised cost (continued)

There are various limitations inherent in this fair value disclosure particularly where prices are derived from unobservable inputs due to some financial instruments not being traded in an active market. The methodologies and assumptions used in the fair value estimates are therefore described in the notes to the tables. The difference between carrying value and fair value is relevant in a trading environment, but is not relevant to assets such as loans and advances.

Group

	30 September 2017					30 September 2016				
			Fair value measurement using:					Fair value measurement using:		
Financial assets	**Carrying value £m**	**Fair value £m**	**Level 1 £m**	**Level 2 £m**	**Level 3 £m**	Carrying value £m	Fair value £m	Level 1 £m	Level 2 £m	Level 3 £m
Loans and advances to customers	**31,293**	**31,088**	**-**	**1,009**	**30,079**	29,202	29,298	-	1,076	28,222
Financial liabilities										
Due to customers	**27,718**	**27,833**	**-**	**27,833**	**-**	27,090	27,114	-	27,114	-
Debt securities in issue	**4,006**	**4,115**	**-**	**4,115**	**-**	4,021	4,133	-	4,133	-
Due to related entities	**809**	**825**	**-**	**825**	**-**	498	480	-	480	-

Bank

	30 September 2017					30 September 2016				
			Fair value measurement using:					Fair value measurement using:		
Financial assets	**Carrying value £m**	**Fair value £m**	**Level 1 £m**	**Level 2 £m**	**Level 3 £m**	Carrying value £m	Fair value £m	Level 1 £m	Level 2 £m	Level 3 £m
Loans and advances to customers	**30,236**	**30,064**	**-**	**1,009**	**29,055**	27,683	27,789	-	1,076	26,713
Financial liabilities										
Due to customers	**27,718**	**27,833**	**-**	**27,833**	**-**	27,090	27,114	-	27,114	-
Debt securities in issue	**708**	**852**	**-**	**852**	**-**	708	900	-	900	-
Due to related entities	**3,724**	**3,740**	**-**	**3,740**	**-**	3,246	3,230	-	3,230	-

3.18 Fair value of financial instruments (continued)

(a) Fair value of financial instruments recognised on the balance sheet at amortised cost (continued)

The Group and Bank's fair values disclosed for financial instruments at amortised cost are based on the following methodologies and assumptions:

(a) *Loans and advances to customers* - The fair value of loans and advances are determined by firstly segregating them into portfolios of similar characteristics. Contractual cash flows are then adjusted for expected credit losses and expectations of customer behaviour based on observed historic data. The cash flows are then discounted using current market rates for instruments of similar terms and maturity to arrive at an estimate of their fair value. Certain variable rate loan portfolios are discounted using market rates on similar loans offered by the Group at the valuation date.

(b) *Due to customers* - The fair value of deposits is determined from a discounted cash flow model using current market rates for instruments of similar terms and maturity.

(c) *Amounts due to related entities* - The fair value of subordinated debt due to related entities is derived from quoted market prices of the related debt security in issue by CYBG Company after accounting for differences in credit spread. All other amounts due from related entities are redeemable at call and therefore carrying value approximates fair value.

(d) *Debt securities in issue* - The fair value is determined from a discounted cash flow model using current market rates for instruments of similar terms and maturity.

(b) Fair value of financial instruments recognised on the balance sheet at fair value

The following tables provide an analysis of financial instruments that are measured subsequent to initial recognition at fair value, using the fair value hierarchy described above.

Group	Fair value measurement at 30 September 2017				Fair value measurement at 30 September 2016			
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets								
Derivative financial assets	-	282	-	282	-	585	-	585
AFS Investments - listed	2,066	-	-	2,066	1,695	-	-	1,695
AFS Investments - unlisted	-	-	4	4	-	-	29	29
AFS - Other	-	-	6	6	-	-	7	7
Other financial assets at fair value	-	-	477	477	-	-	750	750
Total financial assets at fair value	2,066	282	487	2,835	1,695	585	786	3,066
Financial liabilities								
Derivative financial liabilities	-	376	-	376	-	598	-	598
Other financial liabilities at fair value	-	-	26	26	-	-	48	48
Total financial liabilities measured at fair value	-	376	26	402	-	598	48	646

Bank	Fair value measurement at 30 September 2017				Fair value measurement at 30 September 2016			
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets								
Derivative financial assets	-	136	-	136	-	388	-	388
Investments - AFS - listed	2,066	-	-	2,066	1,695	-	-	1,695
Investments - AFS - unlisted	-	-	4	4	-	-	29	29
Other financial assets at fair value	-	-	477	477	-	-	750	750
Total financial assets measured at fair value	2,066	136	481	2,683	1,695	388	779	2,862
Financial liabilities								
Derivative financial liabilities	-	376	-	376	-	587	-	587
Other financial liabilities at fair value	-	-	26	26	-	-	48	48
Total financial liabilities measured at fair value	-	376	26	402	-	587	48	635

Notes to the consolidated financial statements (continued)
Section 3: Assets and liabilities (continued)

3.18 Fair value of financial instruments (continued)

(b) Fair value of financial instruments recognised on the balance sheet at fair value (continued)

There were no transfers between Level 1 and 2 in the year.

The Group and Bank's fair values for financial instruments that are measured subsequent to initial recognition at fair value are based on the following methodologies and assumptions:

(a) *Derivative financial assets and liabilities* - The fair values of derivatives, including foreign exchange contracts, interest rate swaps, interest rate and currency option contracts, and currency swaps, are obtained from discounted cash flow models or option pricing models as appropriate.

(b) *Available for sale - investments*

- *Listed* (Level 1) - The fair values of listed investments are based on quoted closing market prices.
- *Unlisted* (Level 3) – Includes £2m of Visa Inc. preferred stock received as partial consideration for the sale of the Group's share in Visa Europe (note 2.3). The preferred stock is convertible into Visa Inc. common stock or its equivalent at a future date, subject to potential reduction for certain litigation losses that may be incurred by Visa Europe. The fair value of the preference shares has been calculated by taking the period end New York Stock Exchange share price for Visa Inc. and discounting for illiquidity and clawback related to contingent litigation. For other unlisted equity and debt investments, the Group's share of the net asset value or the transaction price respectively are considered the best representation of the exit price and are the Group's best estimates of fair value.
- *Available for sale - other* (Level 3) - The other available for sale financial asset represents deferred consideration receivable and consists of the rights to future commission. The valuation is determined from a discounted cash flow model incorporating estimated attrition rates and investment growth rates appropriate to the underlying funds under management.

(c) *Financial assets and liabilities at fair value through profit or loss* - fair values are derived from data or valuation techniques based upon observable market data and non-observable inputs as appropriate to the nature and type of the underlying instrument.

Notes to the consolidated financial statements (continued)
Section 3: Assets and liabilities (continued)

3.18 Fair value of financial instruments (continued)

(b) Fair value of financial instruments recognised on the balance sheet at fair value (continued)

Assets and liabilities measured at fair value based on valuation techniques for which any significant input is not based on observable market data (Level 3):

Level 3 movements analysis:	**2017**		
Group	**Financial assets available for sale £m**	**Other financial assets at fair value £m**	**Other financial liabilities at fair value £m**
Balance at the beginning of the year	36	750	(48)
Fair value gains/(losses) recognised[1]			
In profit or loss (unrealised)	-	(39)	2
In profit or loss (realised)	1	2	-
In available for sale reserve (unrealised)	1	-	-
Purchases	-	-	-
Sales[2]	(26)	-	-
Settlements	(2)	(236)	20
Balance at the end of the year	10	477	(26)

Level 3 movements analysis: Group	2016		
	Financial assets available for sale £m	Other financial assets at fair value £m	Other financial liabilities at fair value £m
Balance at the beginning of the year	15	1,097	(67)
Fair value gains/(losses) recognised[1]			
In profit or loss (unrealised)	-	10	2
In profit or loss (realised)	8	-	-
In available for sale reserve (unrealised)	21	-	-
Purchase	2	-	-
Sales	(8)	-	-
Settlements [3]	(2)	(357)	17
Balance at the end of the year	36	750	(48)

Level 3 movements analysis:	**2017**		
Bank	**Financial assets available for sale £m**	**Other financial assets at fair value £m**	**Other financial liabilities at fair value £m**
Balance at the beginning of the year	29	750	(48)
Fair value gains/(losses) recognised[1]			
In profit or loss (unrealised)	-	(39)	2
In profit or loss (realised)	-	2	-
In available for sale reserve (unrealised)	1	-	-
Purchases	-	-	-
Sales [2]	(26)	-	-
Settlements	-	(236)	20
Balance at the end of the year	4	477	(26)

Notes to the consolidated financial statements (continued)
Section 3: Assets and liabilities (continued)

3.18 Fair value of financial instruments (continued)

(b) Fair value of financial instruments recognised on the balance sheet at fair value (continued)

Level 3 movements analysis: Bank	2016		
	Investments – available for sale £m	Other financial assets at fair value £m	Other financial liabilities at fair value £m
Balance at the beginning of the year	8	1,097	(67)
Fair value gains/(losses) recognised[(1)]			
In profit or loss (unrealised)	-	10	2
In profit or loss (realised)	7	-	-
In available for sale reserve (unrealised)	20	-	-
Purchase	2	-	-
Sales	(8)	-	-
Settlements [(3)]	-	(357)	17
Balance at the end of the year	29	750	(48)

(1) Net gains or losses were recorded in non-interest income, interest income or expense and impairment losses or within the available for sale reserve as appropriate.

(2) The sale principally relates to the disposal of the VocaLink investment during the year (Note 2.3)

(3) Settlements for the year ended 30 September 2016 include a realised loss of £5m relating to financial assets that are measured at fair value at the end of each reporting period. Such fair value gains or losses are included in non-interest income (note 2.3).

There were no transfers into or out of Level 3 in the year ended 30 September 2017 (2016: £Nil).

Notes to the consolidated financial statements (continued)
Section 3: Assets and liabilities (continued)

3.18 Fair value of financial instruments (continued)

Qualitative information about significant unobservable inputs in Level 3 valuations

The table below lists key unobservable inputs to Level 3 financial instruments, and provides the range of those inputs as at 30 September 2017.

Financial assets	Fair value £m	Valuation Technique	Unobservable inputs	Low range	High range
Other financial assets at fair value	477	Discounted cash-flow	Portfolio lifetime probability of default	2.2%	11.3%
Available for sale – other	6	Discounted cash-flow	Funds under management attrition rate	10%	20%
Available for sale – investments - unlisted	4	Discounted cash-flow	Contingent litigation risk	0%	100%

The Group has £26m (2016: £48m) of financial liabilities at fair value classed as Level 3 which represent a portfolio of term deposits that are directly linked to the customer loans, which are also held at fair value and classed as Level 3. Their relationship to the fair value assets is such that should the liability be settled, the amount payable would be net of the fair value asset.

Sensitivity of Level 3 fair value measurements to reasonably possible alternative assumptions

Where valuation techniques use non-observable inputs that are significant to a fair value measurement in its entirety, changing these inputs will change the resultant fair value measurement.

The most significant exposure to Level 3 fair value measurements is in respect of the Group's fair value loan portfolio with the most significant input (other than interest rates) being the future expectations of credit losses. If lifetime expected losses were 20% greater than predicted, the carrying value of the loans would decrease by £2m and vice versa.

The most significant input impacting the fair value of the available for sale – other asset is the funds under management attrition rate. The Group currently assumes a 15% attrition rate. If this rate was 20% the fair value would reduce by £1m, if it was 10% the fair value would increase by £2m.

The most significant input impacting the fair value of the available for sale – investments is contingent litigation risk. If this risk crystallised, the fair value would reduce by £2m. In the event the litigation risk did not transpire the fair value would increase by £3m.

Other than these significant Level 3 measurements, the Group has a limited remaining exposure to Level 3 fair value measurements, and changing one or more of the inputs for fair value measurements in Level 3 to reasonable alternative assumptions would not change the fair value significantly with respect to profit or loss, total assets, total liabilities or equity on these remaining Level 3 measurements.

Notes to the consolidated financial statements (continued)
Section 4: Capital

4.1 Equity

Accounting policy

The financial instruments issued by the Company are treated as equity (i.e. forming part of shareholders' funds) only to the extent that they meet the following two conditions:

(a) they include no contractual obligations upon the Company to deliver cash or other financial assets or to exchange financial assets or financial liabilities with another party under conditions that are potentially unfavourable to the Group; and

(b) where the instrument will or may be settled in the Company's own equity instruments, it is either a non-derivative that includes no obligation to deliver a variable number of the Company's own equity instruments or is a derivative that will be settled by the Company exchanging a fixed amount of cash or other financial assets for a fixed number of its own equity instruments.

To the extent that this definition is not met, the proceeds of issue are classified as a financial liability.

Dividends

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

Final dividends on ordinary shares are recognised as a liability and deducted from equity when they are approved by the Bank's shareholders. Interim dividends are deducted from equity when they are no longer at the discretion of the Bank.

Proposed final dividends for the year are disclosed as an event after the balance sheet date.

4.1.1 Share capital

Group and Bank	**2017**	2016	**2017**	2016
Allotted, called up and fully paid	**Number of shares**	Number of shares	**£m**	£m
Ordinary shares of £1 each				
Opening ordinary share capital	**3,237,094,491**	2,811,538,864	**324**	2,812
Issued during the year	**1,787,611,335**	425,555,627	**178**	426
Share capital reduction	**-**	-	**-**	(2,914)
Closing ordinary share capital	**5,024,705,826**	3,237,094,491	**502**	324

On 17 November 2016, 72,226,720 ordinary shares of £0.10 were issued, on 16 March 2017, 361,133,603 ordinary shares of £0.10 were issued and on 2 June 2017, 1,354,251,012 ordinary shares of £0.10 were issued. All ordinary shares issued were at par and fully paid up.

The holders of ordinary shares are entitled to dividends as declared from time to time and are entitled to one vote per share at meetings of the shareholders of the Bank. All shares in issue at 30 September 2017 rank equally with regard to the Bank's residual assets. No ordinary dividend was paid during the year (2016: £51m).

Notes to the consolidated financial statements (continued)
Section 4: Capital (continued)

4.1 Equity (continued)

A description of the other equity categories included within the consolidated statement of changes in equity, and significant movements during the year, is provided below.

4.1.2 Other equity instruments

Other equity instruments consist of Perpetual Subordinated Permanent Write Down Notes (fixed 8%) which were issued on 8 February 2016 with a nominal value of £450m to CYBG.

AT1 distributions of £36m were paid during the year, £29m net of tax (2016: £19m paid, £15m net of tax).

4.1.3 Other reserves

4.1.3.1 Asset revaluation reserve

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

4.1.3.2 Available for sale reserve

The available for sale reserve records the gains and losses arising from changes in the fair value of available for sale financial assets. The principal movement in the reserve reflects the sale of VocaLink during the year as described in note 2.3.

4.1.3.3 Cash flow hedge reserve

The cash flow hedge reserve represents the cumulative post-tax gains and losses on derivatives designated as cash flow hedging instruments that will be recycled to the income statement when the hedged items affect profit or loss.

As at 30 September 2017, the cash flow hedge reserve reflected a cumulative gain of £1m (2016: £69m cumulative gain). The fair value of derivatives in cash flow hedges decreased by £84m in the year (2016: £108m increase), and a £5m gain (2016: £1m gain) was recycled to interest income in line with hedged items affecting profit or loss. A £0.3m loss (2016: £1m loss) was transferred to non-interest income due to ineffectiveness arising from cash flow hedges. These movements were offset by a deferred tax credit of £21m (2016: charge of £25m).

4.1.3.4 Equity based compensation reserve

The Group's equity based compensation reserve records the value of equity settled share based payment benefits provided to the Group's employees as part of their remuneration that has been charged through the income statement and adjusted for deferred tax.

4.1.3.5 Capital contribution reserve

As discussed within note 3.14, where provisions for Relevant Conduct Matters are increased in respect of a reporting period, but proceeds from that claim are not received from NAB prior to the period close, CYBG has put in place an agreement with the Bank in order to mitigate the effect of capital losses at the end of the reporting period. Upon raising a provision for a Relevant Conduct Matter, CYBG indemnifies the Bank for the Qualifying Conduct Costs (excluding the CYBG Group's loss share) until CYBG subscribes for an equivalent amount of capital in the Bank. The Bank recognises and measures amounts receivable from CYBG under this indemnity as a separate asset (note 5.3) in accordance with IAS 37: *Provisions, Contingent Liabilities and Contingent Assets* and recognises an associated capital contribution within equity.

The capital contribution reserve of £364m (2016: £7m) reflects this amount.

4.2 Equity based compensation

Accounting policy

The Group operates a number of equity settled share based compensation plans in respect of services received from certain of its employees. The fair value of the services received is recognised as an expense. The total amount to be expensed is measured by reference to the fair value of CYBG's shares, performance options or performance rights granted, including, where relevant, any market performance conditions and any non-vesting conditions. The impacts of any service and non-market performance vesting conditions are not included in the fair value and instead are included in estimating the number of awards or options that are expected to vest.

The total expense is recognised over the vesting period, which is the period over which all of the specified vesting conditions are to be satisfied. A corresponding credit is recognised in the equity based compensation reserve, adjusted for deferred tax. In some circumstances employees may provide services in advance of the grant date and therefore the grant date fair value is estimated for the purposes of recognising the expense during the period between the start of the service period and the grant date.

At the end of each reporting period, the Group revises its estimates of the number of shares, performance options and performance rights that are expected to vest based on the non-market and service vesting conditions. The impact of the revision to original estimates, if any, is recognised in the income statement, with a corresponding adjustment to the equity based compensation reserve.

The equity settled share based payment charge for the year is £6m (2016: £5m).

In the prior year, the figures include awards under the Group's and NAB share plans. The charges under the NAB share plans were classified as equity settled share based payments up to the demerger date of 8 February 2016 and are included in the total above. Following the demerger these plans no longer meet the definition of share based payments under IFRS 2 '*Share based payments';* accordingly, the total above excludes NAB share plan costs after 8 February 2016.

CYBG awards

The Group made a number of awards under its share plans:

Plan	Eligible employees	Nature of award	Vesting conditions [1]	Grant dates[2]
Deferred Equity Plan [3]	Selected employees	Conditional rights to shares	Continuing employment or leaving in certain limited circumstances	2016 & 2017
Long Term Incentive Plan	Selected senior employees	Conditional rights to shares	Continuing employment or leaving in certain limited circumstances and achievement of delivery of the Group's strategic goals and growth in shareholder value.	2017
Share Incentive Plan	All employees	Non-conditional share award	Continuing employment	2016

[1] All awards are subject to vesting conditions and therefore may or may not vest.
[2] The year in which grants have been made under the relevant plan.
[3] Grants made under the Deferred Equity Plan are made the year following the financial year to which they relate.

Further detail on each plan is provided below:

Deferred Equity Plan (DEP)

Under the plan employees were awarded conditional rights to CYBG PLC shares. The shares are subject to forfeiture conditions including forfeiture as a result of resignation, termination by the Group or failure to meet compliance requirements. Awards include:

- The upfront and deferred elements of bonus awards where required to comply with the PRA Remuneration Code or the Group's deferral policy.
- Buyout of equity from previous employment for senior new hires.
- Demerger awards which are also subject to the achievement of performance conditions over a three-year period. Details of the performance conditions are set out in the Directors' remuneration report section of the CYBG annual report and accounts.

Notes to the consolidated financial statements (continued)
Section 4: Capital (continued)

4.2 Equity based compensation (continued)

Long Term Incentive Plan (LTIP)

Under the plan employees were awarded conditional rights to CYBG PLC shares. The shares are subject to forfeiture conditions including forfeiture as a result of resignation, termination by the Group or failure to meet compliance requirements.

The performance conditions of the plan must be met over a three year period. The measures reflect a balanced approach between financial and non-financial performance and are aligned to the organisation's strategic goals. Measures, relative weightings and the quantum for assessing performance are outlined in the Directors' remuneration report section of the CYBG annual report and accounts.

Share Incentive Plan (SIP)

Employees eligible at the date of the award were awarded Group shares, which are held in the Share Incentive Plan Trust (SIP Trust). Awards are not subject to performance conditions and participants are the beneficial owners of the shares granted to them, but not the registered owners. Voting rights over the shares are normally exercised by the registered owner at the direction of the participants. For the 2015 Demerger award, leavers (with the exception of gross misconduct) retain their awards but they must withdraw their shares from the SIP Trust.

Awards/rights made during the year:

Plan	Number outstanding as 1 October 2016	Number awarded	Number forfeited	Number released	Number outstanding as 30 September 2017	Average fair value of awards at grant pence
Deferred Equity Plan						
2015 Demerger	2,235,204	-	(197,152)	-	2,038,052	196.96
2015 Bonus	1,489,390	-	(7,370)	(1,346,425)	135,595	195.17
2015 Commencement	111,127	-	-	(46,059)	65,068	194.67
2016 Bonus	-	1,193,700	(6,776)	(643,729)	543,195	266.03
2016 Commencement	-	169,997	-	(38,001)	131,996	266.03
Long Term Incentive Plan						
2016 LTIP	-	2,261,948	(18,561)	-	2,243,387	266.03
Share Incentive Plan						
2015 Demerger	1,822,976	-	(2,560)[1]	(337,408)[2]	1,483,008	194.67

(1) Forfeited shares remain in the SIP Trust

(2) Shares withdrawn from SIP Trust on leaving the Group.

Determination of grant date fair values

Participants of the DEP and LTIP plans are not entitled to dividends until the awards vest, but the number of shares which vest may be increased to reflect the value of dividends that would have been paid up to the end of the holding period for the awards, subject to the extent permitted under the relevant remuneration regulation. Accordingly, the grant date fair value of the awards with only service conditions and/or non-market performance conditions has been taken as the market value of CYBG's ordinary shares at the grant date. Where awards are subject to non-market performance conditions, an estimate is made of the number of awards expected to vest in order to determine the overall share-based payment charge to be recognised over the vesting period.

The Group has not issued awards under any CYBG plan with market performance conditions.

Notes to the consolidated financial statements (continued)
Section 5: Other notes

5.1 Contingent liabilities and commitments

Accounting policy

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 and are primarily issued to support direct financial obligations such as commercial bills or other debt instruments issued by a counterparty. The rating of the Group as a guarantee provider enhances the marketability of the paper issued by the counterparty in these circumstances. Financial guarantee contracts are initially recorded at fair value which is equal to the premium received, unless there is evidence to the contrary.

Operating lease commitments
The leases entered into by the Group are primarily operating leases; with operating lease rentals charged to the income statement on a straight line basis over the period of the lease. The Group discloses its obligations for future minimum payments under non-cancellable leases.

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 benefit is uncertain or cannot be reliably measured. Contingent liabilities are not recognised on the balance sheet but are disclosed unless they are remote.

The table below sets out the amounts of financial guarantees and commitments which are not recorded on the balance sheet. Financial guarantees and commitments are credit-related instruments which include acceptances, letters of credit, guarantees and commitments to extend credit. The 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 customer default. Since a significant portion of guarantees and commitments is expected to expire without being drawn upon, the total of the contract amounts is not representative of future liquidity requirements.

	Group		Bank	
	2017	2016	**2017**	2016
	£m	£m	**£m**	£m
Financial guarantees				
Guarantees and assets pledged as collateral security:				
Due in less than 3 months	**19**	19	**19**	19
Due between 3 months and 1 year	**40**	44	**40**	44
Due between 1 year and 3 years	**7**	9	**7**	9
Due between 3 years and 5 years	**3**	3	**3**	3
Due after 5 years	**42**	48	**42**	48
	111	123	**111**	123
Other credit commitments				
Undrawn formal standby facilities, credit lines and other commitments to lend at call	**8,408**	7,690	**8,382**	7,660

Capital commitments

The Group and Bank had future capital expenditure which had been contracted for but not provided for at 30 September 2017 of £1m (2016: £2m).

Notes to the consolidated financial statements (continued)
Section 5: Other notes (continued)

5.1 Contingent liabilities and commitments (continued)

Operating lease commitments

	Group		Bank	
	2017	2016	**2017**	2016
	£m	£m	**£m**	£m
Leases as lessor				
Future minimum lease payments under non-cancellable operating leases are:				
Within 1 year	**1**	2	**1**	2
Between 1 year and 5 years	**4**	4	**4**	4
Over 5 years	**-**	1	**-**	1
	5	7	**5**	7
Leases as lessee				
Future minimum lease payments under non-cancellable operating leases are:				
Within 1 year	**30**	29	**30**	29
Between 1 year and 5 years	**100**	94	**100**	94
Over 5 years	**137**	117	**137**	117
	267	240	**267**	240

Other contingent liabilities

Financial Services Compensation Scheme (FSCS)

The 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, claims were triggered against the FSCS, initially to pay interest on borrowings which the FSCS has raised from the UK Government to support the protected deposits. During 2015, the FSCS levy was also invoiced to institutions for the third 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 2018 for the interest on borrowings and an accrual of £2m (30 September 2016: £8m) is held for the Group's calculated liability to that date. The ultimate FSCS levy as a result of the failures is uncertain.

Conduct risk related matters

There continues to be significant uncertainty and thus judgement is required in determining the quantum of conduct risk related liabilities with note 3.14 reflecting the Group's current position in relation to redress provisions including those for PPI. The final amount required to settle the Group's potential liabilities for these, and other conduct related matters, is materially uncertain. Contingent liabilities include those matters where redress is likely to be paid and costs incurred but the amounts cannot currently be estimated. The Group will continue to reassess the adequacy of provisions for these matters and the assumptions underlying the calculations at each reporting date based upon experience and other relevant factors at that time.

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)
Section 5: Other notes (continued)

5.2 Notes to the statement of cash flows

	Group		Bank	
	2017	2016	2017	2016
	£m	£m	£m	£m
Adjustments included in loss before tax				
Interest receivable	(1,075)	(1,101)	(1,055)	(1,113)
Interest payable	230	294	236	355
Depreciation and amortisation (note 2.4)	87	88	87	57
Net gain on capital and debt restructure	-	(1)	-	(1)
Loss on sale of tangible fixed assets	1	-	1	-
Fair value movement on investment properties	-	1	-	1
Transfer from cash flow hedge reserve	-	1	-	1
Derivative financial instruments fair value movements	(6)	(10)	(8)	(11)
Impairment losses on credit exposures (note 3.6)	48	39	48	38
Impairment losses on software (note 2.4)	-	45	-	45
Gain on disposal of Vocalink	(20)	-	(20)	-
	(735)	(644)	(711)	(628)
Changes in operating assets				
Net (increase)/decrease in:				
Balances with supervisory central banks	(1)	1	(1)	1
Due from other banks	135	(819)	18	(390)
Derivative financial instruments	284	(63)	261	(76)
Financial assets at fair value through profit or loss	237	346	237	346
Loans and advances to customers	(2,140)	(1,758)	(2,600)	(1,514)
Other assets	(12)	14	(13)	7
	(1,497)	(2,279)	(2,098)	(1,626)
Changes in operating liabilities				
Net increase/(decrease) in:				
Due to other banks	608	960	608	960
Derivative financial instruments	(223)	60	(210)	118
Financial liabilities at fair value through profit or loss	(21)	(19)	(21)	(19)
Due to customers	699	672	698	672
Provisions for liabilities and charges	(298)	(154)	(298)	(154)
Defined benefit pension obligations	(128)	(52)	(128)	(52)
Other liabilities	280	118	281	128
	917	1,585	930	1,653

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. This includes cash and liquid assets and amounts due from other banks (to the extent less than 90 days).

Cash and cash equivalents				
Cash and balances with central banks (note 3.1)	6,893	5,912	6,893	5,912
Other assets	99	111	99	111
Due to other banks	(12)	(25)	(12)	(25)
Other liabilities	(28)	(48)	(28)	(48)
	6,952	5,950	6,952	5,950

5.3 Related party transactions

Amendments have been made to the classification of structured entity intercompany balances during the year. Refer to note 1.9 Presentation Changes for details. To aid understanding of this presentation change the prior year comparatives for the Bank related party transactions note have been restated.

	Bank		
	Original 2016 £m	Reclassification 2016 £m	Restated 2016 £m
Amounts due from related entities			
Loans - controlled entities of the Bank	1,507	-	1,507
Other receivables - controlled entities of the Bank	996	(905)	91
All other amounts due from related entities	7	-	7
Total amounts due from related entities	2,510	(905)	1,605
Amounts due to related entities			
Other payables - controlled entities of the Bank	5,074	(2,359)	2,715
All other amounts due to related entities	531	-	531
Total amounts due to related entities	5,605	(2,359)	3,246

	Group		Bank	
Amounts due from related entities	**2017 £m**	2016 £m	**2017 £m**	Restated 2016 £m
Loans				
Controlled entities of the Bank	-	-	1,097	1,507
	-	-	1,097	1,507
Other receivables				
CYBG	366	7	366	7
Controlled entities of the Bank	-	-	84	91
	366	7	450	98
Total amounts due from related entities	366	7	1,547	1,605
Interest Income on the above amounts was as follows (note 2.2):				
NAB Group	-	1	-	-
Controlled entities of the Bank	-	-	25	30
	-	1	25	30

Notes to the consolidated financial statements (continued)
Section 5: Other notes (continued)

5.3 Related party transactions (continued)

Amounts due to related entities	Group		Bank	
				Restated
	2017	2016	2017	2016
	£m	£m	£m	£m
Deposits				
CYBG	27	15	27	15
Controlled entities of the Bank	-	-	12	33
	27	15	39	48
Debt securities				
Controlled entities of the Bank	782	483	782	483
	782	483	782	483
Other payables				
Controlled entities of the Bank	-	-	2,903	2,715
	-	-	2,903	2,715
Total amounts due to related entities	809	498	3,724	3,246
Interest expense on the above amounts was as follows (note 2.2):				
NAB Group	-	10	-	7
CYBG	26	15	26	15
Controlled entities of the Bank	-	-	42	44
	26	25	68	66

Notes to the consolidated financial statements (continued)
Section 5: Other notes (continued)

5.3. Related party transactions (continued)

Subordinated debt

Subordinated debt comprises dated, unsecured loan capital and is issued to CYBG PLC. These debts will, in the event of the winding-up of the issuer, be subordinated to the claims of the depositors and all other creditors of the issuer, other than creditors whose claims rank junior to the claims of the holders of the subordinated liabilities. The debt is employed in the general business of the Bank.

The rates of interest stated below apply at 30 September.

	2017 £m	2016 £m
10-year, 5% fixed rate reset callable subordinated Tier 2 Notes due 2026	**479**	479
Accrued interest payable	**3**	4
Total subordinated debt	**482**	483

Medium-term loans

Medium term loans comprise dated unsecured loans and are issued to CYBG PLC. These securities will, in the event of the winding-up of the issuer, be subordinated to the claims of the depositors and all other creditors of the issuer, other than creditors whose claims rank junior to the claims of the medium term loan liabilities, including those of subordinated debt holders. The debt is employed in the general business of the Bank.

The rates of interest stated below apply at 30 September.

	2017 £m	2016 £m
8-year, 3.125% fixed rate/floating rate callable senior notes due 2025	**297**	-
Accrued interest payable	**3**	-
Total medium-term notes	**300**	-

Notes to the consolidated financial statements (continued)
Section 5: Other notes (continued)

5.3. Related party transactions (continued)

Other transactions with related entities	Group		Bank	
	2017	2016	**2017**	2016
	£m	£m	**£m**	£m
Gain on debt and capital restructures				
Controlled entities of the Bank	-	1	-	1
Non-interest income received				
Controlled entities of the Bank	-	-	38	42
Administrative expenses				
NAB Group	-	5	-	5
Controlled entities of the Bank	-	-	-	147
	-	5	-	152

Included within administrative expenses paid to controlled entities in the year ended 30 September 2016, are recharges from CYB Services Limited, which was owned by the intermediate parent group, CYBI Limited, and which was purchased by the Group on 30 September 2016. On 31 March 2016, assets and liabilities of CYB Services Limited were transferred to Clydesdale Bank PLC for a consideration equal to their net book value of £322m. The consideration was recorded in the respective intercompany accounts and no gains or losses were recognised. No further recharges were made from CYB Services Limited from that date. Results for CYB Services Limited have been consolidated into the Group results from 1 October 2015.

The Group incurred costs in relation to pension scheme administration. These costs, which amounted to £0.3m in the year ended 30 September 2017 (2016: £0.5m), were charged to the Group sponsored Scheme. The Group has deposits of £20.3m (2016: £31.7m) at the year end placed by the Scheme at market rates.

Pension contributions of £69m (2016: £84m) were made during the year to the Yorkshire and Clydesdale Bank Pension Scheme sponsored by the Bank (note 3.16).

During the current year, the Bank and Pension Trustee entered into a contingent security arrangement. The Security Arrangement provides additional support to the Scheme by underpinning recovery plan contributions and some additional investment risk. The security is in the form of a pre-agreed maximum level of assets, that are set aside for the benefit of the Pension Scheme in certain trigger events. These assets are held by Red Grey Square Funding LLP, an insolvency remote consolidated structured entity.

5.3. Related party transactions (continued)

Compensation of key management personnel (KMP)

KMP comprise Directors of the Bank and members of the Leadership Team.

	2017 £m	2016 £m
Salaries and other short-term benefits	8	8
Other long-term employee benefits	-	1
Termination benefits	-	2
Equity based compensation[1]	1	4
	9	15

[1] Basis of the expense recognised in the year in accordance with IFRS 2 'Equity-based compensations', including associated employers' NIC.

Directors' emoluments

Total emoluments of all Directors for the year ended 30 September 2017 were £5m (2016: £6m).

For the year ended 30 September 2017 the total emoluments disclosed do not include the value of shares or share rights awarded under long term incentive schemes in accordance with Schedule 5 paragraph 1(3)(a) of The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008.

None of the Directors were members of the Group's defined contribution pension scheme during 2017 (2016: none). One of the Directors was a member of the Group's defined benefit pension scheme during 2017 (2016: one).

None of the Directors hold share options and none were exercised during the year (2016: none).

Disclosures in respect of the highest paid Director

	2017 £m	2016 £m
Aggregate remuneration	2	2
Share based awards[1]	1	1
	3	3

[1] Reflects deferred bonus and other share based awards for the year, excluding LTIP

The highest paid Director does not hold any share options, nor were they a member of any pension plan during 2017, nor 2016.

Transactions with KMP

KMP, their close family members and any entities controlled or significantly influenced by the KMP 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.

	2017 £m	2016 £m
Loans and advances	2	8
Deposits	4	3

No provisions have been recognised in respect of loans provided to KMPs (2016: £Nil). There were no debts written off or forgiven during the year to 30 September 2017 (2016: £Nil). Included in the above are three (2016: six) loans totalling £1m (2016: £7.4m) made to Directors. In addition to the above, there are guarantees of £Nil (2016: £0.4m) made to Directors and their related parties.

Notes to the consolidated financial statements (continued)
Section 5: Other notes (continued)

5.4. Pillar 3 disclosures

Basel III Capital Requirements Directive IV

Pillar 3 disclosure requirements are set out in Part Eight of the CRR. The consolidated disclosures of CYBG PLC, for the 2017 financial year will be issued concurrently with the Annual Report and Accounts and will be found at www.cybg.com/investor-centre/financial-results.

Notes to the consolidated financial statements (continued)
Section 6: Notes to the Bank financial statements

6.1 Bank income statement

No individual income statement is presented for the Bank, as permitted by Section 408 of the Companies Act 2006.

6.2 Bank investments in controlled entities

Accounting policy

The Bank's investments in controlled entities are valued at cost or valuation less any provision for impairment. Such investments are reviewed annually for potential evidence of 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 are recognised in the income statement.

	2017 **£m**	2016 £m
At 30 September	**10**	16

Wholly owned subsidiary undertakings	Nature of business	Class of share held	Proportion held	Country of incorporation	Registered office
CGF No 9 Limited	Leasing	Ordinary	100%	Scotland	30 St Vincent Place, Glasgow, G1 2HL
Clydesdale Bank Asset Finance Limited	Leasing	Ordinary	100%	Scotland	30 St Vincent Place, Glasgow, G1 2HL
Clydesdale Bank (Head Office) Nominees Limited	In liquidation	Limited by guarantee	100%	Scotland	Saltire Court, 20 Castle Terrace, Edinburgh, EH1 2DB
Craig Yr Haul Management Company Limited	Property management	Ordinary	100%	England	20 Merrion Way, Leeds, Yorkshire, LS2 8NZ
CYB Intermediaries Holdings Limited	In liquidation	Ordinary	100%	England	15 Canada Square, London, E14 5GL
CYB Intermediaries Limited	Insurance intermediary	Ordinary	100%	England	20 Merrion Way, Leeds, Yorkshire, LS2 8NZ
CYB Services Limited	In liquidation	Ordinary	100%	Scotland	30 St Vincent Place, Glasgow, G1 2HL
St Vincent (Equities) Limited	Investment company	Ordinary	100%	Scotland	30 St Vincent Place, Glasgow, G1 2HL
Yorkshire Bank Home Loans Limited	Mortgage finance	Ordinary	100%	England	20 Merrion Way, Leeds, Yorkshire, LS2 8NZ
11 Tudor Hill Residential Management Company Limited	Dormant	Ordinary	100%	England	20 Merrion Way, Leeds, Yorkshire, LS2 8NZ
CB Nominees Limited	Dormant	Limited by guarantee	100%	Scotland	30 St Vincent Place, Glasgow, G1 2HL
CYB SSP Trustee Limited	Dormant	Ordinary	100%	England	20 Merrion Way, Leeds, Yorkshire, LS2 8NZ
Linton Springs Residential Management Company Limited	Dormant	Ordinary	100%	England	20 Merrion Way, Leeds, Yorkshire, LS2 8NZ
St Johns Place Residential Management Company Limited	Dormant	Ordinary	100%	England	20 Merrion Way, Leeds, Yorkshire, LS2 8NZ
YCB DC Trustee Limited	Dormant	Ordinary	100%	Scotland	30 St Vincent Place, Glasgow, G1 2HL
YCBPS Property Nominee Company Limited	Dormant	Ordinary	100%	England	20 Merrion Way, Leeds, Yorkshire, LS2 8NZ
Yorkshire and Clydesdale Bank Pension Trustee Limited	Dormant	Ordinary	100%	Scotland	30 St Vincent Place, Glasgow, G1 2HL
Yorkshire Bank PLC	Dormant	Ordinary	100%	England	20 Merrion Way, Leeds, Yorkshire, LS2 8NZ

Notes to the consolidated financial statements (continued)
Section 6: Notes to the Bank financial statements (continued)

6.2 Bank investments in controlled entities (continued)

The Bank also has an interest in the Yorkshire and Clydesdale Bank Foundation, a charitable foundation registered in Scotland as a company limited by guarantee. The Bank acts as a guarantor for £10 and is the main donor.

All subsidiaries have a financial year end of 30 September with the exception of the following entities:

Wholly owned subsidiary undertakings	Accounting reference date
Craig Yr Haul Management Company Limited	31 January
11 Tudor Hill Residential Management Company Limited	31 December
Linton Springs Residential Management Company Limited	31 December
St Johns Place Residential Management Company Limited	31 December

In addition to the above, the Bank also has an interest in a number of structured entities:

Other controlled entities as at 30 September 2017	Nature of business	Country of incorporation	Registered office
Clydesdale Covered Bonds No. 2 LLP	Acquisition of mortgage loans	England	20 Merrion Way Leeds LS2 8NZ
Lanark Holdings Limited	Holding company	England	Winchester House Mail Stop 429 1 Great Winchester Street London EC2N 2DB
Lanark Trustees Limited	Mortgages trustee	England	Winchester House Mail Stop 429 1 Great Winchester Street London EC2N 2DB
Lanark Funding Limited	Funding company	England	Winchester House Mail Stop 429 1 Great Winchester Street London EC2N 2DB
Lanark Master Issuer PLC	Issuer of securitised notes	England	Winchester House Mail Stop 429 1 Great Winchester Street London EC2N 2DB
Lannraig Holdings Limited	Holding company	England	35 Great St. Helen's London EC3A 6AP United Kingdom
Lannraig Trustees Limited	Mortgages trustee	Jersey	44 Esplanade St Helier Jersey JE4 9WG Channel Islands
Lannraig Funding Limited	Funding company	England	35 Great St. Helen's London EC3A 6AP United Kingdom
Lannraig Master Issuer PLC	Issuer of securitised notes	England	35 Great St. Helen's London EC3A 6AP United Kingdom
Red Grey Square Funding LLP [1]	Security provider	England	35 Great St. Helen's London EC3A 6AP United Kingdom

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

Details of the Group's interests in consolidated structured entities associated with securitisation and covered bond arrangements are set out in note 3.7.

(1) During the year the Bank sponsored the formation of Red Grey Square Funding LLP for the purpose of entering into the Security Arrangement with the Clydesdale and Yorkshire Bank Pension Scheme (note 5.3).

Measuring financial performance - glossary

Financial

Term	Definition
Underlying profit after tax attributable to ordinary equity holders	Underlying profit before tax of £298m (2016: £225m) less tax charge of £33m (2016: £206m), less dividends and distributions (net of tax relief) of £29m (2016: £15m). The underlying tax charge is calculated by applying the statutory tax rate for the relevant period to the taxable items adjusted on the underlying basis.

Asset quality:

Term	Definition
Impairment charge to average customer loans **(cost of risk)**	Impairment losses on credit exposures plus credit risk adjustment on fair value loans to average customer loans (defined as loans and advances to customers, other financial assets at fair value and due from customers on acceptances).
90+ days past due ***(DPD)*** plus impaired assets to customer loans	Customer loans that are either impaired or where the repayment is more than 90 days overdue as a percentage of total customer loans at a given date.
Net write offs to customer loans	Net write offs, including loans at fair value, as a percentage of total customer loans at a given date.

Capital optimisation:

Term	Definition
Common Equity Tier 1 ***(CET1)*** ratio	CET1 capital divided by RWAs at a given date.
Tier 1 ratio	Tier 1 capital as a percentage of risk-weighted assets.
Total capital ratio	Total capital resources divided by risk-weighted assets at a given date.
Leverage ratio	This is a regulatory standard ratio proposed by the Basel III as a supplementary measure to the risk based capital requirements. It is intended to constrain the build-up of excess leverage in the banking sector and is calculated by dividing Tier 1 capital resources by a defined measure of on- and off-balance sheet items plus derivatives.
Modified leverage ratio	The Group's leverage ratio on a modified basis, excluding qualifying central bank claims from the exposure measure in accordance with the policy statement issued by the PRA in October 2017.
Loan to deposit ratio ***(LDR)***	Customer loans as a percentage of customer deposits at a given date.
Liquidity coverage ratio **(LCR)**	Measures the surplus (or deficit) of the bank's high quality liquid assets relative to weighted net stressed cash outflows over a 30 day period. It assesses whether the bank has sufficient liquid assets to withstand a short-term liquidity stress based on cash outflow assumptions provided by regulators.
Net stable funding ratio **(NSFR)**	The total amount of available stable funding divided by the total amount of required stable funding, expressed as a percentage. The Group monitors the NSFR based on its own interpretations of current guidance available for CRD IV NSFR reporting. Therefore, the reported NSFR may change over time with regulatory developments. Due to possible differences in interpretation of the rules, the Group's ratio may not be directly comparable with those of other financial institutions.

Measuring financial performance - glossary (continued)

Underlying adjustments to the Statutory view of performance

In arriving at an underlying basis, the effects of certain items that do not promote an understanding of historical or future trends of earnings or cash flows are removed, with management believing this presents a set of results that provide a more reflective year on year comparison. These items are:

Item	FY17	FY16	Description	Reason for exclusion from the Group's current underlying performance
Restructuring expenses	(67)	(45)	Restructuring of the business is currently ongoing with costs including redundancy payments, property vacation costs and associated enablement costs.	These costs are significant and are part of the Group's strategic objective in simplifying and streamlining operations and processes to enhance productivity. Consequently, this expense is not viewed as a normal ongoing operating cost to the Group.
Separation costs	(8)	(11)	Costs incurred directly relating to the demerger from NAB.	Specific costs relating to the demerger from NAB are historic and not indicative of the Group's current underlying performance.
Impairment of intangible assets	-	(45)	This relates to the impairment of historic development costs and legacy software developed pre demerger.	Specific costs (or gains) relating to the demerger from NAB are historic and not indicative of the Group's current underlying performance. This includes the impact on the impairment of legacy intangible fixed assets where post demerger, the Group had greater flexibility in its digital direction.
Conduct charges	(592)	(484)	These are customer redress and associated costs arising from legacy products and past sales practices.	These costs are historical in nature and are not indicative of the Group's current underlying performance.
Gain on defined benefit pension scheme reforms	88	-	A one-off gain on the closure of the defined pension schedule to future accrual for the majority of members	Losses or gains from one-off or infrequent transactions are not indicative of the Group's current underlying performance.
Gain on disposal of VocaLink/Visa share	20	7	A one-off gain recognised on the disposal of the Group's VocaLink and VISA Europe Limited share.	Losses or gains from one-off or infrequent transactions are not indicative of the Group's current underlying performance.
Net gain on debt restructuring	-	1	These are the net gains arising on the repurchase of subordinated debt from NAB at the time of the demerger.	Losses or gains from one-off or infrequent transactions, such as those rising from debt restructures, are not indicative of the Group's current underlying performance.

Main Glossary

Term	Definition
Additional Tier 1 securities ***(AT1)***	Securities that are considered additional Tier 1 capital in the context of CRD IV.
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.
'B'	The Group's digital application suite, offering Retail customers money management capabilities across Web, Android and Apple platforms.
Bank	Clydesdale Bank PLC.
Bank levy	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.
Bank surcharge	Introduced by the Finance Act (No2) 2015 for the Group's banking entity from 1 January 2016 and is an 8% charge on taxable profits over £25m before the offset of brought forward losses or Group relief.
Basel II	The capital adequacy framework issued by the BCBS in June 2006 defining how firms should calculate their regulatory capital requirements.
Basel III	Reforms issued by the BCBS in December 2010 to strengthen global capital and liquidity rules with the goal of promoting a more resilient banking sector. In Europe the new requirements were implemented by "CRD IV", on a phased basis from 1 January 2014 with full implementation by 1 January 2019.
Basis points ***(bps)***	One hundredth of a percent (0.01%); meaning that 100 basis points is equal to 1%. This term is commonly used in describing interest rate movements.
Board	Refers to the CYBG PLC Board or the Clydesdale Bank PLC Board as appropriate.
Capped Indemnity	The indemnity from NAB in favour of CYBG PLC in respect of certain qualifying conduct costs incurred by CYBG Group, which is capped at the "Capped Indemnity Amount", subject to the "Loss Sharing Arrangement", under the terms of the "Conduct Indemnity Deed".
Capped Indemnity Amount	An amount equal to £1.58 bn less any "Pre Covered provision amount".
Carrying value (also referred to as carrying amount)	The value of an asset or a liability in the balance sheet based on either amortised cost or fair value principles.
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.
Common Equity Tier 1 capital ***(CET1)***	The highest quality form of regulatory capital that comprises total shareholders' equity and related non-controlling interests, less goodwill and intangible assets and certain other regulatory adjustments.
Company	Clydesdale Bank PLC.
Conduct Indemnity Deed	The deed between NAB and CYBG PLC setting out the terms of: • The "Capped Indemnity"; and • Certain arrangements for the treatment and management of certain "Conduct Matters".

Main Glossary (continued)

Conduct Matters	In the context of the 'Conduct Indemnity Deed', conduct issues relating to PPI, standalone 'IRHP', voluntary scope TBLs and FRTBLs and other conduct matters in the period prior to the demerger date whether or not known at the "demerger date".
Conduct risk	The risk of treating customers unfairly and/or delivering inappropriate outcomes resulting in customer detriment, regulatory fines, compensation, redress costs and reputational damage.
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.
Counterparty	The other party that participates in a financial transaction, with every transaction requiring a counterparty in order for the transaction to complete.
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 a source of term funding for the Group.
CRD IV	European legislation to implement Basel III. It replaces earlier European capital requirements directives with a revised package consisting of a new Capital Requirements Directive and a new Capital Requirements Regulation. CRD IV sets out capital and liquidity requirements for European banks and harmonises the European framework for bank supervision. See also "Basel III".
CRD V	A set of proposals issued by the European Commission including amendments of (among other things) the existing Capital Requirements Directive and Capital Requirements Regulation. See also "CRD IV".
Credit risk adjustment/credit valuation adjustment	An adjustment to the valuation of financial instruments held at fair value to reflect the creditworthiness of the counterparty.
Customer deposits	Money deposited by individuals and corporate entities that are not credit institutions, and can be either interest bearing, non-interest bearing or term deposits.
Default	A customer is in default when either they are more than 90 days past due on a credit obligation to the Group, or are considered unlikely to pay their credit obligations in full without recourse to actions such as realisation of security (if held).
Delinquency	See "Arrears".
Demerger	The demerger of CYBG Group from NAB pursuant to which all of the issued share capital of CYBI Limited was transferred to CYBG PLC by NAB in consideration for the issue and transfer of CYBG shares to NAB in part for the benefit of NAB (which NAB subsequently sold pursuant to the IPO) and in part for the benefit of NAB shareholders under a scheme of arrangement.
Demerger date	8 February 2016
Derivative	A financial instrument that 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	The method used to measure the carrying value of certain financial instruments which amortises the relevant fees over the expected life of the instrument.
Effective tax rate	The tax charge in the statutory income statement as a percentage of the statutory profit before tax.
Encumbered assets	Assets that have been pledged as security, collateral or legally "ring fenced" in some other way which prevents those assets being transferred, pledged, sold or otherwise disposed.
Exposure	A claim, contingent claim or position which carries a risk of financial loss.
Fair value	The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal (or most advantageous) market at the measurement date under current market conditions.

Main Glossary (continued)

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.
Financial Ombudsman Service ***(FOS)***	An independent body set up by the UK Parliament to resolve individual complaints between financial businesses and their customers.
Financial Services Compensation Scheme ***(FSCS)***	The UK's compensation fund of last resort for customers of authorised financial services firms and is funded by the financial services industry. The FSCS may pay compensation if a firm is unable, or likely to be unable, to pay claims against it. This is usually because it has stopped trading or has been declared in default.
FINREP	A standardised Financial Reporting framework mandated by the EBA. Its aim is to establish a single rule book to ensure a robust and uniform regulatory framework.
Forbearance	The term generally applied to the facilities provided or changes to facilities provided to assist borrowers, both retail and SME, who are experiencing, or are about to experience, a period of financial stress.
Forborne non-performing loans	Loans to which forbearance measures have been granted and which are more than 90 DPD, or where the debtor is assessed as unlikely to pay its credit obligations in full without realisation of collateral, regardless of the existence of any past-due amount or of the number of DPD.
Forborne performing loans	Loans to which forbearance measures have been granted and which are up to 90 DPD and do not otherwise meet the criteria of forborne non-performing loans.
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 or cash flows of hedging instruments not being fully offset by changes in fair value or cash flows of hedged items.
Housing lending	Mortgages secured by residential properties as collateral
iB	The Group's IT digital platform, built on an open architecture framework providing integration and connectivity for our customer systems, applications and technology partners.
IFRS 9	The new financial instrument accounting standard which is applicable for accounting periods beginning on or after 1 January 2018, which the Group will adopt from 1 October 2018.
Impaired loans	Loans in arrears with insufficient security to cover principal and arrears of interest revenue or where there is sufficient doubt about the ultimate collectability of principal and interest.
Impairment allowances	A provision held on the balance sheet to recognise that a loan is impaired. This can be calculated at either the individual or collective level.
Impairment losses	Where an asset's recoverable amount is less than its carrying value and the difference is recognised in the income statement with the carrying value of the asset reduced by creating an impairment allowance. This can be assessed at either the individual or collective level.
Interest rate hedging products ***(IRHP)***	This incorporates: (i) standalone hedging products identified in the Financial Services Authority (FSA) 2012 notice; (ii) the voluntary inclusion of certain of the Group's more complex tailored business loan (TBL) products; and (iii) the Group's secondary review of all fixed-rate tailored business loans (FRTBLs) complaints which were not in scope for the FSA notice.
Internal Capital Adequacy Assessment Process ***(ICAAP)***	The Group's assessment of the levels of capital that it needs to hold through an examination of its risk profile from regulatory and economic capital viewpoints.

Main Glossary (continued)

Internal Liquidity Adequacy Assessment Process ***(ILAAP)***	The Group's assessment and management of balance sheet risks relating to funding and liquidity.
Internal ratings-based approach ***(IRB)***	A method of calculating credit risk capital requirements using internal, rather than supervisory, estimates of risk parameters.
Investment grade	The highest possible range of credit ratings, from "AAA" to "BBB", as measured by external credit rating agencies.
'Jaws'	The net difference between movements in total income and underlying costs for the period expressed as a percentage.
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 markets 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.
Listing Rules	Regulations applicable to any company listed on a United Kingdom stock exchange, subject to the oversight of the UK Listing Authority (UKLA). The Listing Rules set out mandatory standards for any company wishing to list its shares or securities for sale to the public.
Loan to value ratio ***(LTV)***	A ratio that expresses the amount of a loan as a percentage of the value of the property on which it is secured.
Loss Share	The percentage of a provision raised or an increase in a provision which CYBG PLC will be responsible for under the "Conduct Indemnity Deed". Fixed at 9.7% at the demerger date.
Loss Sharing Arrangement	The arrangement relating to the "Capped Indemnity" pursuant to which CYBG PLC will be responsible for the "Loss Share".
Medium Term Notes	Debt instruments issued by corporates, including financial institutions, across a range of maturities.
Minimum requirement for own funds and eligible liabilities ***(MREL)***	MREL is a minimum requirement for institutions to maintain equity and eligible debt liabilities, to help ensure that when an institution fails the resolution authority can use these financial resources to absorb losses and recapitalise the continuing business. The Bank of England set out its approach to setting banks' MREL in November 2016.
Net interest income	The amount of interest received or receivable on assets, net of interest paid or payable on liabilities.
Net promoter score ***(NPS)***	This is an externally collated customer loyalty metric that measures loyalty between a Provider, who in this context is the Group, and a consumer.
Non-impaired assets 90+ DPD	Consist of well-secured assets that are more than 90 DPD and portfolio-managed facilities that are not well secured and are between 90 and 180 DPD.
Operational risk	The risk of loss resulting from inadequate or failed internal processes, people strategies and systems or from external events.
Overall Liquidity Adequacy Rule ***(OLAR)***	An FCA and PRA rule that firms must at all times maintain liquidity resources which are adequate both as to amount and quality, to ensure that there is no significant risk that its liabilities cannot be met as they fall due. This is included in the Group's 'Risk Appetite' and subject to approval by the Board as part of the 'ILAAP'.
Past due loans and advances	Loans and advances on which repayments are overdue.
Pension risk	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.
PPI redress	Includes PPI customer redress and all associated costs excluding fines.

Main Glossary (continued)

Pre Covered provision amount	The amount of any provision(s) relating to "Conduct Matters" raised or increased by CYBG Group between 31 March 2015 and the "demerger date" in respect of which NAB has provided specific support at any time after 31 March 2015 but before the "demerger date". This was £465m at the "demerger date".
Probability of default ***(PD)***	The probability that a customer will default (usually within a one-year time horizon); although the time horizon will change on 1 October 2018 in line with IFRS 9 requirements.
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 the PRA.
Residential mortgage-backed securities ***(RMBS)***	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).
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 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 lending	Lending to individuals rather than institutions. This includes both secured and unsecured lending such as personal loans, residential and BTL mortgages, overdrafts and credit card balances.
Ring fencing	A new regime of rules which require banks to change the way that they are structured by separating retail banking services from investment and international banking. This is to ensure the economy and taxpayers are protected in the event of any future financial crises.
Risk appetite	The level and types of risk the Group is willing to assume within the boundaries of its risk capacity to achieve its strategic objectives.
Risk-weighted assets ***(RWA)***	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 counterparty (buying the security and agreeing to sell in the future) it is a reverse repurchase agreement or a reverse repo.
Scheme of arrangement	A scheme of arrangement under Part 5.1 of the Australian Corporations Act between NAB and NAB shareholders to effect the demerger.
Scheme	The Group's defined benefit pension scheme, the Yorkshire and Clydesdale Bank Pension Scheme.
Secured lending	Lending in which the borrower pledges some asset (e.g. property) as collateral for the lending.
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.

Main Glossary (continued)

SME lending	Lending to non-retail customers, including overdrafts, asset and lease financing, term lending, bill acceptances, foreign currency loans, international and trade finance, securitisation and specialised finance.
Sovereign exposures	Exposures to governments, ministries, departments of governments, embassies, consulates and exposures on account of cash balances and deposits with central banks.
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.
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.
Stress testing	The term used to describe techniques where plausible events are considered as vulnerabilities to ascertain how this will impact the own funds or liquidity which a bank holds.
Structured entities (**SE**)	An entity created to accomplish a narrow well-defined objective (e.g. securitisation of financial assets). An SE may take the form of a corporation, trust, partnership or unincorporated entity. SEs are often created with legal arrangements that impose strict limits on the activities of the SE. May also be referred to as an SPV.
Subordinated debt	Liabilities which rank after the claims of other creditors of the issuer in the event of insolvency or liquidation.
Term Funding Scheme (**TFS**)	Launched in 2016 by the BoE to allow banks and building societies to borrow from the BoE at rates close to base rate. This is designed to increase lending to businesses by lowering interest rates and increasing access to credit.
Tier 1 capital	A measure of a bank's financial strength defined by CRD IV. It captures Common Equity Tier 1 capital plus other Tier 1 securities in issue, subject to deductions.
Tier 2 capital	A component of regulatory capital, including qualifying subordinated debt, eligible collective impairment allowances and other Tier 2 securities as defined by CRD IV.
Unaudited/unverified	Financial information that has not been subject to validation by the Group's external auditor.
Unsecured lending	Lending in which the borrower pledges no assets as collateral for the lending (such as credit cards and current account overdrafts).
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.

Abbreviations

ALCO	Assets and Liabilities Committee
ASX	Australian Securities Exchange
AT1	Additional Tier 1
BCBS	Basel Committee on Banking Supervision
BoE	Bank of England
bps	Basis points
BTL	Buy-to-let mortgages
CAGR	Compound Annual Growth Rate
CCB	Capital Conservation Buffer
CCyB	Countercyclical Capital Buffer
CET1	Common Equity Tier 1 Capital
CIR	Cost to income ratio
CMA	Competition and Markets Authority
CPI	Consumer Prices Index
CRD	Capital Requirements Directive
CRR	Capital Requirements Regulation
DB	Defined benefit
DPD	Days past due
DTR	Disclosure and Transparency Rules
EAD	Exposure at Default
EaR	Earnings at risk
eCRS	electronic Customer Rating System
EPS	Earnings per share
FCA	Financial Conduct Authority.
FPC	Financial Policy Committee
FRC	Financial Reporting Council
FSCS	Financial Services Compensation Scheme
FTE	Full time equivalent
GHG	Greenhouse Gases
HMRC	Her Majesty's Revenue and Customs
IAS	International Accounting Standards
IASB	International Accounting Standards Board
ICAAP	Internal Capital Adequacy Assessment Process
IFRS	International Financial Reporting Standards
ILAAP	Internal Liquidity Adequacy Assessment Process
IPO	Initial Public Offering
IRB	Internal ratings-based
IRHP	Interest rate hedging products
IRRBB	Interest rate risk in the banking book
ISDA	International Swaps and Derivatives Association
LCR	Liquidity coverage ratio
LDR	Loan to deposit ratio
LGD	Loss Given Default
LIBOR	London Interbank Offered Rate.
LSE	London Stock Exchange
LTIP	Long term incentive plan
LTV	Loan to value
MREL	Minimum Requirement for Own Funds and Eligible Liabilities
NAB	National Australia Bank
NIM	Net interest margin
NPS	Net promoter score
NSFR	Net stable funding ratio
OLAR	Overall liquidity adequacy rule
PBT	Profit before tax
PCA	Personal current accounts
PD	Probability of Default
PPI	Payment protection insurance
PRA	Prudential Regulation Authority
RAS	Risk Appetite Statement
RMBS	Residential mortgage-backed securities
RMF	Risk Management Framework
RoTE	Return on Tangible Equity
RPI	Retail Price Index
RWA	Risk weighted assets
SME	Small or medium sized enterprises
SRB	Systemic Risk Buffer
TCC	Transactional Credit Committee
TFS	Term Funding Scheme
TNAV	Tangible net asset value
TSA	Transitional Services Agreements
VaR	Value at risk

Other information

Country by Country Reporting ('CBCR')

The Capital Requirements (Country-by-Country Reporting) Regulations 2013 came into effect on 1 January 2014 and place certain reporting obligations on financial institutions that are within the scope of the European Union's Capital Requirements Directive (CRD IV). The purpose of the Regulations is to provide clarity on the source of the Group's income and the locations of its operations. Refer to CYBG PLC's Annual Report and Accounts for country by country reporting disclosures.

Website www.cybg.com/investor-centre/financial-results.

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