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A DIFFERENT WAY OF BANKING

PRELIMINARY RESULTS 2017

21 November 2017

Preliminary Results Announcement

For the year ended 30 September 2017

Contents

Highlights 2

Business and financial review 5

Consolidated financial statements 18

Supplementary risk management disclosures 73

Glossary 85

Abbreviations 93

Overview

CYBG PLC (the 'Company'), 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.

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 information contained within this announcement is deemed by the Group to constitute inside information as stipulated under the Market Abuse Regulation No 596/2014. Upon the publication of this announcement via Regulatory Information Service, this inside information is now considered to be in the public domain.

The forward-looking statements disclaimer can be found on page 95.

CYBG PLC Preliminary Results 2017

Targets delivered, 33% increase in underlying PBT and inaugural dividend recommended

Strong financial performance

- Underlying income up 3% and costs down 7%, delivering a 7%pts improvement in underlying CIR to 67%
- Stable net interest margin of 2.27% in a competitive environment
- Underlying profit before tax up 33% to £293m
- First statutory profit after tax in over five years of £182m including restructuring and conduct charges
- Significantly improved returns: underlying RoTE 7.5% (FY16: 5.2%)
- CET1 ratio of 12.4% comfortably within 12-13% operating range; IRB accreditation on track
- Recommending payment of an inaugural dividend of 1p per share
- FY18 guidance for NIM of c.220bps and underlying costs <£650m; medium-term guidance reiterated

Delivering sustainable customer growth

- 3% deposit growth to £27.7bn with over £1 billion of balances now held through our B offering
- Total lending growth of 6%:
  - Mortgages up 8% to £23.5bn driven by enhancements to our customer and channel experience
  - Core SME lending up 6% to £6.8bn following the continued reinvigoration of our SME franchise
- Robust asset quality reflects prudent underwriting standards; cost of risk 14bps (FY16: 9bps)

Ongoing business transformation driving enhanced customer experience

- All personal customers now benefiting from next generation mobile technology
- New digital capabilities delivered to improve customer experience: straight through online account opening, B on Web, Android Pay and mobile cheque depositing
- Launched an innovative new online SME lending facility with our first Fintech partner
- New B store in Birmingham first step in geographic expansion in the Midlands and North West
- Clydesdale and Yorkshire Bank personal customers have begun migrating to iB digital platform with SME customers to follow in early 2018

David Duffy, Chief Executive Officer commented

"We have delivered a strong performance in 2017 having met all of our targets and recorded our first statutory profit in over five years. As a result, we are pleased to be recommending an inaugural dividend to our shareholders. This is a good first step in our three-year plan and we remain fully focused on the delivery of our medium-term targets, which factor in our cautious view of the economic outlook.

We continue to leverage our unique focus in Scotland and the North of England, with our powerful Clydesdale and Yorkshire Bank footprint delivering ahead of market growth in both SME and mortgages. Our new digital brand, B, is proving highly successful in attracting new customers nationally, with over 100,000 accounts opened since launch.

We are investing c. £350m to drive a transformation in our customers' experience right across the Group. At the heart of this investment is our iB digital platform, which will enable us to provide a superior experience for all our customers and ensures we are ready for the dawn of Open Banking and PSD2.

These results show how we're building the UK's leading digitally enabled challenger bank, offering stress-free banking to millions of personal and small business customers, and sustainable returns for our shareholders."

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CYBG will be hosting a presentation for analysts and investors covering the preliminary results at its offices at 15 Floor, 122 Leadenhall Street, London EC3V 4AB, starting at 08:30 GMT today (19:30 AEDT). The meeting will be webcast live and available at www.cybg.com. Webcast participants will be able to send questions into the meeting. A recording of the webcast and conference call will be made available on the website www.cybg.com shortly after the meeting. Alternatively there is a conference call facility to listen to the meeting. Dial in details:

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Key performance indicators [1]

	12 months to 30-Sep-17	12 months to 30-Sep-16
Profitability:		
NIM	2.27%	2.26%
Underlying RoTE	7.5%	5.2%
Underlying cost to income ratio (CIR)	67%	74%
Underlying basic EPS	21.5p	16.2p
Statutory RoTE	6.1%	(7.2%)
Statutory CIR	69%	88%
Statutory basic earnings/(loss) per share	17.3p	(22.5)p

As at:	**30-Sep-17**	**30-Sep-16**
Asset Quality:		
Impairment charge to average customer loans (cost of risk)	0.14%	0.09%
90+ DPD plus impaired assets to customer loans	1.06%	1.27%
Specific provision to total impaired assets	32.6%	30.8%
Total provision to customer loans	0.69%	0.79%
Indexed loan to value (LTV) of mortgage portfolio [2]	57.5%	55.7%
Regulatory Capital:		
CET1 ratio	12.4%	12.6%
Tier 1 ratio	14.7%	15.0%
Total capital ratio	17.9%	18.2%
Leverage ratio	6.3%	6.8%
Tangible net asset value (TNAV) per share	295.6p	284.1p
Funding and Liquidity:		
Loan to deposit ratio (LDR)	115%	112%
Liquidity coverage ratio (LCR)	164%	140%
Net stable funding ratio (NSFR)	118%	124%

(1) For a definition of each of the Key Performance Indicators, refer to 'Measuring financial performance – glossary' on page 85. The Key Performance Indicators include statutory, regulatory and alternative performance measures.

(2) LTV of the mortgage portfolio is defined as mortgage portfolio weighted by balance and indexed using the MIAC Acadametrics indices at a given date.

Chief Executive Officer's review

"Whether it is prototyping new technologies, opening our first consumer innovation lab, Studio B, or collaborating with Fintech partners with the development of our new small business e-lending solution, we are building a bank focused on a differentiated customer experience that will put customers more in control of their money."

I am delighted to report that we have maintained momentum in delivering our strategic priorities and commitments and, as a result, we are delivering significantly improved financial performance, have recorded our first statutory profit in over five years and are recommending an inaugural dividend to shareholders.

As the only truly full-service challenger bank of scale across both Retail and SME in the UK market, we have delivered ahead of market growth in both mortgages and SME lending and we remain on track to deliver our commitment to provide up to £6bn of lending to SMEs by the end of 2019.

Our results show improved underlying profit, sustainable loan growth, a stable margin and improved returns – all achieved in a highly competitive market and a continuing low growth, low interest rate environment. Our cost efficiency programme is also ahead of plan, with underlying operating costs coming in at £675m, down 7% year on year. We have also continued to work through our legacy conduct issues and our statutory profit includes the impact of a conduct charge of £58m primarily due to historical payment protection insurance (PPI) mis-selling.

CYBG is perfectly placed to disrupt the market – we have the size and full-service Retail and SME capabilities that no other UK challenger bank can offer, yet we are smaller and more agile than the complex structures of the 'big five' UK banks. We are well capitalised, have a high-quality loan book and prudent risk appetite, along with powerful, established local brands. These have now been joined by an innovative brand in B, which has broadened our customer demographic and reach outside of our core regions. We have over 100,000 B customers since launch in 2016 and we were proud to receive the FStech Award 2017 for Digital Launch of the Year.

The pace and scale of transformation across our business has been considerable in 2017. We have kept up our relentless focus on enhancing our customers' experience through operational improvements and have maintained excellent progress on the delivery of our plan to provide a truly omni-channel model for customers. As part of our digital journey, over the past year we have introduced straight-through online account opening, Apple and Android Pay, as well as piloting an innovative new online SME lending facility through one of our Fintech partnerships. In addition, our migration of our Clydesdale and Yorkshire Bank accounts to our digital platform, iB, is well advanced and we expect all personal customers to begin migrating to iB on the web by the end of 2017 with SME customers to begin migration onto iB, both mobile and web, in 2018.

Like other banks and high street retailers we are seeing a shift in the way customers choose to do business with us and more often customers are using telephone, internet and mobile channels to do day-to-day banking. As a result, the number of transactions which take place in branches is falling, with customers increasingly using a branch only when they want to speak with us about a significant life event. We are constantly reviewing our branch footprint and while a number of branches were closed this year, we opened new flagship branches in Edinburgh and Birmingham as part of a broader multiyear strategy to expand our presence in key northern cities.

In April, we opened our innovation lab, Studio B, in London. Unlike anything else on the high street, Studio B enables us to collaborate directly with customers and other interested parties on the design of future banking products and services, then showcase and test our best ideas with colleagues, customers and members of the public – all within a fully functioning customer banking centre. While in September we expanded our UK presence into Birmingham with the opening of a next generation B store which, as well as being a fully operational branch, is also a showcase for customers to experience our digital innovations.

Over the next 12 months I am confident we have both the opportunity and the ability to create a differentiated customer experience that positions us as a progressive, forward-looking organisation able to thrive today, tomorrow and in the future, delivering on commitments to our customers, our people and our shareholders. Finally, I am very grateful to the Chairman, the Board and our colleagues for their backing and insight as we continue on our journey.

David Duffy
Chief Executive Officer

Overview of Group results

Our FY2017 results reflect a year of strong financial performance as we have delivered on our strategic priorities in a period of challenging market and economic conditions. We have grown our customer lending without compromising on asset quality, delivered cost savings well ahead of our targets in the first phase of our three year efficiency programme, and taken concrete steps to improve our capital position. We are firmly focused on building a solid base for delivering sustainable returns to our shareholders.

Summary balance sheet

as at 30 September	**2017 £m**	2016 £m
Customer loans	**31,967**	30,147
Other financial assets	**10,469**	9,223
Other non-financial assets	**795**	559
Total assets	**43,231**	39,929
Customer deposits	**(27,679)**	(27,000)
Wholesale funding	**(8,602)**	(5,810)
Other liabilities	**(3,548)**	(3,908)
Total liabilities	**(39,829)**	(36,718)
Ordinary shareholders' equity	**(2,952)**	(2,761)
AT1 equity	**(450)**	(450)
Equity	**(3,402)**	(3,211)
Total liabilities and equity	**(43,231)**	(39,929)

Summary income statement – underlying and statutory basis[1]

for the year ended 30 September	**2017 £m**	2016 £m
Net interest income	**844**	806
Non-interest income	**172**	183
Total operating income	**1,016**	989
Total operating and administrative expenses	**(675)**	(729)
Operating profit before impairment losses	**341**	260
Impairment losses on credit exposures[2]	**(48)**	(39)
Underlying profit on ordinary activities before tax	**293**	221
Restructuring expense	**(67)**	(45)
Separation costs	**(8)**	(11)
Impairment of intangible assets	**–**	(45)
Conduct charges	**(58)**	(51)
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 profit on ordinary activities before tax	**268**	77
Tax expense	**(86)**	(241)
Statutory profit/(loss) attributable to equity holders	**182**	(164)

(1) The summary income statement is presented on a statutory and underlying basis. In addition, the financial key performance indicators (KPIs) used by management in monitoring the Group's performance and reflected throughout this section are determined on a combination of bases (including statutory, regulatory and alternative performance measures), as detailed in the Glossary on page 85. A reconciliation from the underlying to statutory basis is shown on page 14.

(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).

Overview of Group results

Capital position

	2017 £m	2016 £m
Common equity tier 1 capital	**2,437**	2,397
Additional tier 1 capital	**450**	450
Tier 2 capital	**627**	625
Total capital	**3,514**	3,472
Risk weighted assets (RWAs)	**19,678**	19,029

Profits up overall

The Group has successfully delivered on each financial target set out at the Capital Markets Day in September 2016 and reported a statutory profit for the first time since 2011 of £182m (2016: loss of £164m). Significant progress has been made against the Group's strategic priorities, which has led to FY2017 underlying profit before tax increasing to £293m, up £72m (33%). Together with a stable capital base, this has been the primary driver of the increase in underlying RoTE, from 5.2% to 7.5% and underlying basic earnings per share from 16.2p to 21.5p. Our disciplined approach to managing our balance sheet has enabled us to increase TNAV from 284.1p to 295.6p per share.

As a result of the progress we have made in improving the performance of our business, we are pleased to declare our intention to pay an inaugural dividend to our equity shareholders.

£1.8bn growth in customer lending

The Group's performance was delivered against a backdrop of challenging economic and market conditions, as the effects of the base rate cuts in 2016 and the corresponding fall in LIBOR rates, together with lower UK credit growth competitive pricing across the industry, prevailed throughout the year. In spite of these pressures, we delivered growth in our mortgage and core SME lending portfolios, up £1.6bn and £0.4bn respectively, and saw an increase in our mortgage market share. We remain cautious in the unsecured lending market, taking a disciplined approach to pricing in a competitive market; nevertheless, our unsecured lending portfolio saw a modest increase in balances year on year.

Growth in the customer lending book has been achieved without compromising asset quality. The Group's cost of risk has remained relatively low at 14bps (2016: 9bps), reflective of the quality and mix of our book with the mortgage portfolio accounting for a high proportion of total customer lending (2017: 73.4%; 2016: 72.4%).

Active management of customer deposits

Customer deposits increased year on year as we saw 5.3% growth in current account balances, with strong recruitment of business current accounts (BCAs) and substantial growth in B savings balances. This growth more than offset the managed reduction in volumes of variable rate savings accounts as we rationalised and repriced our ISA portfolio.

This repricing was part of an overall plan to improve our funding mix, with a shift from higher cost deposits towards lower cost funding. The Group's participation in the Government's Term Funding Scheme was another element of this plan, and together these actions helped to drive down the Group's funding costs, with the blended rate on interest-bearing liabilities falling by 25bps to 75bps.

While the rate environment dampened growth in interest income, the actions taken across the liabilities portfolio allowed us to grow net interest income by £38m (4.7%). Overall, these factors combined to drive a 1bps increase in NIM to 227bps.

Cost savings well ahead of plan

We continued to improve our operational efficiency during the year through the restructuring and streamlining of our business. We incurred restructuring charges of £67m to deliver gross run rate savings of £90m, we saw the benefits of these actions as the year progressed as our full year underlying costs fell by £54m (7%) to £675m, well below our FY2017 guidance of £690m–£700m. As a result, and combined with the increase in income, our underlying cost to income ratio improved from 74% to 67%.

Optimisation of our capital base – CET1 ratio 12.4%

Our key capital ratios remain within our required operating range. The core business generated 13bps of CET1 capital over the year. Offsetting the growth in our core business were the costs associated with restructuring, separation from our former parent and legacy conduct issues which together absorbed 61bps of CET1.

the capital position benefited from the closure of the defined benefit pension scheme to future accrual for the majority of employees, Improving the IAS19 position by £88m and contributing to an IAS 19 surplus of £207m at the year end. In addition, the trustees completed the 2016 triennial valuation, whichh resulted in a reduction in the scheme deficit (on a trustee funding basis) from £450m to £290m and no change to the existing deficit repayment schedule agreed with the Trustee in June 2014.

In April 2017 we submitted our application to the PRA for permission to use the IRB approach to calculating credit RWA. This marked a key milestone in our path to IRB accreditation.

Overview of Group results

Outlook for 2018

The lending market will, we expect, remain competitive, especially for home loans. However, our pipeline in both our mortgage and SME businesses is strong and supports our plans to deliver continued asset growth. It is likely that we will see future price pressure in the mortgage and unsecured personal loan market. Our strong deposit-generating capabilities, founded on our personal and business asset account franchise, will ensure that we fund our growth in a sustainable and cost-effective manner. We expect to see modest pressure on net interest margin and our NIM guidance for FY2018 is 220bps.

Our efficiency programme will capitalise on the momentum seen over the past 12 months, and will focus on procurement and organisational design enhancements in the coming year. With a track record of achieving sustainable cost savings, we are confident in our ability to deliver savings in line with our guidance and further reduce our CIR.

We will manage our capital base within our stated operating range for CET1 of 12% to 13%.

Financial performance review

1. Sustainable customer growth

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 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%).

We have managed our deposit base throughout the year - growing balances, improving the mix and reducing funding costs.

		2017 £m	2016 £m*
Mortgages		**23,480**	21,836
SME lending [(1)]	– 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[(2)]		**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 loans from the non-core to the core portfolio.

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[(3)] 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%).

(1) Includes financial assets at fair value of £477m (September 2016: £750m).
(2) Includes financial liabilities at fair value of £26m (September 2016: £48m).
(3) System growth is sourced from the BoE 'Mortgages outstanding by type of lender, UK (BOE)' report (MM4).

Financial performance review

SME lending

Our core SME lending portfolio increased by of £383m (5.9%) in the year, ahead of system growth[1] 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).

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. While 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 ISAs along with the launch of new notice accounts for SME depositors.

(1) 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 and pension funds, and financial intermediation (excluding insurance and pension funds) results.

Financial performance review

Funding and liquidity

The Group continues to maintain its strong funding and liquidity position and seeks to achieve an appropriate balance between profitability, liquidity risk and capital optimisation. 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, has resulted in an increase in LDR from 112% to 115%, well within our guidance for the year of <120%.

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.

Net interest income

	2017			2016		
Average balance sheet	**Average balance £m**	**Interest income/ (expense) £m**	**Average yield/ (rate) %**	Average balance £m	Interest income/ (expense) £m	Average yield/ (rate) %
Interest-earning assets						
Mortgages	**22,439**	**652**	**2.91**	21,261	672	3.16
SME lending[1]	**7,110**	**264**	**3.71**	6,904	263	3.80
Unsecured personal lending	**1,172**	**105**	**8.99**	1,216	119	9.76
Liquid assets	**6,007**	**21**	**0.34**	6,001	31	0.51
Other interest-earning assets	**969**	**33**	**3.41**	875	16	1.83
Total average interest-earning assets	**37,697**	**1,075**	**2.85**	36,257	1,101	3.04
Total average non-interest-earning assets	**2,489**			2,759		
Total average assets	**40,186**			39,016		
Interest-bearing liabilities						
Current accounts	**11,032**	**(6)**	**(0.05)**	10,701	(11)	(0.10)
Savings accounts	**7,832**	**(32)**	**(0.41)**	8,034	(63)	(0.78)
Term deposits	**5,190**	**(89)**	**(1.71)**	5,397	(114)	(2.11)
Other wholesale deposits	**8**	**–**	**(0.58)**	70	(1)	(0.95)
Wholesale funding	**6,932**	**(104)**	**(1.51)**	5,140	(95)	(1.85)
Other interest-earning liabilities	**–**	**–**	**–**	303	(11)	(3.54)
Total average interest-bearing liabilities	**30,994**	**(231)**	**(0.75)**	29,645	(295)	(1.00)
Total average non-interest-bearing liabilities	**5,926**			5,905		
Total average liabilities	**36,920**			35,550		
Total average equity attributable to ordinary equity holders	**3,266**			3,466		
Total average liabilities and average equity attributable to ordinary equity holders	**40,186**			39,016		
Net interest income		**844**			806	

(1) Includes loans designated at fair value through profit or loss.

Financial performance review

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%). As average interest-bearing assets saw a similar increase, Group NIM similarly increased by 1bps to 2.27% (2016: 2.26%).

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 trading costs.

Non-interest income

Non-interest income reduced by £11m (6.0%), largely driven by a reduction in fees and commission income, principally in relation to insurance revenues from off-sale products which have continued to unwind, lower account fees on the Signature current account and lower home insurance profit share due to a higher level of claims,

Impairment losses on credit exposures

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, but remains low reflecting the continuing benign credit environment.

	2017				2016			
	Retail – secured	**Retail – unsecured**	**SME**	**Total**	Retail – secured	Retail – unsecured	SME	Total
Gross cost of risk	2	266	70	28	4	210	76	29
Specific provision releases and recoveries				(12)				(16)
Fair value loans				(2)				(4)
Net cost of risk (bps)				**14**				9

2. Delivering on our efficiency programme

Operating and administrative expenses	**2017 £m**	2016 £m
Personnel expenses	**248**	280
Depreciation and amortisation expenses	**87**	88
Other operating and administrative expenses	**340**	361
Total underlying operating and administrative expenses	**675**	729
Restructuring expense	**67**	45
Gain on defined benefit pension scheme reforms	**(88)**	–
Separation costs	**8**	11
Conduct charges	**58**	51
Impairment of intangible assets	**–**	45
Total statutory operating and administrative expenses	**720**	881

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 £54m (7%) from £729m to £675m, exceeding our FY2017 cost guidance of £690m–£700m. As a result, and combined with the increase in net interest income, our underlying cost to income ratio improved from 74% to 67% for the full year (61% for the second half).

During the year we implemented a new reward programme for colleagues across the business, including a revised pensions 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 employees, with affected employees' 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.

Financial performance review

On an underlying basis, personnel expenses reduced by £32m in line with headcount, which reduced from 6,718 to 6,040[1]. Other operating and administrative expenses fell by £21m due to the impact of branch closures and tighter cost control across the board.

While 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 Service Agreements by December 2018.

3. Capital optimisation

	Capital change bps	**CET1**
At 30 September 2016		**12.6%**
Generated	168	
Asset growth	(42)	
Investment spend	(93)	
AT1	(20)	
Core business – net capital generated	13	
Restructuring costs	(31)	
Separation costs	(3)	
IAS 19 pension movement	21	
Conduct costs	(27)	
Other	7	
Total net capital absorbed	(20)	
At 30 September 2017		**12.4%**

The Group continued to maintain its strong capital position throughout the year, delivering a fully loaded total capital ratio of 17.9% and CET1 ratio of 12.4% at September 2017.

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 spend, 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 20bps lower at 12.4%.

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 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. In aggregate, only 9.7% of the charge, or £58m, impacts the income statement as a result of the Capped Indemnity, and has absorbed 27bps of capital in the year.

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 employees, 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.

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

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

Financial performance review

The Group is working towards implementation of the requirement to meet the minimum requirements for own funds and eligible liabilities (MREL) on 1 January 2022, and issued £300m of senior bail-in 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.

Reconciliation of statutory to underlying results

The underlying results presented within this CFO report reflect the Group's results prepared on an underlying basis and as presented to the CEO and his Leadership Team and the Board. These exclude certain items that are included in the statutory results, as management believes that these items are not reflective of the underlying business and do not aid meaningful year-on-year comparison. The table below reconciles the statutory results to the underlying basis, and full details on the adjusted items are included on page 16:

2017 income statement	**Statutory results £m**	**Legacy conduct costs £m**	**Business restructuring £m**	**Pension scheme reforms £m**	**AFS investment disposal £m**	**Underlying basis £m**
Net interest income	**844**	**–**	**–**	**–**	**–**	**844**
Non-interest income	**192**	**–**	**–**	**–**	**(20)**	**172**
Total operating income	**1,036**	**–**	**–**	**–**	**(20)**	**1,016**
Total operating and administrative expenses before impairment losses	**(720)**	**58**	**75**	**(88)**	**–**	**(675)**
Operating profit before impairment losses	**316**	**58**	**75**	**(88)**	**(20)**	**341**
Impairment losses on credit exposures[1]	**(48)**	**–**	**–**	**–**	**–**	**(48)**
Profit on ordinary activities before tax	**268**	**58**	**75**	**(88)**	**(20)**	**293**
Tax expense	**(86)**	**(5)**	**(11)**	**31**	**(2)**	**(73)**
Profit attributable to equity holders	**182**	**53**	**64**	**(57)**	**(22)**	**220**
Financial performance measures						
Cost to income ratio	**69%**	**(5)%**	**(7)%**	**8%**	**2%**	**67%**
Return on tangible equity	**6.1%**	**2.1%**	**2.3%**	**(2.1)%**	**(0.9)%**	**7.5%**
Basic EPS	**17.3p**	**5.9p**	**7.3p**	**(6.5)p**	**(2.5)p**	**21.5p**

(1) Impairment losses on credit exposures relate solely to loans and advances to customers (refer to note 3.6 to the financial statements) and exclude the credit risk adjustments on loans at fair value through profit or loss which are incorporated in the movement in other assets and liabilities at fair value within non-interest income (refer to note 2.3 to the financial statements).

Underlying profit after tax attributable to ordinary equity holders is equal to the underlying profit attributable to equity holders less dividends and distributions (net of tax relief) of £29m (2016: £34m) and amounted to £191m (2016: £143m).

Financial performance review

2016 income statement

	Statutory results £m	Legacy conduct costs £m	Business restructuring £m	Intangibles impairment £m	AFS investment disposal £m	Deferred tax asset write-off £m	Underlying basis £m
Net interest income	806	–	–	–	–	–	806
Non-interest income	191	–	(1)	–	(7)	–	183
Total operating income	997	–	(1)	–	(7)	–	989
Total operating and administrative expenses before impairment losses	(881)	51	56	45	–	–	(729)
Operating profit before impairment losses	116	51	55	45	(7)	–	260
Impairment losses on credit exposures[1]	(39)	–	–	–	–	–	(39)
Profit on ordinary activities before tax	77	51	55	45	(7)	–	221
Tax expense	(241)	(5)	(10)	(9)	1	220	(44)
(Loss)/profit attributable to equity holders	(164)	46	45	36	(6)	220	177
Financial performance measures							
Cost to income ratio	88%	(5)%	(5)%	(5)%	1%	–	74%
Return on tangible equity	(7.2)%	1.7%	1.6%	1.3%	(0.2)%	8.0%	5.2%
Basic EPS	(22.5)p	5.2p	5.2p	4.1p	(0.7)p	24.9p	16.2p

(1) Impairment losses on credit exposures relate solely to loans and advances to customers (refer to note 3.6 to the financial statements) and exclude the credit risk adjustments on loans at fair value through profit or loss which are incorporated in the movement in other assets and liabilities at fair value within non-interest income (refer to note 2.3 to the financial statements).

Measuring financial performance

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	FY2017 £m	FY2016 £m	Description	Reason for exclusion from the Group's current underlying performance
Conduct charges	(58)	(51)	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.
Restructure expense	(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.
Net gains 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.
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 assets where post demerger, the Group had greater flexibility in its digital direction.
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.
Gain on DB pension scheme reforms	88	–	A one-off gain on the closure of the defined benefit pension scheme 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.

Responsibility Statement of the Directors in respect of the Annual Report and Accounts

The responsibility statement below has been prepared in connection with the Company's full Annual Report and Accounts for the year ending 30 September 2017. Certain parts thereof are not included within this announcement.

We confirm to the best of our knowledge:

- the financial statements, prepared in accordance with the applicable set of accounting standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and the undertakings included in the consolidation taken as a whole; and
- the business and financial review includes a fair review of the development and performance of the business and the position of the Company and the Group, together with a description of the principal risks and uncertainties that they face.

The Directors consider the Annual Report and Accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's position and performance, business model and strategy.

This responsibility statement was approved by the board of directors on 20 November 2017 and is signed on its behalf by:

David Duffy
Chief Executive Officer

20 November 2017

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		**(231)**	(295)
Net interest income	2.2	**844**	806
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		**1,036**	997
Personnel expenses		**(166)**	(280)
Restructuring expenses		**(67)**	(45)
Depreciation and amortisation expense		**(87)**	(88)
Other operating and administrative expenses		**(400)**	(468)
Total operating and administrative expenses before impairment losses	2.4	**(720)**	(881)
Operating profit before impairment losses		**316**	116
Impairment losses on credit exposures	3.6	**(48)**	(39)
Profit on ordinary activities before tax		**268**	77
Tax expense	2.5	**(86)**	(241)
Profit/(loss) for the year		**182**	(164)
Profit/(loss) attributable to ordinary shareholders		**146**	(206)
Profit attributable to other equity holders		**36**	42
Profit/(loss) for the year attributable to equity holders		**182**	(164)
Basic earnings/(loss) per share (pence)	2.6	**17.3**	(22.5)
Diluted earnings/(loss) per share (pence)	2.6	**17.2**	(22.5)

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

The notes on pages 23 to 72 form an integral part of these financial statements.

Consolidated statement of comprehensive income

for the year ended 30 September	Note	**2017 £m**	2016 £m
Profit/(loss) for the year		**182**	(164)
Items that may be reclassified to the income statement			
Change in cash flow hedge reserve			
(Losses)/gains during the year		**(84)**	105
Transfers to the income statement		**(4)**	(1)
Taxation thereon		**21**	(25)
		(67)	79
Change in available for sale reserve			
(Losses)/gains during the year		**(7)**	29
Transfers to the income statement		**(20)**	(8)
Taxation thereon		**7**	(6)
		(20)	15
Total items that may be reclassified to the income statement		**(87)**	94
Items that will not be reclassified to the income statement			
Remeasurement of defined benefit pension plans	3.16	**154**	(179)
Taxation thereon		**(35)**	43
Total items that will not be reclassified to the income statement		**119**	(136)
Other comprehensive income/(losses), net of tax		**32**	(42)
Total comprehensive income/(losses) for the year, net of tax		**214**	(206)
Total comprehensive income/(losses) attributable to ordinary shareholders		**178**	(248)
Total comprehensive income attributable to other equity holders		**36**	42
Total comprehensive income/(losses) attributable to equity holders		**214**	(206)

The notes on pages 23 to 72 form an integral part of these financial statements.

Consolidated balance sheet

as at 30 September	Note	2017 £m	2016 £m
Assets			
Cash and balances with central banks	3.1	**6,937**	5,955
Due from other banks		**1,174**	952
Financial assets available for sale	3.2	**2,076**	1,731
Other financial assets at fair value	3.3	**477**	750
Derivative financial instruments	3.4	**282**	585
Loans and advances to customers	3.5	**31,293**	29,202
Due from customers on acceptances		**4**	4
Current tax assets		**–**	2
Property, plant and equipment	3.8	**86**	99
Investment properties	3.9	**14**	22
Intangible assets	3.10	**339**	256
Deferred tax assets	3.11	**154**	183
Defined benefit pension assets	3.16	**207**	–
Other assets		**188**	188
Total assets		**43,231**	39,929
Liabilities			
Due to other banks	3.12	**3,817**	1,309
Other financial liabilities at fair value	3.3	**26**	48
Derivative financial instruments	3.4	**376**	598
Due to customers	3.13	**27,718**	27,090
Liabilities on acceptances		**4**	4
Provisions for liabilities and charges	3.14	**554**	852
Debt securities in issue	3.15	**4,785**	4,501
Retirement benefit obligations	3.16	**3**	79
Deferred tax liabilities	3.11	**75**	27
Other liabilities	3.17	**2,471**	2,210
Total liabilities		**39,829**	36,718
Equity			
Share capital	4.1	**88**	88
Other equity instruments	4.1	**450**	450
Capital reorganisation reserve	4.1	**(839)**	(839)
Merger reserve	4.1	**633**	633
Other reserves	4.1	**15**	100
Retained earnings		**3,055**	2,779
Total equity		**3,402**	3,211
Total liabilities and equity		**43,231**	39,929

The notes on pages 23 to 72 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

CYBG PLC, Registered number: 09595911

Consolidated statement of changes in equity

	Note	Share capital £m	Share premium account £m	Capital reorganisation reserve £m	Merger reserve £m	Other equity instruments £m	Other reserves				Retained earnings £m	Total equity £m
							Equity based compensation reserve £m	Asset revaluation reserve £m	Available for sale reserve £m	Cash flow hedge reserve £m		
As at 1 October 2015		223	670	–	–	450	3	2	12	(13)	2,096	3,443
Loss for the year		–	–	–	–	–	–	–	–	–	(164)	(164)
Other comprehensive income/(losses), net of tax		–	–	–	–	–	–	–	15	79	(136)	(42)
Total comprehensive income/(losses) for the year		–	–	–	–	–	–	–	15	79	(300)	(206)
AT1 distribution paid (net of tax)		–	–	–	–	–	–	–	–	–	(28)	(28)
Insertion of new parent company		(223)	(670)	893	–	–	–	–	–	–	–	–
Share for share exchange		1,099	–	(1,732)	633	–	–	–	–	–	–	–
Share capital reduction		(1,011)	–	–	–	–	–	–	–	–	1,011	–
Capital note repurchase (net of tax)		–	–	–	–	(450)	–	–	–	–	(5)	(455)
Capital note issued		–	–	–	–	450	–	–	–	–	–	450
Transfer from equity based compensation reserve		–	–	–	–	–	(4)	–	–	–	4	–
Transfer from asset revaluation reserve		–	–	–	–	–	–	(1)	–	–	1	–
Equity based compensation expensed		–	–	–	–	–	5	–	–	–	–	5
Equity based compensation settled		–	–	–	–	–	2	–	–	–	–	2
As at 30 September 2016	4.1	**88**	**–**	**(839)**	**633**	**450**	**6**	**1**	**27**	**66**	**2,779**	**3,211**
Profit for the year		**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**182**	**182**
Other comprehensive (losses)/income, net of tax		**–**	**–**	**–**	**–**	**–**	**–**	**–**	**(20)**	**(67)**	**119**	**32**
Total comprehensive (losses)/income for the year		**–**	**–**	**–**	**–**	**–**	**–**	**–**	**(20)**	**(67)**	**301**	**214**
AT1 distribution paid (net of tax)		**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**(29)**	**(29)**
Transfer from equity based compensation reserve		**–**	**–**	**–**	**–**	**–**	**(4)**	**–**	**–**	**–**	**4**	**–**
Equity based compensation expensed		**–**	**–**	**–**	**–**	**–**	**6**	**–**	**–**	**–**	**–**	**6**
As at 30 September 2017	4.1	**88**	**–**	**(839)**	**633**	**450**	**8**	**1**	**7**	**(1)**	**3,055**	**3,402**

The notes on pages 23 to 72 form an integral part of these financial statements.

Consolidated statement of cash flows

for the year ended 30 September	Note	**2017 £m**	2016 £m
Operating activities			
Profit on ordinary activities before tax		**268**	77
Adjustments for:			
Non-cash or non-operating items included in profit before tax	5.2	**(728)**	(643)
Changes in operating assets	5.2	**(1,857)**	(2,285)
Changes in operating liabilities	5.2	**919**	1,587
Interest received		**1,123**	1,101
Interest paid		**(258)**	(200)
Tax received/(paid) – Group relief		**1**	4
Net cash used in operating activities		**(532)**	(359)
Cash flows from investing activities			
Interest received		**11**	11
Proceeds from sale or maturity of investments		**20**	101
Proceeds from sale of tangible fixed assets [1]		**19**	17
Purchase of tangible fixed assets [1]		**(21)**	(22)
Purchases of investments		**(492)**	(357)
Proceeds from sale of available for sale investments		**60**	56
Purchase and development of intangible assets		**(148)**	(99)
Net cash used in investing activities		**(551)**	(293)
Cash flows from financing activities			
Interest received		**3**	1
Interest paid		**(90)**	(98)
Proceeds from other equity instruments issued		**–**	450
Repurchase of other equity instruments		**–**	(457)
Repurchase of subordinated debt		**–**	(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
Issuance of medium-term notes/subordinated debt	3.15	**298**	475
Amounts drawn under the TFS		**1,900**	–
Net decrease in amounts due from related entities		**–**	786
Net decrease in amounts due to related entities		**–**	(106)
Equity based compensation		**–**	2
AT1 distributions		**(36)**	(35)
Net cash provided by financing activities		**2,085**	265
Net increase/(decrease) in cash and cash equivalents		**1,002**	(387)
Cash and cash equivalents at the beginning of the year		**5,950**	6,337
Cash and cash equivalents at the end of the year [2]	5.2	**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 23 to 72 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 Company is a public company limited by shares, incorporated in the United Kingdom under the Companies Act and registered in England and Wales.

The consolidated financial statements comprise those of the Company and its controlled entities, together the 'Group'.

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.

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 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 contained within the Group's Annual Report and Accounts. In addition, the Risk report included within the Group's Annual Report and Accounts 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 Company 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.

1.4 Basis of consolidation

Controlled entities are all entities (including structured entities) to which the Company 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.

Section 1: Basis of preparation continued

1.5 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.

1.6 Financial assets and liabilities

Recognition and derecognition

A financial asset or a financial liability is recognised on the balance sheet when the Group 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 Group 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 Group 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.

1.7 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 Group has internal control systems in place to ensure that estimates can be reliably measured, actual amounts may differ from those estimates. The Group 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).

Section 1: Basis of preparation continued

1.8 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;
- '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.

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

Section 1: Basis of preparation continued

1.8 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'

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, that will be 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.

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

Section 1: Basis of preparation continued

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.

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.

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

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.

Section 2: Results for the year 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**	**(51)**	**–**	**844**
Non-interest income	**83**	**100**	**(11)**	**20**	**192**
Operating income	**334**	**744**	**(62)**	**20**	**1,036**
Operating and administrative expenses	**(61)**	**(97)**	**(517)**	**(45)**	**(720)**
Impairment losses on credit exposures[2]	**(33)**	**(15)**	**–**	**–**	**(48)**
Segment operating profit/(loss) before tax	**240**	**632**	**(579)**	**(25)**	**268**
Average interest earning assets	**10,154[3]**	**20,577**	**6,966**	**–**	**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	(63)	–	806
Non-interest income	87	100	(4)	8	191
Operating income	329	727	(67)	8	997
Operating and administrative expenses	(70)	(119)	(540)	(152)	(881)
Impairment losses on credit exposures[2]	(30)	(9)	–	–	(39)
Segment operating profit/(loss) before tax	229	599	(607)	(144)	77
Average interest earning assets	10,404[3]	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 include £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.

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	**90**	87
Due to related entities	**–**	11
Total interest expense and similar charges	**231**	295
Net interest income	**844**	806

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.

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 £m	2016 £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	**400**	468
Total operating and administrative expenses	**720**	881

Personnel expenses comprise the following items:

	2017 £m	2016 £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 Number	2016 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 £m	2016 £m
Operating lease charges	**29**	30
Impairment losses on software (note 3.10)	**–**	45
PPI redress expense (note 3.14)	**48**	44
Other conduct expenses (note 3.14)	**10**	7
Separation costs	**8**	11
Auditor's remuneration	**2**	2

Section 2: Results for the year continued

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

	2017 £'000	2016 £'000
Fees payable to the Company's auditor for the audit of the Company's financial statements	**20**	20
Fees payable to the Company's auditor for the audit of the Company's subsidiaries	**1,251**	1,387
Total audit fees	**1,271**	1,407
Audit related assurance services	**124**	180
Other assurance services	**308**	35
Total non-audit fees	**432**	215
Fees payable to the Company's auditor in respect of associated pension schemes	**63**	75
Total fees payable to the Company's auditor	**1,766**	1,697

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 £48k (2016: £58k) were borne by the Group, principally related to reimbursement of travel expenses incurred by staff when performing the above services.

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	**17**	12
Adjustment in respect of prior years	**–**	(3)
	17	9
Deferred tax (note 3.11)		
Current year	**64**	236
Adjustment in respect of prior years	**5**	(4)
	69	232
Tax expense for the year	**86**	241

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 expense implied by the standard rate to the actual tax expense is as follows:

	2017 £m	2016 £m
Profit on ordinary activities before tax	**268**	77
Tax expense based on the standard rate of corporation tax in the UK of 19.5% (2016: 20%)	**52**	15
Effects of:		
Disallowable expenses	**9**	8
Conduct indemnity adjustment	**7**	(1)
Deferred tax assets (recognised)/written off	**(21)**	237
Impact of rate changes	**34**	(11)
Adjustments in respect of prior years	**5**	(7)
Tax expense for the year	**86**	241

Section 2: Results for the year continued

2.5 Taxation continued

The total amount of tax, current and deferred, recognised directly in equity during the year was a credit of £1m (2016: £21m).

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

The Conduct indemnity adjustment represents the receipt from/payment to the Group's former parent less refunds attributable in accordance with the indemnity agreement (note 3.14).

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.

2.6 Earnings per share (EPS)

Accounting policy

Basic earnings per share

Basic earnings per share is calculated by taking the profit attributable to ordinary shareholders of the parent company and dividing this by the weighted-average number of ordinary shares outstanding during the period.

Diluted earnings per share

This requires the weighted average number of ordinary shares in issue to be adjusted to assume conversion of all dilutive potential ordinary shares. These arise from awards made under equity based compensation schemes. Share awards with performance conditions attaching to them are not considered to be dilutive unless these conditions have been met at the reporting date.

The Group presents basic and diluted earnings/(loss) per share data in relation to the ordinary shares of CYBG PLC.

	2017 £m	2016 £m
Profit/(loss) attributable to ordinary shareholders	**146**	(206)
Tax relief on AT1 distribution attributable to ordinary equity holders	**7**	7
Tax relief on loss on repurchase of CYB Investments Limited (CYBI) AT1 issued to NAB	**–**	1
Profit/(loss) attributable to ordinary equity holders for the purposes of basic and diluted EPS	**153**	(198)

	2017 Number of shares (million)	2016 Number of shares (million)
Weighted-average number of ordinary shares in issue		
– Basic	**883**	880
– Diluted	**884**	880
Basic earnings/(loss) per share (pence)	**17.3**	(22.5)
Diluted earnings/(loss) per share (pence)[1]	**17.2**	(22.5)

(1) The comparative has been restated so that the dilutive effect of the potentially dilutive share based payment awards has been excluded from the calculation on the basis that it would have reduced the loss per share.

Section 3: Assets and liabilities

3.1 Cash and balances with central banks

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

	2017 £m	2016 £m
Listed securities	**2,066**	1,695
Unlisted securities	**4**	29
Other financial assets	**6**	7
	2,076	1,731

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

	2017 £m	2016 £m
Available for sale		
Senior investment grade	**2,066**	1,695
Other	**10**	36
	2,076	1,731

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.

Section 3: Assets and liabilities continued

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.

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

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).

Section 3: Assets and liabilities continued

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).

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.

	2017 £m	2016 £m
Fair value of derivative financial assets		
Designated as hedging instruments	**202**	351
Designated as held for trading	**80**	234
	282	585
Fair value of derivative financial liabilities		
Designated as hedging instruments	**229**	257
Designated as held for trading	**147**	341
	376	598

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 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.

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**

Section 3: Assets and liabilities continued

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
Cross currency 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

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:

Nominal values per time period	**2017 £m**	2016 £m
Within 0 to 3 months	**92**	1,452
Between 3 and 12 months	**2,986**	6,710
1 to 5 years	**14,817**	8,063
Greater than 5 years	**590**	66
	18,485	16,291

Section 3: Assets and liabilities continued

3.4 Derivative financial instruments continued

The Group has 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:

	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

	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)

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.

	2017 £m	2016 £m
Overdrafts	**1,524**	1,536
Credit cards	**396**	400
Lease finance	**594**	515
Mortgages	**23,480**	21,836
Other term lending – SME	**4,762**	4,393
Other term lending – Retail	**709**	690
Trade finance	**23**	26
Gross loans and advances to customers	**31,488**	29,396
Accrued interest receivable	**75**	76
Unearned income	**(28)**	(26)
Deferred and unamortised fee income	**(32)**	(29)
Impairment provisions on credit exposures (note 3.6)	**(210)**	(215)
	31,293	29,202

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

The Group also has 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).

Lease finance
The Group leases 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 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 and hire purchase contracts were £17m (2016: £8m) and £550m (2016: £482m) respectively.

Finance lease and hire purchase receivables

	2017 £m	2016 £m
Gross investment in finance lease and hire purchase receivables		
Due within 1 year	**241**	224
Due within 1 to 5 years	**346**	288
Due after more than 5 years	**7**	3
	594	515
Unearned income	**(27)**	(25)
Net investment in finance lease and hire purchase receivables	**567**	490

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 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').

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.

Section 3: Assets and liabilities continued

3.6 Impairment provisions on credit exposures continued

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.

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.

Section 3: Assets and liabilities continued

3.6 Impairment provisions on credit exposures continued

	2017 £m	2016 £m
Opening balance	**215**	230
Charge for the year	**48**	39
Amounts written off	**(75)**	(68)
Recoveries of amounts written off in previous years	**18**	18
Other[1]	**4**	(4)
Closing balance	**210**	215
Specific	**56**	64
Collective	**154**	151
	210	215

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

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 1.4 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 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 continues servicing these mortgage loans in return for an administration fee.

The mortgage loans do not qualify for derecognition because the Group remains 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 balance sheet. 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, 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'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. Similar to the securitisation programmes, the Group is entitled to any residual income after all payment obligations due under the terms of the covered bonds and senior programme expenses have been met. The Group continues servicing these mortgage loans in return for an administration fee.

The mortgage loans do not qualify for derecognition because the Group retains all of the risks and rewards of the mortgage loan portfolio. The covered bond partnership is consolidated with the mortgage loans retained on the consolidated balance sheet and the covered bonds issued included within debt securities in issue. The covered bond holders have dual recourse: firstly, to Clydesdale Bank PLC 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.

Section 3: Assets and liabilities continued

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

2017

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

2016

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

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

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 £m	2016 £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 transferred financial assets being derecognised.

The Group has contractual and non-contractual arrangements which may require it to provide financial support as follows:

Securitisation programmes
The Group 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 Group has a beneficial interest in the securitised mortgage portfolio held by the structured entities of £711m (2016: £977m).

Furthermore, the Group 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 Group, 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 Group to provide over-collateralisation may increase due to the formal requirements of the programme.

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

Section 3: Assets and liabilities continued

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.

	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

Section 3: Assets and liabilities continued

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:

	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

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.

	2017 £m	2016 £m
At 1 October	**22**	32
Disposals	**(7)**	(10)
Revaluation	**(1)**	–
At 30 September	**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).

Notes to the consolidated financial statements

Section 3: Assets and liabilities continued

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.

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.

Section 3: Assets and liabilities continued

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 £154m (2016: £183m); the reduction from the previous balance sheet date is due to the movement in the defined benefit pension scheme to a surplus and the utilisation of the capital allowance deferred tax asset. 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

	2017 £m	2016 £m
At 1 October	**156**	379
Recognised in the income statement (note 2.5)	**(69)**	(232)
Recognised directly in equity	**(8)**	9
At 30 September	**79**	156

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

	2017 £m	2016 £m
Deferred tax assets		
Tax losses carried forward	**28**	35
Capital allowances	**120**	127
Cash flow hedge reserve	**1**	1
Transitional adjustment – available for sale reserve	**3**	–
Employee equity based compensation	**2**	2
Defined benefit pension scheme deficit	**–**	18
	154	183
Deferred tax liabilities		
Defined benefit pension scheme surplus	**(72)**	–
Cash flow hedge reserve	**–**	(21)
Gains on unlisted available for sale investments	**(3)**	(6)
	(75)	(27)
Net deferred tax asset	**79**	156

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.

Section 3: Assets and liabilities continued

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.

	2017 £m	2016 £m
Securities sold under agreements to repurchase	**1,864**	1,226
Transaction balances with other banks	**21**	23
Deposits from other banks	**31**	60
Secured loans	**1,901**	–
	3,817	1,309

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.

3.13 Due to customers

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

Section 3: Assets and liabilities continued

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.

	2017 £m	2016 £m
PPI redress provision		
Opening balance	**725**	774
Charge to the income statement (note 2.4)	**48**	44
Charge reimbursed/reimbursable under Conduct Indemnity	**446**	406
Utilised	**(797)**	(499)
Closing balance	**422**	725
Customer redress and other provisions		
Opening balance	**101**	214
Charge to the income statement (note 2.4)	**10**	8
Charge reimbursed/reimbursable under Conduct Indemnity	**88**	27
Utilised	**(90)**	(148)
Closing balance	**109**	101
Restructuring provision[(1)]		
Opening balance	**26**	18
Charge to the income statement	**58**	39
Utilised	**(61)**	(31)
Closing balance	**23**	26
Total provisions for liabilities and charges	**554**	852

(1) Restructuring provision includes surplus lease space provision.

Section 3: Assets and liabilities continued

3.14 Provision for liabilities and charges continued

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 PS17/3 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. Only 9.7% of the charge impacts the Group's income statement (£48m) as a result of the Capped Indemnity. 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 complaints (2016: 282,000) 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.

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.

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.

Section 3: Assets and liabilities continued

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, but only 9.7% of the charge impacts the Group's income statement (£10m) as a result of the Capped Indemnity. 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 Group's economic exposure to the impact of historic conduct related liabilities is mitigated by a Capped Indemnity from NAB. The Company and NAB have an agreement under which NAB has provided the Company 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 the Company, up to the amount of the Capped Indemnity.

Claims under the Capped Indemnity are recognised in the consolidated income statement simultaneously with the charge for Relevant Conduct Matters. The conduct expense and associated reimbursement income are presented net within Other operating and administrative expenses. A reimbursement receivable is recognised on the consolidated balance sheet within Due from other banks; this receivable is periodically settled by NAB. The reimbursement receivable is not offset against the provision amount on the Group's consolidated balance sheet. The provision expense and reimbursement income are disclosed above.

No reimbursement income or receivable is recognised on the consolidated balance sheet in relation to contingent liabilities for Relevant Conduct Matters. Any possible future reimbursement income linked to contingent liabilities in respect of Relevant Conduct Matters is not disclosed as a contingent asset as the amounts cannot be reliably estimated and are not virtually certain to be received.

To the extent that it is no longer probable that provisions for a Relevant Conduct Matter previously raised will be required to settle conduct obligations and a provision for a Relevant Conduct Matter is released as unutilised, the related Capped Indemnity amounts received will become repayable to NAB.

Should the Qualifying Conduct costs exceed the Capped Indemnity, any excess cost will be borne by the Group.

To the extent that tax relief is expected in relation to provisions for which reimbursement income is applicable, amounts may become repayable to NAB. In the consolidated financial statements, deferred tax assets are only recognised in respect of the loss share proportion (9.7%) of unused tax losses on Relevant Conduct Matters, on the basis that the Group does not obtain the economic benefit of the future tax relief which is repayable to NAB.

Section 3: Assets and liabilities continued

3.14 Provision for liabilities and charges continued

The utilisation and undrawn balance of the Capped Indemnity 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 period 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 on 24 September 2015 related to the Conduct Indemnity Deed.
(2) £465m of the £898m represents the pre-covered provision amount.

Duration and termination

The indemnity protection provided by NAB to the Company in respect of Relevant Conduct Matters under the Capped Indemnity is perpetual in nature, except in the following circumstances:

(a) it is fully utilised by the Group; or

(b) in the event that, at any time:

(i) the PRA determines that NAB's remaining exposure under the Capped Indemnity; or

(ii) the Unutilised Indemnity Amount,

is £100m or less, NAB will have the right (with the approval of the PRA (at its sole discretion)) to terminate the Capped Indemnity by subscribing for shares (at a price equivalent to the prevailing five-day average market price for the shares) in an amount equal to the Unutilised Indemnity Amount, provided that the maximum value of the shares to be subscribed for does not exceed a value equal to 9.9% of the issued share capital of the Group (on an undiluted basis) at such time (a '£100m Termination').

(c) NAB and the Group may also agree arrangements to terminate or replace the Capped Indemnity with the consent of the PRA. In particular, NAB and the Group have agreed that they will, on the fifth anniversary of the demerger (and, if relevant, each subsequent anniversary of the demerger), seek to agree arrangements to terminate the Capped Indemnity. If any such arrangements are agreed between NAB and the Group, they will be required to obtain the approval of the PRA (at its sole discretion) before commencing the implementation of such arrangements. In relation to proposals made by NAB to the Group in connection with such termination of the Capped Indemnity, the Group cannot unreasonably withhold its agreement to the Capped Indemnity being replaced by a payment equal to the Unutilised Indemnity Amount to be applied (in whole or in part) in subscribing for shares (at a price equivalent to the prevailing five-day average market price for the shares), provided that the maximum value of the shares to be subscribed for pursuant to such proposal would not exceed £200m or if lower, a value equal to 9.9% of the issued share capital of the Group (on an undiluted basis) at such time (a 'Post-5 Year Equity Subscription Termination').

If £100m Termination or Post-5 Year Equity Subscription Termination occurs, the Group will not be entitled to make any further claims under the Capped Indemnity, but will be entitled to retain in a designated account for a period of three years following such termination, any Unutilised Covered Amount and any amount to be withdrawn from the designated account in respect of conduct costs that fall within the scope of the Capped Indemnity which have been incurred and paid by the Group prior to such termination. The Company will be required to return to NAB any other amounts in a designated account and to release to NAB all amounts remaining in the collateral account. Following the expiry of such three-year period, the Group will be required to repay all remaining amounts in a designated account net of any amount to be withdrawn from a designated account in respect of conduct costs that fall within the scope of the Capped Indemnity which have been incurred and paid by Group prior to such anniversary.

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.

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:

	Medium-term notes	Subordinated debt	Securitisation	Covered bonds	**2017 Total £m**	2016 Total £m
Amortised cost	**297**	**476**	**3,242**	**698**	**4,713**	4,383
Fair value hedge adjustments	**–**	**–**	**–**	**50**	**50**	99
Total debt securities	**297**	**476**	**3,242**	**748**	**4,763**	4,482
Accrued interest payable	**3**	**3**	**6**	**10**	**22**	19
	300	**479**	**3,248**	**758**	**4,785**	4,501

There were no new issuances of covered bonds during the year. The following new issuances 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.

On 22 June 2017, the Group issued a £300m 8-year, callable, 3.125% fixed to floating medium term note with a final maturity of 22 June 2025.

Medium-term notes	**2017 £m**	2016 £m
8-year, 3.125% fixed to floating rate callable senior notes due 2025	**297**	–
Accrued interest payable	**3**	–
Total medium-term notes	**300**	–

Subordinated debt	**2017 £m**	2016 £m
10-year, non-call five years, with a final maturity of 9 February 2026 – fixed 5%	**476**	477
Accrued interest payable	**3**	3
Total subordinated debt	**479**	480

Section 3: Assets and liabilities continued

3.15 Debt securities in issue continued

Details of the terms and conditions of the notes issued under the securitisation and covered bond programmes as at 30 September 2017 were 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**	3M GBP LIBOR + 2.20%	19 November 2017
		3,242		
Covered bonds				
31 May 2012	GBP	**748**	4.63%	8 June 2026
Total securitised notes and covered bonds (note 3.7)		**3,990**		

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 Group's principal trading subsidiary, Clydesdale Bank PLC, 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.

Notes to the consolidated financial statements

Section 3: Assets and liabilities continued

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:

	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.

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, Clydesdale Bank PLC 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.

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)

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

Section 3: Assets and liabilities continued

3.16 Retirement benefit obligations continued

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 Scheme assets	**102**	90
Transfer payments	**150**	19
Curtailments and settlements	**13**	–
Closing defined benefit pension scheme obligations	**(3,974)**	(4,537)

The major 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. Derivative 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 subject also 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.

Section 3: Assets and liabilities continued

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 (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.

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 assumption changes	**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 Post-retirement mortality:	2017 years	2016 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

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 Scheme 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).

3.17 Other liabilities

	2017 £m	2016 £m
Notes in circulation	**2,197**	1,912
Accruals and deferred income	**163**	152
Other	**111**	146
	2,471	2,210

Section 3: Assets and liabilities continued

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.

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.

Section 3: Assets and liabilities continued

3.18 Fair value of financial instruments continued

	30 September 2017					30 September 2016				
			Fair value measurement using:					Fair value measurement using:		
	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
Financial assets										
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	**4,785**	**4,910**	**795**	**4,115**	**–**	4,501	4,592	459	4,133	–

The Group'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 values 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) *Debt securities in issue* – The fair value is taken directly from quoted market prices where available or 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.

	Fair value measurement as at 30 September 2017				Fair value measurement as 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 at fair value	**–**	**376**	**26**	**402**	–	598	48	646

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

The Group'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.

Section 3: Assets and liabilities continued

(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.

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 movement analysis:

	2017		
	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 movement analysis:

	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	–	–
Purchases	2	–	–
Sales	(8)	–	–
Settlements[3]	(2)	(357)	17
Balance at the end of the year	36	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).

Section 3: Assets and liabilities continued

3.18 Fair value of financial instruments continued

Quantitative 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.

	Fair value £m	Valuation technique	Unobservable inputs	Low range	High range
Financial assets					
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.

Section 4: Capital

4.1 Equity

Accounting policy

Equity

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 Company's shareholders. Interim dividends are deducted from equity when they are no longer at the discretion of the Company.

Proposed final dividends for the year are disclosed as an event after the balance sheet date.

4.1.1 Share capital

	2017 Number of shares	2016 Number of shares	**2017 £m**	2016 £m
Ordinary shares – allotted, called up and fully paid				
Opening ordinary share capital	**881,531,852**	2,232,012,512	**88**	223
Share for share exchange	**–**	(1,352,697,256)	**–**	876
Share capital reduction	**–**	–	**–**	(1,011)
Issued under employee share schemes	**2,074,214**	2,216,596	**–**	–
Closing ordinary share capital	**883,606,066**	881,531,852	**88**	88

During the year 2,074,214 (2016: 2,216,596) ordinary shares were issued under employee share schemes with a nominal value of £0.2m (2016: £0.2m).

The share for share exchange in the year to 30 September 2016 arose on the Group's demerger from NAB and listing on the London Stock Exchange.

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 Company. All shares in issue at 30 September 2017 rank equally with regard to the Company's residual assets.

The Directors have recommended a final dividend in respect of the year ended 30 September 2017 of 1p per ordinary share in the Company (2016: Nil) to be paid on 16 February 2018. The payment of the final dividend is subject to approval of the shareholders at the 2018 Annual General Meeting. These financial statements do not reflect the recommended dividend.

With regards to utilisation of the Conduct Indemnity, note 3.14 sets out a number of circumstances where share capital in the Company could be subscribed for by NAB.

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 consists of Perpetual Contingent Convertible Notes (fixed 8%) which were issued on 8 February 2016 with a principal amount of £450m and an optional redemption on 8 December 2022.

AT1 distributions of £36m were paid in the year, £29m net of tax (2016: £35m paid, £28m net of tax).

Section 4: Capital continued

4.1.3 Capital reorganisation reserve

The capital reorganisation reserve of £839m was recognised on the issuance of CYBG PLC ordinary shares in February 2016 in exchange for the acquisition of the entire share capital of the Group's previous parent company, CYBI Limited. The reserve reflects the difference between the consideration for the issuance of CYBG PLC shares and CYBI Limited's share capital and share premium.

4.1.4 Merger reserve

A merger reserve of £633m was recognised on the issuance of CYBG PLC ordinary shares in February 2016 in exchange for the acquisition of the entire share capital of CYBI Limited. The merger reserve reflects the difference between the consideration for the issuance of CYBG PLC shares and the nominal value of the shares issued.

4.1.5 Other reserves

4.1.5.1 Asset revaluation reserve

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

4.1.5.2 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 detailed in note 2.3.

4.1.5.3 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 loss of £1m (2016: £66m cumulative gain). The fair value of derivatives in cash flow hedges decreased by £84m in the year (2016: £105m increase), and a £4m gain (2016: £2m 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).

4.1.5.4 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.

4.2 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 the Company'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. Details of these plans are included within the Directors' remuneration report contained in the Group's Annual Report and Accounts.

Section 4: Capital continued

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 and 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.

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.

Share Incentive Plan (SIP)

Eligible employees 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.

Section 4: Capital continued

4.2 Equity based compensation continued

Awards/rights made during the year

Plan	Number outstanding at 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 the Company'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.

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.

Financial guarantees

	2017 £m	2016 £m
Guarantees and assets pledged as collateral security:		
Due in less than 3 months	**19**	19
Due between 3 months and 1 year	**40**	44
Due between 1 year and 3 years	**7**	9
Due between 3 years and 5 years	**3**	3
Due after 5 years	**42**	48
No specified maturity	**–**	–
	111	123
Other credit commitments		
Undrawn formal standby facilities, credit lines and other commitments to lend at call	**8,408**	7,690

Capital commitments

The Group 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

Section 5: Other notes

5.1 Contingent liabilities and commitments continued

Operating lease commitments

	2017 £m	2016 £m
Leases as lessor		
Future minimum lease payments under non-cancellable operating leases are:		
Within 1 year	**1**	2
Between 1 year and 5 years	**4**	4
Over 5 years	**–**	1
	5	7
Leases as lessee		
Future minimum lease payments under non-cancellable operating leases are:		
Within 1 year	**30**	29
Between 1 year and 5 years	**100**	94
Over 5 years	**137**	117
	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 financial exposure to the Group related to legacy conduct risks is mitigated by the Capped Indemnity provided by NAB (note 3.14). 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.

Section 5: Other notes

5.2 Notes to the statement of cash flows

	2017 £m	2016 £m
Adjustments included in profit before tax		
Interest receivable	**(1,075)**	(1,101)
Interest payable	**231**	295
Depreciation and amortisation (note 2.4)	**87**	88
Net gain on capital and debt restructure	**–**	(1)
Transfer from cash flow hedge reserve	**–**	1
Derivative financial instruments fair value movements	**(6)**	(10)
Impairment losses on credit exposures (note 3.6)	**48**	39
Impairment losses on software (note 2.4)	**–**	45
Fair value movement on investment properties	**1**	1
Equity based compensation	**6**	–
Gain on disposal of VocaLink	**(20)**	–
	(728)	(643)
Changes in operating assets		
Net (increase)/decrease in:		
Balances with supervisory central banks	**(1)**	1
Due from other banks	**(221)**	(826)
Derivative financial instruments	**280**	(63)
Financial assets at fair value through profit or loss	**237**	346
Loans and advances to customers	**(2,140)**	(1,758)
Other assets	**(12)**	15
	(1,857)	(2,285)
Changes in operating liabilities		
Net increase/(decrease) in:		
Due to other banks	**608**	960
Derivative financial instruments	**(221)**	60
Financial liabilities at fair value through profit or loss	**(21)**	(19)
Due to customers	**699**	672
Provisions for liabilities and charges	**(298)**	(154)
Defined benefit pension obligations	**(128)**	(52)
Other liabilities	**280**	120
	919	1,587

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 to other banks (to the extent less than 90 days).

	2017 £m	2016 £m
Cash and balances with central banks (note 3.1)	**6,893**	5,912
Other assets	**99**	111
Due to other banks	**(12)**	(25)
Other liabilities	**(28)**	(48)
	6,952	5,950

Section 5: Other notes

5.3 Related party transactions

Compensation of key management personnel (KMP)

KMP comprises Directors of the Company and members of the Executive Leadership Team.

	2017 £m	2016 £m
Salaries and 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.

The following information regarding Directors' remuneration is presented in accordance with the Companies Act 2006.

	2017 £m	2016 £m
Aggregate remuneration	5	6

In addition to the above, £0.2m (2016: £Nil) was expensed relating to long-term incentive plans. 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).

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 the KMP (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.

Other related party transactions

During the current year, the Group and 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.

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 Group (note 3.16).

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 the Group, 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/.

Supplementary risk management disclosures

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.

Distribution of loans and advances to customers by credit quality

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

(1) SME lending includes business overdrafts.

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.

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

Credit risk

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

(1) Includes balances due from customers on acceptances and excludes accrued interest.

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[1]	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

(1) eCRS – electronic Customer Rating System.

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:

	2017 £m	2016 £m
Senior investment grade	**946**	1,077
Investment grade	**1,807**	1,557
Sub-investment grade	**3,873**	3,533
	6,626	6,167

Credit risk

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 (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. 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. Prior period comparatives have been restated on the new basis of indexation, previous basis adopted the Halifax House Price Index.

Forbearance

The tables below summarise the level of forbearance in respect of the Group's mortgage portfolio at 30 September:

	Total Retail loans and advances subject to forbearance measures			Impairment allowance on Retail loans and advances subject to forbearance measures	
As at 30 September 2017	**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**

	Total Retail loans and advances subject to forbearance measures			Impairment allowance on Retail loans and advances subject to forbearance measures	
As at 30 September 2016	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).

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 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

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

	Total SME loans and advances subject to forbearance measures			Impairment allowance on SME loans and advances subject to forbearance measures	
As at 30 September 2017	**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**

	Total SME loans and advances subject to forbearance measures			Impairment allowance on SME loans and advances subject to forbearance measures	
As at 30 September 2016	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 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%).

Loans and advances which were past due but not impaired

The distribution of gross loans and advances that are past due but not impaired is analysed below:

2017	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**

2016	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

Movement in impairment provisions throughout the year

2017	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	**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**

2016	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	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.

Balance sheet and 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.

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 growth. Capital risk is the risk that the Group has insufficient quantity or quality of capital to support its operations.

Regulatory capital [1]

CET1 capital	2017 £m	2016 £m
Capital instruments	**88**	88
Retained earnings and other reserves	**2,854**	2,673
Regulatory adjustments and deductions		
Defined benefit pension fund assets[2]	**(135)**	–
Prudent valuation adjustment[3]	**(4)**	(7)
Intangible assets[4]	**(339)**	(256)
Deferred tax asset relying on future profitability[5]	**(28)**	(35)
Cash flow hedge reserve	**1**	(66)
	2,437	2,397
Tier 1 capital		
Additional Tier 1 (AT1) capital instruments	**450**	450
Total Tier 1 capital	**2,887**	2,847
Tier 2 capital		
Subordinated debt	**473**	474
Credit risk adjustments	**154**	151
Total Tier 2 capital	**627**	625
Total capital	**3,514**	3,472

(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	2017 £m	2016 £m
Statutory total equity	**3,402**	3,211
Deductions from capital	**(478)**	(263)
Deferred tax asset relying on future profitability	**(28)**	(35)
Cash flow hedge reserve	**1**	(66)
Foreseeable AT1 dividends and charges	**(10)**	–
Regulatory Tier 1 capital	**2,887**	2,847

Balance sheet and prudential regulation risks

Regulatory capital flow of funds	CRD IV 2017 £m	CRD IV 2016 £m
CET1 capital		
CET1 capital at 1 October	**2,397**	2,405
Share for share exchange and nominal reduction	**–**	(135)
Share premium	**–**	(670)
Retained earnings and other reserves (including structured entities)	**181**	576
Prudent valuation adjustment	**3**	(2)
Intangible assets	**(83)**	9
Deferred tax asset relying on future profitability	**7**	238
Defined benefit pension fund assets	**(135)**	42
Cash flow hedge reserve	**67**	(66)
CET1 capital at 30 September	**2,437**	2,397
Tier 1 capital		
Tier 1 capital at 1 October	**450**	450
Capital instruments repurchased: Perpetual Capital Notes	**–**	(450)
Capital instruments issued: Perpetual Subordinated Contingent Convertible Notes	**–**	450
Tier 1 capital at 30 September	**450**	450
Total Tier 1 capital	**2,887**	2,847
Tier 2 capital		
Tier 2 capital at 1 October	**625**	598
Credit risk adjustments	**3**	13
Other movements	**(1)**	–
Capital instruments repurchased: subordinated debt	**–**	(475)
Capital instruments issued: subordinated debt	**–**	474
Removal of minority interest deduction on subordinated debt	**–**	15
Tier 2 capital at 30 September	**627**	625
Total capital	**3,514**	3,472

Minimum Pillar 1 capital requirements	2017 £m	2016 £m
Credit risk	**1,420**	1,352
Operational risk	**130**	130
Counterparty risk	**11**	17
Credit valuation adjustment	**13**	23
Tier 1 regulatory capital requirements	**1,574**	1,522

Balance sheet and prudential regulation risks

RWA movements

RWA flow statement	2017 £m	2016 £m
RWAs at 1 October	**19,029**	18,227
Book size growth	**529**	619
Book quality (improvement)/deterioration[1]	**(28)**	183
Methodology and policy[2]	**148**	–
RWAs at 30 September	**19,678**	19,029

(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

	At 30 September 2017			At 30 September 2016		
Capital requirements for calculating RWAs	**Capital required £m**	**RWA £m**	**Exposure £m**	Capital required £m	RWA £m	Exposure (restated) £m
Central governments or central banks [1]	**–**	**–**	**12,947**	–	–	8,139
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**	**1,453**	19	234	1,344
Corporates [1]	**273**	**3,418**	**3,791**	273	3,419	3,732
Retail	**72**	**905**	**1,207**	72	897	1,196
Secured by mortgages on immovable property	**961**	**12,001**	**28,203**	897	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 [1]	**45**	**557**	**585**	52	633	627
Total credit risk	**1,420**	**17,752**	**49,692**	1,352	16,906	42,473
Operational risk	**130**	**1,621**		130	1,623	
Counterparty risk	**11**	**138**		17	214	
Credit valuation adjustment	**13**	**167**		23	286	
	1,574	**19,678**		1,522	19,029	

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 BoE 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.

Balance sheet and prudential regulation risks

Capital position and CET1	2017 £m	2016 £m
RWA[1]		
Retail mortgages	**8,646**	7,998
Business lending	**7,359**	7,087
Other retail lending	**932**	915
Other lending	**148**	152
Other[2]	**667**	754
Credit risk	**17,752**	16,906
Credit valuation adjustment	**167**	286
Operational risk	**1,621**	1,623
Counterparty risk	**138**	214
Total RWAs	**19,678**	19,029
Capital ratios		
CET1 ratio[3]	**12.4%**	12.6%
Tier 1 ratio	**14.7%**	15.0%
Total capital ratio	**17.9%**	18.2%

(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.
(3) CET1 capital is comprised of shares issued and related share premium, retained earnings and other reserves less specified regulatory adjustments.

While RWAs increased by £649m, driven by growth in mortgages, underlying capital generation post AT1 distribution of 13bps (before the net impact of pension movements, and below-the-line charges such as the Group's proportion of conduct provision charges and exceptional restructuring charges) ensured the CET1 ratio remained robust at 12.4%.

As announced above the Board has recommended a 1p per share dividend. The dividend would equate to approximately £9m of CET1 (equivalent to 4bps of CET1 based on RWAs as at 30 September 2017).

Leverage ratio	2017 £m	2016 £m
Total Tier 1 capital for the leverage ratio		
Total CET1 capital	**2,437**	2,397
AT1 capital	**450**	450
Total Tier 1	**2,887**	2,847
Exposures for the leverage ratio		
Total assets as per published financial statements	**43,231**	39,929
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	**(505)**	(364)
Leverage ratio exposure	**45,978**	41,749
Leverage ratio	**6.3%**	6.8%
Modified leverage ratio[1]	**7.4%**	8.0%

(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.

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.

Balance sheet and prudential regulation risks

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.

External credit ratings

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

	Outlook as at		
	20 Nov 2017[1]	**30 Sep 2017**	**30 Sep 2016**
CYBG PLC			
Fitch	Stable	BBB+	BBB+
Standard & Poor's	Stable	BBB-	BBB-
Clydesdale Bank PLC			
Fitch	Stable	BBB+	BBB+
Standard & Poor's	Stable	BBB+	BBB+
Moody's[2]	Review for upgrade	Baa2	Baa2

(1) For detailed background on the latest credit opinions, by S&P and Fitch, please refer to the respective rating agency websites.
(2) Long-term deposit rating.

Liquid assets

The quantity and quality of the Group's liquid assets are calibrated to the Board's view of liquidity risk appetite and remain at a prudent level above regulatory requirements. The Group was compliant with all internal and regulatory liquidity metrics at 30 September 2017.

The liquid asset portfolio provides a buffer against sudden and potentially sharp outflows of funds and liquid assets must therefore be of a high quality so they can be realised for cash and cannot be encumbered for any other purpose (e.g. to provide collateral for payments systems). Details on encumbered assets are provided in the following section.

The liquid asset portfolio is primarily comprised of cash at the BoE, UK Government Securities (Gilts) and listed securities (e.g. bonds issued by supra-nationals and AAA rated covered bonds).

Liquid asset portfolio	**2017 £m**	2016 £m
Cash and balances with central banks	**4,367**	3,702
UK government treasury bills and gilts	**1,129**	1,187
Other debt securities	**829**	399
Total	**6,325**	5,288

The liquid asset portfolio has seen some diversification over 2017 with an increase in Other Debt securities. Before investing in any security an assessment is completed for both the credit quality and the treatment for liquidity purposes. ALCO oversees the composition of the liquid asset portfolio.

Balance sheet and prudential regulation risks

Encumbered assets by asset category

Examples of reasons for asset encumbrance include, among others, supporting the Group's secured funding programmes to provide stable term funding to the Group, use of assets as collateral for payments systems in order to support customer's transactional activity, and providing security for the Group's issuance of Scottish bank notes. The Group monitors the level of asset encumbrance to ensure an appropriate balance is maintained.

Encumbered assets by asset category

	Assets encumbered with non-central bank counterparties				Other assets					
						Assets not positioned at the central bank				
September 2017	Covered bonds £m	Securiti-sations £m	Other £m	Total £m	Positioned at the central bank (including encumbered) £m	Readily available for encumbrance £m	Other assets capable of being encumbered £m	Cannot be encumbered £m	Total £m	**Total £m**
Cash and balances with central banks	–	–	–	–	2,850	4,087	–	–	6,937	**6,937**
Due from other banks	46	358	338	742	–	–	432	–	432	**1,174**
Investments – available for sale	–	–	–	–	95	1,971	–	10	2,076	**2,076**
Other financial assets	–	–	–	–	–	–	477	–	477	**477**
Derivatives	–	–	–	–	–	–	–	282	282	**282**
Loans and advances to customers	1,347	5,841	–	7,188	6,294	5,940	8,906	2,965	24,105	**31,293**
Intangible assets	–	–	–	–	–	–	–	339	339	**339**
Deferred tax assets	–	–	–	–	–	–	–	154	154	**154**
Other assets	–	–	–	–	–	–	100	399	499	**499**
Total assets	1,393	6,199	338	7,930	9,239	11,998	9,915	4,149	35,301	**43,231**

	Assets encumbered with non-central bank counterparties				Other assets					
						Assets not positioned at the central bank				
September 2016	Covered bonds £m	Securiti-sations £m	Other £m	Total £m	Positioned at the central bank (including encumbered) £m	Readily available for encumbrance £m	Other assets capable of being encumbered £m	Cannot be encumbered £m	Total £m	Total £m
Cash and balances with central banks	–	–	–	–	2,468	3,487	–	–	5,955	**5,955**
Due from other banks	156	282	337	775	–	–	177	–	177	**952**
Investments – available for sale	–	–	–	–	101	1,594	36	–	1,731	**1,731**
Other financial assets	–	–	–	–	–	–	750	–	750	**750**
Derivatives	–	–	–	–	–	–	–	585	585	**585**
Loans and advances to customers	1,149	5,144	–	6,293	2,902	3,946	13,003	3,058	22,909	**29,202**
Intangible assets	–	–	–	–	–	–	–	256	256	**256**
Deferred tax assets	–	–	–	–	–	–	–	183	183	**183**
Other assets	–	–	–	–	–	–	122	193	315	**315**
Total assets	1,305	5,426	337	7,068	5,471	9,027	14,088	4,275	32,861	**39,929**

Other information

The financial information included in this preliminary results announcement does not constitute statutory accounts within the meaning of section 434 of the Companies Act 2006. Statutory accounts for the year ended 30 September 2017 were approved by the directors on 20 November 2017 and will be delivered to the Registrar of Companies following publication in December 2017. The auditors' report on those accounts was unqualified and did not include a statement under sections 498(2) (accounting records or returns inadequate or accounts not agreeing with records and returns) or 498(3) (failure to obtain necessary information and explanations) of the Companies Act 2006.

Additional information

Measuring financial performance – glossary

Financial performance measures
As highlighted throughout the preliminary results announcement, the Group utilises a range of performance measures[1] to assess the Group's performance. These can be grouped under the following headings:

Profitability;

Asset quality; and

Capital optimisation.

The performance measures used are a combination of statutory, regulatory and alternative performance measures; with the type of performance measure used dependent on the component elements and source of what is being measured.

Statutory performance measures (S)
These are used when the basis of the calculation is derived from a measure that is required under generally accepted accounting principles (GAAP). An example of this would be references to earnings per share.

Regulatory performance measures (R)
These are used when the basis of the calculation is required and specified by the Group's regulators. Examples of this would be the leverage ratio and the Tier 1 ratio.

Alternative performance measures (A)
These are used when the basis of the calculation is derived from a non-GAAP measure – also referred to as APMs. Examples of this would be the cost to income ratio and the return on tangible equity.

Where a performance measure refers to an 'underlying' metric, the detail on how this measure is arrived at, along with management's reasoning for excluding the item from the Group's current underlying performance rationale, can be found on page 16. These adjustments to the Group's statutory results made by management are necessary to provide a more meaningful underlying basis.

Descriptions of the performance measures used, including the basis of calculation where appropriate, are set out below:

Profitability:

Term	Type	Definition
Net interest margin **(NIM)**	**A**	Net interest income as a percentage of average interest earning assets for a given period. Net interest income of £844m (2016: £806m) is divided by average interest earning assets for a given period of £37,697m (2016: £36,257m) (which is then adjusted to exclude short-term repos used for liquidity management purposes, amounts received under the Conduct Indemnity and not yet utilised, and any associated income). As a result of the exclusions noted above, average interest earning assets used as the denominator have reduced by £491m (2016: £698m) and the net interest income numerator has reduced by £1.1m (2016: £2.6m).
Underlying return on tangible equity **(RoTE)**	**A**	Underlying profit after tax less preference share and other distributions as a percentage of average tangible equity (total equity less intangible assets and AT1) for a given period.
Underlying cost to income ratio **(CIR)**	**A**	Underlying total operating expenses as a percentage of underlying total operating income for a given period.
Underlying basic earnings per share **(EPS)**	**A**	Underlying profit/(loss) attributable to ordinary equity shareholders including tax relief on any distributions made to other equity holders divided by the weighted average number of ordinary shares in issue for a given period.
Statutory RoTE	**A**	Statutory profit/(loss) after tax less preference share and non-controlling interest distributions as a percentage of average tangible equity (total equity less intangible assets and AT1) for a given period.
Statutory CIR	**A**	Statutory total operating expenses as a percentage of total operating income for a given period.
Statutory basic EPS	**S**	Statutory profit/(loss) attributable to ordinary equity shareholders including tax relief on any distributions made to other equity holders divided by the weighted average number of ordinary shares in issue for a given period.

(1) The term 'financial performance measure' covers all metrics, ratios and percentage calculations used to assess the Group's performance and is interchangeable with similar terminology used in the preliminary results announcement such as highlights, key metrics, key performance indicators (KPIs) and key credit metrics.

Measuring financial performance – glossary

Asset quality:

Term	Type	Definition
Impairment charge to average customer loans **(cost of risk)**	**A**	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	**A**	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.
Specific provision to gross impaired assets	**A**	The specific impairment provision on credit exposures as a percentage of gross impaired assets at a given date.
Total provision to customer loans	**A**	Total impairment provision on credit exposures as a percentage of total customer loans at a given date.
Indexed loan to value **(LTV)** of the mortgage portfolio	**A**	The mortgage portfolio weighted by balance and indexed using the MIAC Acadametrics indices at a given date.
Net write offs to customer loans	**A**	Net write offs, including loans at fair value, as a percentage of total customer loans at a given date.

Capital optimisation:

Term	Type	Definition
Common Equity Tier 1 **(CET1)** ratio	**R**	CET1 capital divided by RWAs at a given date.
Tier 1 ratio	**R**	Tier 1 capital as a percentage of risk-weighted assets.
Total capital ratio	**R**	Total capital resources divided by risk-weighted assets at a given date.
Leverage ratio	**R**	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	**R**	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.
Tangible net asset value **(TNAV)** per share	**A**	Tangible equity as at the period end divided by the closing number of ordinary shares.
Loan to deposit ratio **(LDR)**	**R**	Customer loans as a percentage of customer deposits at a given date.
Liquidity coverage ratio **(LCR)**	**R**	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)**	**R**	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.

The Group no longer reports Return on Assets (statutory and underlying basis) as a financial performance measure. Other measures presented, such as RoTE, are considered more relevant and useful for assessing profitability.

Additional information

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 Basel Committee on Banking Supervision (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 £1.58bn 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.
Collateral Account	A cash deposit with The Bank of England in an amount equal to the Unutilised Indemnity Amount from time to time used to collateralise certain obligations of NAB under the Capped Indemnity
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	CYBG 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'.
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.

Glossary

Term	Definition
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.
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.

Glossary

Term	Definition
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	CYBG 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.
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.

Additional information

Glossary

Term	Definition
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 BoE 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.
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).

Glossary

Term	Definition
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	The Group's defined benefit pension scheme, the Yorkshire and Clydesdale Bank Pension Scheme.
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.
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.
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.

Glossary

Term	Definition
Structured entities	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).
Unutilised Covered Amount	The amount of any unutilised accounting provision in the accounts of a member of the Group for matters covered by the Capped Indemnity to the extent indemnified by NAB pursuant to the Capped Indemnity or covered by an amount of a released or reduced provision, interest or tax deduction applied or required to be applied against such provision pursuant to the Conduct Indemnity.
Unutilised Indemnity Amount	The amount of support available pursuant to the Capped Indemnity at any given time following the demerger of the Group from NAB.
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.

Additional information

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

Abbreviations

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
MRT	Material Risk Takers
NAB	National Australia Bank
NIM	Net interest margin
NPS	Net promotor 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

Additional information

Forward-looking statements

The information in this document may include forward-looking statements, which are based on assumptions, expectations, valuations, targets, estimates, forecasts and projections about future events. These can be identified by the use of words such as 'expects', 'aims', 'targets', 'seeks', 'anticipates', 'plans', 'intends', 'prospects' 'outlooks', 'projects', 'believes', 'estimates', 'potential', 'possible', and similar words or phrases. These forward-looking statements, as well as those included in any other material discussed at any presentation, are subject to risks, uncertainties and assumptions about the Group and its securities, investments and the environment in which it operates, including, among other things, the development of its business and strategy, trends in its operating industry, changes to customer behaviours and covenant, macroeconomic and/or geopolitical factors, changes to its board and/ or employee composition, exposures to terrorist activity, IT system failures, cyber-crime, fraud and pension scheme liabilities, changes to law and/or the policies and practices of the BoE, the FCA and/or other regulatory bodies, inflation, deflation, interest rates, exchange rates, changes in the liquidity, capital, funding and/ or asset position and/or credit ratings of the Group, the repercussions of the UK's referendum vote to leave the European Union, and future capital expenditures and acquisitions.

In light of these risks, uncertainties and assumptions, the events in the forward-looking statements may not occur. Forward-looking statements involve inherent risks and uncertainties. Other events not taken into account may occur and may significantly affect the analysis of the forward-looking statements. No member of the Group or their respective directors, officers, employees, agents, advisers or affiliates gives any assurance that any such projections or estimates will be realised or that actual returns or other results will not be materially lower than those set out in this document and/or discussed at any presentation. All forward-looking statements should be viewed as hypothetical. No representation or warranty is made that any forward-looking statement will come to pass. No member of the Group or their respective directors, officers, employees, agents, advisers or affiliates undertakes any obligation to update or revise any such forward-looking statement following the publication of this document nor accepts any responsibility, liability or duty of care whatsoever for (whether in contract, tort or otherwise) or makes any representation or warranty, express or implied, as to the truth, fullness, fairness, merchantability, accuracy, sufficiency or completeness of, the information in this document.

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