This Prospectus, which comprises a prospectus relating to CYBG PLC ("**CYBG**"), has been prepared in accordance with the Prospectus Rules of the Financial Conduct Authority (the "**FCA**") made under section 73A of the Financial Services and Markets Act 2000 (the "**FSMA**") and approved by the FCA under section 85 of FSMA. This Prospectus has (i) been filed with the FCA and made available to the public in accordance with Rule 3.2.1 of the Prospectus Rules, and (ii) been prepared in order to provide details of the New CYBG Shares being issued and allotted pursuant to the Offer.

No CYBG Shares or any other securities in CYBG have been marketed to, nor are available for purchase, in whole or in part, by the public in the United Kingdom or elsewhere in connection with the admission of the New CYBG Shares to the Official List and the London Stock Exchange, save for to the Virgin Money Shareholders in connection with the Offer. **This Prospectus does not constitute or form part of any invitation to purchase, subscribe for, sell or issue, or any solicitation of any offer to purchase, subscriber for, sell or issue CYBG Shares.**

YOU SHOULD READ THE WHOLE OF THIS PROSPECTUS AND ALL DOCUMENTS INCORPORATED INTO IT BY REFERENCE IN THEIR ENTIRETY. IN PARTICULAR, YOU SHOULD TAKE ACCOUNT OF THE PART ENTITLED "RISK FACTORS" OF THIS PROSPECTUS FOR A DISCUSSION OF THE RISKS THAT MIGHT AFFECT THE VALUE OF YOUR SHAREHOLDING IN CYBG. YOU SHOULD NOT RELY SOLELY ON INFORMATION SUMMARISED IN THE SUMMARY.

Investors should only rely on the information contained in this Prospectus and contained in any documents incorporated into this Prospectus by reference. No person has been authorised to give any information or make any representations other than those contained in this Prospectus and any document incorporated by reference and, if given or made, such information or representation must not be relied upon as having been so authorised by CYBG, the Board, Morgan Stanley & Co. International plc ("**Morgan Stanley**"), Deutsche Bank AG, London Branch ("**Deutsche Bank**" and together with Morgan Stanley, the "**Financial Advisers**") or Macquarie Capital (Europe) Limited ("**Macquarie**"). CYBG will comply with its obligation to publish supplementary prospectuses containing further updated information required by law or by any regulatory authority but assumes no further obligation to publish additional information.

CYBG PLC

(a public limited company incorporated and registered in England and Wales under number 9595911)

PROPOSED ACQUISITION OF VIRGIN MONEY HOLDINGS (UK) PLC

and

ISSUE AND ADMISSION OF UP TO 548,000,000 NEW CYBG SHARES

Prospectus

Application will be made to the FCA for the New CYBG Shares to be admitted to the premium listing segment of the Official List and will be made to the London Stock Exchange for the New CYBG Shares to be admitted to trading on the London Stock Exchange's main market for listed securities (together "**Admission**"). It is expected that Admission will become effective, and that dealings in the New CYBG Shares will commence, on the Effective Date which, subject to the satisfaction of certain conditions, is expected to be in the fourth quarter of calendar year 2018. Application will also be made to allow for quotation of CHESS Depositary Interests ("**CDIs**") representing the New CYBG Shares on the Australian Securities Exchange (the "**ASX**") following Completion.

The release, publication or distribution of this Prospectus in jurisdictions other than the United Kingdom may be restricted by law and, therefore, any persons who are subject to the laws of any jurisdiction other than the United Kingdom should inform themselves about, and observe, any applicable requirements. Failure to comply with any such restrictions may constitute a violation of the securities laws of any jurisdiction. This Prospectus has been prepared to comply with requirements of English law, the Listing Rules, the Prospectus Rules and the rules of the London Stock Exchange and information disclosed may not be the same as that which would have been disclosed if this Prospectus had been prepared in accordance with the laws of jurisdictions outside England. This Prospectus is not for release, publication or distribution, directly or indirectly, in whole or in part, in, into or from any jurisdiction in which the same would be restricted, unlawful or unauthorised (each an "**Excluded Territory**"). This Prospectus does not constitute an offer to sell or issue or the solicitation of an offer to buy, acquire or subscribe for shares in the capital of CYBG in any Excluded Territory or to any person to whom it is unlawful to make such offer or solicitation. Any failure to comply with these restrictions may constitute a violation of the securities laws of such jurisdictions. Subject to certain exemptions, the securities referred to herein may not be offered or sold in any Excluded Territory or for the account or benefit of any national resident or citizen of any Excluded Territory.

The New CYBG Shares have not been and will not be registered under the US Securities Act of 1933 (the "**US Securities Act**"), as amended, or under the securities laws of any state or other jurisdiction of the United States, and may not be offered or sold, directly or indirectly, in the United States absent registration under the US Securities Act or an available exemption from, or in a transaction not subject to, the registration requirements of the US Securities Act and in compliance with any applicable securities laws of any state or other jurisdiction of the United States. The securities referred to in this Prospectus have not been approved or disapproved by the US Securities and Exchange Commission, any state securities commission or any other regulatory authority in the United States, nor have any of the foregoing authorities passed upon, determined or endorsed the merits of the Offer or the accuracy or adequacy of the information contained in this Prospectus. Any representation to the contrary is a criminal offence in the United States. No public offering of the New CYBG Shares is being made in the United Kingdom, the United States, any other Excluded Territory or elsewhere.

The Offer is to be implemented by way of the Scheme. The New CYBG Shares are expected to be issued in reliance upon the exemption from the registration requirements of the US Securities Act provided by Section 3(a)(10) thereof. Virgin Money Shareholders (whether or not US persons) who are or will be affiliates (within the meaning of the US Securities Act) of CYBG or Virgin Money prior to, or of CYBG after, the Effective Date will be subject to certain US transfer restrictions relating to the New CYBG Shares received pursuant to the Offer.

The New CYBG Shares generally should not be treated as "restricted securities" within the meaning of Rule 144(a)(3) under the US Securities Act and persons who receive securities under the Offer (other than "affiliates" as described in the paragraph below) may resell them without restriction under the US Securities Act. Under US securities laws, persons who are or will be deemed to be affiliates (as defined under the US Securities Act) of CYBG or Virgin Money prior to, or of CYBG after, the Effective Date may not resell the New CYBG Shares received under the Offer without registration under the US Securities Act, except pursuant to an applicable exemption from, or in a transaction not subject to, the registration requirements of the US Securities Act. Whether a person is an affiliate of a company for such purposes depends upon the circumstances, but affiliates of a company can include certain officers and directors and significant shareholders. Virgin Money Shareholders who believe they may be affiliates for the purposes of the US Securities Act should consult their own legal advisers prior to any resale of New CYBG Shares received under the Offer.

The Offer relates to the securities of a UK-registered company admitted to trading on the London Stock Exchange. A transaction effected by means of a Scheme is not subject to proxy solicitation or tender offer rules under the US Securities Exchange Act of 1934, as amended. The Offer is subject to United Kingdom disclosure requirements, which are different from certain United States disclosure requirements. The financial information included in this Prospectus has been or will be prepared in accordance with IFRS and may not be comparable to financial information of US companies or companies whose financial statements are prepared in accordance with generally accepted accounting principles in the United States. It may be difficult for US Virgin Money Shareholders to enforce their rights and claims arising out of the US federal securities laws, since CYBG and Virgin Money are located outside of the United States, and some or all of their officers and directors may be residents of countries other than the United States. US Virgin Money Shareholders may not be able to sue a non-US company or its officers or directors in a non-US court for violations of the US securities laws. Further, it may be difficult to compel a non-US company and its affiliates to subject themselves to a US court's judgment.

Morgan Stanley is authorised by the Prudential Regulation Authority (the "**PRA**") and regulated in the United Kingdom by the PRA and the FCA. Deutsche Bank is authorised under German Banking Law (competent authority: European Central Bank) and in the United Kingdom, by the PRA. It is subject to supervision by the European Central Bank and by BaFin, Germany's Federal Financial Supervisory Authority, and is subject to limited regulation in the United Kingdom by the PRA and the FCA. Details about the extent of Deutsche Bank's authorisation and regulation by the PRA, and regulation by the FCA, are available on request or from www.db.com/en/content/eu_disclosures.htm. Deutsche Bank is a corporation domiciled in Frankfurt am Main, operating in the United Kingdom under branch registration number BR000005, acting through its London Branch. Macquarie is authorised and regulated in the United Kingdom by the FCA. Each of the Financial Advisers and Macquarie has been appointed by CYBG and are acting exclusively for CYBG and for no one else in connection with the Offer and the Admission. None of the Financial Advisers or Macquarie will regard any other person (whether or not a recipient of this Prospectus) as their client in relation to the Offer, the Admission or any other matter referred to in this Prospectus. The Financial Advisers and Macquarie will not be responsible to anyone other than CYBG for providing the protections afforded to clients of the Financial Advisers nor for providing advice in relation to the Offer, the Admission or any other matter referred to in this Prospectus. The Financial Advisers and Macquarie have not independently verified the contents of this Prospectus. Accordingly, no representation, warranty or undertaking, expressed or implied, is made and no responsibility is accepted by the Financial Advisers or Macquarie as to the accuracy, completeness or verification of the information contained in, or incorporated by reference into, this Prospectus, and nothing contained in, or incorporated by reference into, this Prospectus is, or shall be relied upon as, a promise or representation in this respect, whether as to the past or the future. The Financial Advisers and Macquarie disclaim, to the fullest extent permitted by applicable law, any and all liability whether arising in tort, contract or otherwise which they might otherwise be found to have in respect of this Prospectus or any such statement.

THE CONTENTS OF THIS PROSPECTUS OR ANY SUBSEQUENT COMMUNICATION FROM CYBG OR THE FINANCIAL ADVISERS OR ANY OF THEIR RESPECTIVE AFFILIATES, OFFICERS, DIRECTORS, EMPLOYEES OR AGENTS ARE NOT TO BE CONSTRUED AS LEGAL, FINANCIAL OR TAX ADVICE. EACH PROSPECTIVE INVESTOR SHOULD CONSULT HIS, HER OR ITS OWN SOLICITOR, INDEPENDENT FINANCIAL ADVISER OR TAX ADVISER FOR LEGAL, FINANCIAL OR TAX ADVICE.

THIS PROSPECTUS DOES NOT CONSTITUTE AN OFFER OF AND MAY NOT BE USED FOR THE PURPOSES OF, AN OFFER TO SELL OR AN INVITATION, OR THE SOLICITATION OF AN OFFER TO SUBSCRIBE FOR OR BUY, ANY SECURITIES. NONE OF THE SECURITIES REFERRED TO IN THIS PROSPECTUS SHALL BE SOLD, ISSUED OR TRANSFERRED IN ANY JURISDICTION IN CONTRAVENTION OF APPLICABLE LAW.

Capitalised terms have the meanings ascribed to them in the "Definitions" Part of this Prospectus.

This Prospectus is dated 31 July 2018.

CONTENTS

SUMMARY

Summaries are made up of disclosure requirements known as ‘Elements’. These elements are numbered in Sections A–E (A.1–E.7). This summary contains all the Elements required to be included in a summary for this type of securities and issuer. Because some Elements are not required to be addressed, there may be gaps in the numbering sequence of the Elements. Even though an Element may be required to be inserted in the summary because of the type of securities and issuer, it is possible that no relevant information can be given regarding the Element. In this case a short description of the Element is included in the summary with the mention of ‘not applicable’.

Section A—Introductions and warnings		
Element	**Disclosure Requirement**	**Disclosure**
A.1	Warning	This summary should be read as an introduction to this Prospectus. Any decision to invest in the New CYBG Shares should be based on consideration of this Prospectus as a whole. Where a claim relating to the information contained in this Prospectus is brought before a court, the plaintiff investor might, under the national legislation of the member states of the EEA, have to bear the costs of translating this Prospectus before the legal proceedings are initiated. Civil liability attaches only to those persons who have tabled the summary including any translation thereof, but only if the summary is misleading, inaccurate or inconsistent when read together with the other parts of this Prospectus or it does not provide, when read together with the other parts of this Prospectus, key information in order to aid investors when considering whether to invest in the New CYBG Shares.
A.2	Resale or final placement of securities through financial intermediaries	Not applicable. CYBG is not engaging any financial intermediaries for any resale of CYBG Shares or final placement of CYBG Shares after publication of this Prospectus.

Section B—Issuer		
Element	**Disclosure Requirement**	**Disclosure**
B.1	Legal and commercial name	CYBG PLC
B.2	Domicile / legal form / legislation under which the issuer operates / country of incorporation	CYBG is incorporated in England and Wales as a public limited company, limited by shares. Its registered office is situated in England and its registered number is 9595911. The principal legislation under which CYBG operates is the 2006 Act.
B.3	Current operations / principal activities / principal markets	With over 175 years of history, the CYBG Group is a leading mid-sized UK retail and SME bank with a long-established customer franchise across its core regions (Scotland, North East England, North West England, Yorkshire and the Humber) and selected national markets. Headquartered in Glasgow, Scotland, the CYBG Group offers, through its community brands “Clydesdale Bank” and “Yorkshire Bank”, a full range of banking products and services, including mortgages, current accounts, deposits, term lending, personal loans, working capital solutions, overdrafts, credit cards and payment and transaction services. In 2016 the CYBG Group launched a new app-based digital banking service under the “B” brand, offering PCAs, savings and transaction banking services in the UK. The range of products and services available in this digital proposition continue to expand and evolve.

Section B—Issuer		
Element	**Disclosure Requirement**	**Disclosure**
		The CYBG Group's long-established retail and SME franchises, serving 2.8 million customers, have significant scale and strength in PCAs, BCAs, SME lending and mortgages in its core regions. As at 31 March 2018, the CYBG Group had £28.4 billion of customer deposits and a £32.7 billion customer loan portfolio, of which £24.1 billion were mortgage loans, £7.4 billion was SME lending and the remainder of the portfolio comprised unsecured personal lending (including credit cards and overdrafts). The CYBG Group has a standalone operating platform, with limited ongoing support required by NAB under transitional service arrangements until the CYBG Group's planned separation is fully implemented (expected by the end of 2018). The CYBG Group's operating platform supports its full-service customer proposition and enables the CYBG Group to provide services to customers through multiple distribution channels. As at 31 March 2018, these distribution channels included 169 retail customer banking centres (70 Clydesdale Bank branded, 97 Yorkshire Bank branded, two "B" branded) and 48 business and private customer banking centres (including 40 centres integrated with retail customer banking centres) strong and well-established relationships with leading third-party mortgage intermediaries, access to certain banking services through the UK Post Office's approximately 11,500 branches, telephony and voice services, and an ATM network. The CYBG Group's distribution platform continues to develop to allow Clydesdale Bank, Yorkshire Bank and "B" customers to complete their retail and SME banking needs across multiple distribution channels with an emphasis on digital and non-branch channel usage which reflects changing customer interaction preferences and behaviour. This distribution capability is underpinned by a rapidly evolving digital platform ("**iB**") which powers CYBG's retail franchises: the digital-only brand "B" and omni-channel distribution of the Clydesdale Bank and Yorkshire Bank brands. During 2018, CYBG's SME franchise will be transferred onto the iB platform, completing a migration of all customer activity onto a platform that offers enhanced capability including the aggregation of customer accounts and seamless aggregation of third party products and services. For the year ended 30 September 2017, the CYBG Group's net interest income was £844 million as compared to £806 million for the year ended 30 September 2016. For the six month period ended 31 March 2018, the CYBG Group's net interest income was £426 million, as compared to £411 million for the six month period ended 31 March 2017. CYBG had approximately 6,500 FTEs as at 30 September 2017. CYBG is building a purpose-led, high performing, team-based culture. A clear set of organisational behaviours shape the culture of the business. Performance approaches drive alignment with the CYBG Group strategy, teamwork and individual focus on improvement. The CYBG Group has significantly increased its focus on wellbeing, inclusion and diversity. These are hardwired into values and behaviours, and built into people practices. The culture transformation is focused on creating a set of leaders, colleagues and ways of working that will allow the business to evolve and change in line with the market and the CYBG Group strategy.

Section B—Issuer		
Element	**Disclosure Requirement**	**Disclosure**
		As part of its wholesale funding activity, CYBG has accessed and will continue, from time to time, to look to access both the securitisation markets through its Lanark or Lannraig Mortgage Backed Securities programmes and its Regulated Covered Bond programme, as well as the wholesale markets through its Medium Term Note Programme. On 5 July 2018, a further series of notes were issued pursuant to the Lanark Mortgage Backed Securities programme.
B.4a	Most significant recent trends of the company and its industry	***Industry*** The CYBG Directors believe that the banking industry in the UK is reaching an inflection point: more and more customers are choosing to interact digitally; new entrants are looking to disrupt the industry and partner with existing players; technological change is happening at a faster pace than ever before; and the implementation of the Payment Services Directive 2 and Open Banking regulation aims to open up banking services and encourage competition. These trends are expected to transform existing bank business models in the UK, with an expected increase in partnerships and disintermediation of traditional value chains. The CYBG Directors believe that the successful banking propositions of the future will be digitally-led customer experiences supported by exceptional omni-channel service, with the winners delivering technology-enabled, customer-centric propositions that resonate with and enhance customers' lifestyles. In addition to these long-term changes in customer behaviour, the immediate uncertainty in the UK's economic outlook has contributed to slower consumer spending and businesses delaying investment. This has had an impact on SME's demand for credit and in retail intense competition has resulted in a challenging pricing environment, particularly in mortgages. ***CYBG*** As at 31 March 2018, the CYBG Group had total assets of £42,353 million, gross loans and advances to customers of £32,749 million, total customer deposits of £28,413 million and total equity of £3,270 million. The CYBG Group's total mortgage book delivered annualised growth of 5.6 per cent. in the six months ended 31 March 2018 compared with market growth of 2.6 per cent. over the same period. The CYBG Group has maintained momentum in its SME business, with annualised growth of 5 per cent. of its core SME balances, in line with Directors' expectations. The run off of the non-core SME book has continued as planned. The asset quality of the CYBG Group's credit exposures remains stable relative to the growth in portfolio size, evidenced by the reduction in the level of impaired assets. Overall customer deposit balances increased by 5 per cent. (annualised) in the six months ended 31 March 2018, and the CYBG Group's net interest margin in the period was 2.18 per cent. The CYBG Group's management reiterates its commitment to investing in its key strategic priorities of delivering cost efficiency alongside sustainable customer growth and capital optimisation.

Section B—Issuer		
Element	**Disclosure Requirement**	**Disclosure**
		Virgin Money All information is based on the consolidated unaudited financial statements of the Virgin Money Group for the six months ended 30 June 2018. As at 30 June 2018 the Virgin Money Group had total assets of £43,696.1 million, total loans and advances to customers of £37,176.0 million, total customer deposits of £31,445.6 million and total equity of £1,861.2 million. Total loans and advances increased by 1.2 per cent. in the first half of 2018, compared to growth of 7.2 per cent. in the first half of 2017, as the Virgin Money Group took a disciplined approach to growth across its core markets. The total mortgage book increased by 1.2 per cent. to £34.1 billion in the first half of 2018, with gross lending of £2.8 billion and a market share of gross lending of 2.2 per cent. during the first half of 2018 as the Virgin Money Group moderated mortgage balance growth to protect returns. Having achieved the Virgin Money Group's target of £3.0 billion of credit card balances by the end of 2017, balances increased by 3.8 per cent. during the first half of 2018 to £3.1 billion, as the Virgin Money Group diversified the portfolio with the successful launch of new Virgin Atlantic credit cards. Overall cost of risk of 0.16 per cent. for the first half of 2018 under IFRS 9 reflected continued low levels of arrears and the benign economic environment. Overall customer deposit balances increased by 2.1 per cent. in the first half of 2018 to £31.4 billion as at 30 June 2018, with strong performance in cash ISAs. Following the launch of new SME deposit accounts in the first half of 2018, SME balances were over £160 million as at 30 June 2018. Banking net interest margin was 1.64 per cent. for the six months ended 30 June 2018, compared to 1.72 per cent for the six months ended 30 June 2017 as pressure from lower mortgage spreads was partially offset by further optimisation of its funding base. In March 2018 the Virgin Money Group submitted an application for a reduction in its mortgage risk-weights to the Prudential Regulation Authority. The PRA approved the model changes in June. The reduction in risk-weights is reflected in a material increase in the Virgin Money Group's CET1 ratio from 13.8 per cent. at 31 December 2017 to 16.3 per cent. at 30 June 2018. The total capital ratio was 21.1 per cent. as at 30 June 2018 and the leverage ratio was 3.8 per cent. as at 30 June 2018. The Virgin Money Group's management has continued to implement its customer-focused strategy of growth, quality and returns while making good progress on delivering its strategic initiatives.
B.5	Group structure	CYBG is a public limited company, incorporated in England and Wales, whose principal activity is to act as the holding company of the CYBG Group and Clydesdale Bank PLC. Following Completion, CYBG will be the ultimate parent company of the Combined Group.

<table>
<tr><th colspan="3">Section B—Issuer</th></tr>
<tr><th>Element</th><th>Disclosure Requirement</th><th>Disclosure</th></tr>
<tr><td>B.6</td><td>Notifiable interests / Different voting rights / controlling interests</td><td>
As at 27 July 2018 (being the latest practicable date prior to the publication of this Prospectus (the "Latest Practicable Date")), CYBG had been notified in accordance with Rule 5 of the Disclosure Guidance and Transparency Rules of the following interests in CYBG Shares:
<table>
<tr><th>Name of Shareholder</th><th>Number of issued shares held</th><th>Percentage of issued share capital</th><th>Percentage of issued share capital of the Combined Group</th></tr>
<tr><td>Coopers Investors Pty Ltd</td><td>52,888,470</td><td>5.97</td><td>3.69</td></tr>
<tr><td>Investors Mutual Limited</td><td>45,016,877</td><td>5.08</td><td>3.14</td></tr>
<tr><td>Schroders PLC</td><td>44,572,459</td><td>5.03</td><td>3.11</td></tr>
<tr><td>Perpetual Limited and subsidiaries</td><td>44,463,361</td><td>5.02</td><td>3.10</td></tr>
<tr><td>Pendal Group Limited</td><td>36,399,949</td><td>4.11</td><td>2.54</td></tr>
<tr><td>JCP Investments Partners Ltd</td><td>35,251,058</td><td>3.98</td><td>2.46</td></tr>
<tr><td>BT Investment Management Limited</td><td>27,036,329</td><td>3.05</td><td>1.89</td></tr>
<tr><td>AMP Life Limited, AMP Capital Investors Limited, Ipac Asset Management Limited, AMP Capital Investors (NZ) Limited</td><td>26,608,485</td><td>3.00</td><td>1.86</td></tr>
</table>
Save as disclosed in this section, CYBG is not aware of any person who, as at the Latest Practicable Date, directly or indirectly, has a holding in CYBG Shares which is notifiable under English law.
None of CYBG's major shareholders have different voting rights.
Following Completion and Admission, Virgin Holdings will hold approximately 13 per cent. of the Company's enlarged share capital.
Save as set out above, CYBG, the CYBG Directors and the Proposed Directors are not aware of any persons who, as at the Latest Practicable Date, directly or indirectly, jointly or severally, exercise or could exercise control over CYBG nor is it aware of any arrangements the operation of which may at a subsequent date result in a change of control of CYBG.
</td></tr>
<tr><td>B.7</td><td>Historical key financial information for the company</td><td>
CYBG
Selected historical financial information which summarises the results of operations and financial condition of the CYBG Group for the three financial years ended 30 September 2017, 30 September 2016, and 30 September 2015 and for the six month periods ended 31 March 2018 and 31 March 2017 is set out in the following tables.
</td></tr>
</table>

Section B—Issuer		
Element	**Disclosure Requirement**	**Disclosure**

Consolidated Income Statement

	Year ended 30 September			Six months ended 31 March	
		(audited)		(unaudited)	
	2017	2016	2015	2018	2017
			£ million		
Interest income and similar income	1,075	1,101	1,110	552	534
Interest expense and similar charges	(231)	(295)	(323)	(126)	(123)
Net interest income	**844**	**806**	**787**	**426**	**411**
Gains less losses on financial instruments at fair value	6	9	2	1	3
Other operating income	186	182	238	76	83
Non-interest income	**192**	**191**	**240**	77	86
Total operating income	**1,036**	**997**	**1,027**	**503**	**497**
Personnel expenses	(166)	(280)	(266)	—	—
Restructuring expenses	(67)	(45)	(17)	—	—
Depreciation expense	(87)	(88)	(83)	—	—
Other operating and administrative expenses	(400)	(468)	(868)	—	—
Total operating and administrative expenses before impairment losses	**(720)**	**(881)**	**(1,234)**	**(576)**	**(425)**
Operating (loss)/profit before impairment losses	**316**	**116**	**(207)**	**(73)**	**72**
Impairment losses on credit exposures	(48)	(39)	(78)	(22)	(26)
Profit/(Loss) on ordinary activities before tax	268	77	(285)	(95)	46
Tax credit	(86)	(241)	56	19	(16)
Profit/(Loss) for the year	**182**	**(164)**	**(229)**	**(76)**	**30**
Attributable to					
Ordinary shareholders	146	(206)	(247)	(94)	12
Other equity holders	36	42	18	18	18
Profit/(loss) for the year attributable to equity holders	**182**	**(164)**	**(229)**	**(76)**	**30**

Section B—Issuer		
Element	**Disclosure Requirement**	**Disclosure**

Consolidated Balance Sheet

	As at 30 September			As at 31 March	
		(audited)		(unaudited)	
	2017	2016	2015	2018	2017
			£ million		
Assets					
Cash and balances with central banks	6,937	5,955	6,431	6,150	5,422
Due from related entities	—	—	786	—	—
Due from other banks	1,174	952	128	830	1,172
Financial assets available for sale	2,076	1,731	1,462	1,352	2,029
Other financial assets at fair value	477	750	1,097	421	570
Derivative financial instruments	282	585	285	334	356
Loans and advances to customers	31,293	29,202	27,482	32,137	29,914
Due from customers on acceptances	4	4	4	4	4
Current tax assets	—	2	4	—	2
Property, plant and equipment	86	99	109	86	91
Investment properties	14	22	32	8	19
Investments in controlled entities and associates	—	—	2	—	—
Intangible assets	339	256	265	371	298
Deferred tax assets	154	183	389	204	162
Defined benefit pension assets	207	—	52	222	—
Other assets	188	188	177	234	189
Total assets	**43,231**	**39,929**	**38,705**	**42,353**	**40,228**
Liabilities					
Due to other banks	3,817	1,309	393	2,683	2,980
Other financial liabilities at fair value	26	48	67	20	32
Derivative financial instruments	376	598	534	388	411
Due to customers	27,718	27,090	26,407	28,463	26,383
Liabilities on acceptances	4	4	4	4	4
Provisions	554	852	1,006	458	639
Due to related entities	—	—	998	—	—
Bonds and notes	4,785	4,501	3,766	4,447	4,180
Retirement benefit obligations	3	79	4	3	31
Deferred tax liabilities	75	27	10	81	24
Other liabilities	2,471	2,210	2,073	2,536	2,295
Total liabilities	**39,829**	**36,718**	**35,262**	**39,083**	**36,979**
Equity					
Share capital	88	88	223	89	88
Other equity instruments	450	450	450	450	450
Share premium	—	—	670	—	—
Capital reorganisation reserve	(839)	(839)	—	(839)	(839)
Merger reserve	633	633	—	633	633
Other reserves	15	100	4	(25)	74
Retained earnings	3,055	2,779	2,096	2,962	2,843
Total parent entity interest	3,402	3,211	3,443	3,270	3,249
Non-controlling interest	—	—	—	—	—
Total equity	**3,402**	**3,211**	**3,443**	**3,270**	**3,249**
Total liabilities and equity	**43,231**	**39,929**	**38,705**	**42,353**	**40,228**

Section B—Issuer		
Element	**Disclosure Requirement**	**Disclosure**
		The following significant changes to the financial condition and operating results of the CYBG Group occurred during these periods: In February 2016, CYBG became the new holding company for the CYBG Group by way of a share for share exchange with its then sole shareholder, NAB, and was admitted to listing on the premium segment of the Official List of the FCA and the main market for listed securities of the London Stock Exchange. Also in February 2016, CYBG issued Perpetual Contingent Convertible Notes (fixed 8 per cent.) with a principal amount of £450 million to NAB with an optional redemption on 8 December 2022. In September 2016 these notes were remarketed by NAB, accordingly they are held by third party investors other than NAB. The CYBG Group made an IFRS statutory loss after tax of £229 million in the financial year ended 30 September 2015. The loss was primarily due to conduct charges of £486 million. The 2015 result also included a net gain of £61 million in relation to capital and debt restructuring. The CYBG Group made an IFRS statutory loss after tax of £164 million in the financial year ended 30 September 2016. The loss was primarily due to the write-off of deferred tax assets as a result of the enactment of Finance Bill 2016, reflecting the inherent uncertainty in the UK's approach to the taxation of Banking Groups. The 2016 result also included a charge of £45 million for restructuring and £45 million for impairment of intangible assets. Conduct charges of £51 million were incurred, after adjusting for the impact of the Capped Indemnity Deed with NAB. The CYBG Group made an IFRS statutory profit after tax of £182 million in the financial year ended 30 September 2017. The result was impacted by a gain of £88 million in relation to the closure of the Defined Benefit Pension Scheme to future accrual. The 2017 result also included a restructuring charge of £67 million. Conduct charges of £58 million were incurred, after adjusting for the impact of the Capped Indemnity Deed with NAB. The Directors recommended a final dividend in respect of the year ended 30 September 2017 of 1 pence per CYBG Share in the Company, which was declared on 31 January 2018. There has been no significant change in the financial condition or operating results of the CYBG Group since 31 March 2018, being the end of the period covered by the selected historical financial information. ***Virgin Money*** Selected historical financial information which summarises the results of operations and financial condition of the Virgin Money Group for the three financial years ended 31 December 2017, 31 December 2016 and 31 December 2015 and for the six month periods ended 30 June 2018 and 30 June 2017 is set out in the following tables.

Section B—Issuer		
Element	**Disclosure Requirement**	**Disclosure**

Consolidated Income Statement

	Year ended 31 December			Six months ended 30 June	
	(audited)			(unaudited)	
	2017	2016	2015	2018	2017
			£ million		
Interest and similar income	958.0	948.1	839.3	518.4	465.4
Interest and similar expense	(363.4)	(425.7)	(384.5)	(215.3)	(176.9)
Net interest income	**594.6**	**522.4**	**454.8**	**303.1**	**288.5**
Net fee and commission income	29.6	27.6	26.2	17.0	14.4
Other operating income	41.8	40.3	41.3	19.9	24.3
Fair value (losses)/gains on financial instruments	(3.3)	(8.9)	(0.4)	0.2	1.3
Other income	68.1	59.0	67.1	37.1	40.0
Total income	**662.7**	**581.4**	**521.9**	**340.2**	**328.5**
Operating expenses	**(355.9)**	**(349.4)**	**(353.6)**	**(182.6)**	**(182.5)**
Profit before tax from operating activities	**306.8**	**232.0**	**168.3**	**157.6**	**146.0**
Impairment	(44.2)	(37.6)	(30.3)	(30.4)	(22.2)
Profit before tax	**262.6**	**194.4**	**138.0**	**127.2**	**123.8**
Taxation	(70.5)	(54.3)	(26.8)	33.7	(33.3)
Profit for the period	**192.1**	**140.1**	**111.2**	**93.5**	**90.5**
Profit attributable to equity owners	192.1	140.1	111.2	93.5	90.5
Profit for the period	**192.1**	**140.1**	**111.2**	**93.5**	**90.5**
Basic earnings per share (pence)	37.8	29.4	22.9	18.3	17.7
Diluted earnings per share (pence)	**37.5**	**29.1**	**22.7**	**18.1**	**17.5**

Section B—Issuer		
Element	**Disclosure Requirement**	**Disclosure**

Consolidated Balance Sheet

	As at 31 December			As at 30 June	
		(audited)		(unaudited)	
	2017	2016	2015	2018	2017
			£ million		
Assets					
Cash and balances at central banks	2,579.0	786.3	888.6	4,164.2	3,677.0
Derivative financial instruments	78.8	104.2	82.3	74.3	89.2
Loans and receivables:					
Loans and advances to banks	359.4	635.6	614.5	309.0	522.3
Loans and advances to customers	36,740.2	32,367.1	27,109.0	37,176.0	34,683.9
Debt securities	0.3	0.7	1.1	0.0	0.5
	37,099.9	**33,003.4**	**27,724.6**	**41,723.5**	**35,206.7**
Financial instruments at fair value through other comprehensive income	0.0	0.0	0.0	1,638.3	0.0
Equity investments at fair value through profit or loss	0.0	0.0	0.0	1.0	0.0
Available-for-sale financial assets	1,051.8	858.8	1,296.9	0.0	1,046.7
Intangible assets	128.4	80.6	64.4	158.5	99.7
Tangible fixed assets	74.5	77.4	74.6	73.0	74.8
Deferred tax assets	11.5	23.0	38.0	21.7	16.6
Other assets	83.9	121.9	59.6	60.4	105.7
Disposal group assets held for sale	0.0	0.0	0.0	19.7	0.0
Total assets	**41,107.8**	**35,055.6**	**30,229.0**	**43,696.1**	**40,316.4**
Liabilities					
Deposits from banks	5,379.0	2,132.5	1,298.7	7,083.4	6,124.7
Customer deposits	30,808.4	28,106.3	25,144.9	31,445.6	29,564.2
Derivative financial instruments	93.5	229.7	156.0	49.2	142.0
Debt securities in issue	2,736.9	2,600.0	2,039.4	2,939.2	2,298.8
Other liabilities	241.5	299.9	243.4	285.9	423.0
Current tax liabilities	23.6	16.7	6.3	28.6	25.7
Disposal group liabilities held for sale	0.0	0.0	0.0	3.0	0.0
Total liabilities	**39,282.9**	**33,385.1**	**28,888.7**	**41,834.9**	**38,578.4**
Equity					
Share capital and share premium	654.6	654.6	654.6	654.6	654.6
Other equity instruments	384.1	384.1	156.5	384.1	384.1
Other reserves	(18.1)	(27.4)	(15.6)	(11.9)	(19.9)
Retained earnings	804.3	659.2	544.8	834.4	719.2
Total equity	**1,824.9**	**1,670.5**	**1,340.3**	**1,861.2**	**1,738.0**
Total liabilities and equity	**41,107.8**	**35,055.6**	**30,229.0**	**43,696.1**	**40,316.4**

Section B—Issuer		
Element	**Disclosure Requirement**	**Disclosure**
		The following significant changes to the financial condition and operating results of the Virgin Money Group occurred during these periods: The Virgin Money Group made an IFRS statutory profit after tax of £111.2 million in the financial year ended 31 December 2015, £140.1 million in the financial year ended 31 December 2016, £192.1 million in the financial year ended 31 December 2017, and £93.5 million in the six months to 30 June 2018. These profits were primarily due to growth in lending and income, a low and stable cost of risk, and continued delivery against cost-efficiency targets. The Virgin Money Group achieved its target of exiting 2017 with a cost:income ratio below 50 per cent. The Virgin Money Group's cost:income ratio had been 63.5 per cent in the financial year ended 31 December 2015. In November 2016 Virgin Money Holdings (UK) plc issued £230 million Fixed rate Resettable Additional Tier 1 Securities. Virgin Money has participated in the Bank of England's Term Funding Scheme ("**TFS**") and Funding for Lending Scheme ("**FLS**") to support lending growth. TFS drawings totalled £6.4 billion at the closure of the scheme at the end of February 2018. TFS drawings in 2018 were used to repay outstanding FLS balances in full. Virgin Money has also established a regulated Covered Bond Programme alongside its existing 'Gosforth' RMBS franchise. In April 2018 Virgin Money completed an inaugural MREL eligible Medium Term Note issuance of £350 million. In the six months ended 30 June 2018 the Virgin Money Group delivered an underlying profit before tax of £141.6 million and statutory profit after tax of £93.5 million. Return on tangible equity increased to 14.2 per cent. from 13.3 per cent. for the first half of 2017. Underlying total income in the first half of 2018 increased by 4.8 per cent. on the first half of 2017, with net interest income increased by 5.1 per cent. on the first half of 2017, to £303.1 million driven by growth in loans and advances to customers and underlying other income increased by 3.1 per cent. on the first half of 2017 to £39.9 million. Further improvements in operating leverage and effective cost management resulted in a 3.1 per cent. reduction in underlying costs to £171.0 million. The underlying cost: income ratio improved to 49.9 per cent. in the first half of 2018, compared to 53.9 per cent. in the first half of 2017. The cost of risk for the first six months ended 30 June 2018 was 0.16 per cent under IFRS 9 reflecting the Virgin Money Group's established risk appetite framework and the benign economic environment. Total capital investment in the business was £44.1 million for the six months ended 30 June 2018, incurred to support the customer proposition, systems, processes and strategic initiatives. The Virgin Money credit card book continued to perform strongly. A full and in depth analysis of customer behaviours as at 30 June 2018 was undertaken, which included the 49,000 customers who have come off their zero per cent promotion period during the first half of the year. This analysis resulted in a net adjustment to reduce total income by

Section B—Issuer		
Element	**Disclosure Requirement**	**Disclosure**
		£7.8 million across the whole portfolio to reflect those behaviours over the seven year modelling period, £5.4 million of the total represents income previously recognised and £2.4 million represents the present value of income not yet earned. In March 2018 the Virgin Money Group submitted an application for a reduction in its mortgage risk-weights to the PRA. The PRA has approved these model changes and the reduction in risk-weights resulted in a material increase in the Virgin Money Group's CET1 ratio from 13.8 per cent. at 31 December 2017 to 16.3 per cent. at 30 June 2018. The total capital ratio was 21.1 per cent. at 30 June 2018 and the leverage ratio was 3.8 per cent. at 30 June 2018. The Virgin Money Group's 2018 Supervisory Review and Evaluation Process ("**SREP**") took effect from 5 July 2018. If this outcome had been effective at 30 June 2018 the Virgin Money Group's minimum regulatory requirements for CET1 and total capital would have been 9.9 per cent. and 15.8 per cent. respectively. The minimum applicable leverage requirement recommended by the EBA remains at 3 per cent.
B.8	Selected key *pro forma* financial information	The unaudited pro forma financial information set out below has been prepared to illustrate the effect of the acquisition of the Virgin Money Group on: (i) the net assets of the CYBG Group as at 31 March 2018 as if the acquisition had taken place on 31 March 2018 and (ii) the consolidated income statement of the CYBG Group for the financial year ended 30 September 2017 as if the acquisition had taken place on 1 October 2016. The unaudited pro forma financial information, which has been produced for illustrative purposes only, by its nature addresses a hypothetical situation and, therefore, does not represent the CYBG Group's actual financial position or results. The unaudited pro forma financial information has been compiled on a basis consistent with the accounting policies of CYBG used to prepare its audited consolidated financial statements for the financial year ended 30 September 2017 and prepared in accordance with Annex II of the Prospectus Directive Regulation and on the basis of the notes set out below.

Section B—Issuer

Element	Disclosure Requirement	Disclosure

Unaudited Pro Forma Income Statement for the financial year ended 30 September 2017

		Adjustments			
	CYBG Group for the year ending 30 September 2017	Virgin Money Group for the year ending 31 December 2017	Adjustments to conform to disclosures	Acquisition Adjustments	Unaudited Pro Forma Combined Group
			(£ million)		
	Note 1	Note 2	Note 3	Note 4	Note 5
Interest income and similar income	1,075	958	—	—	2,033
Interest expense and similar charges	(231)	(363)	—	—	(594)
Net interest income	**844**	**595**	—	—	**1,439**
Gains less losses on financial instruments at fair value	6	(3)	—	—	3
Other operating income	186	42	29	—	257
Fee and commission income	—	29	(29)	—	—
Non-interest income	**192**	**68**	—	—	**260**
Total operating income	**1,036**	**663**	—	—	**1,699**
Personnel expenses.	(166)	—	(198)	—	(364)
Restructuring expenses	(67)	—	—	—	(67)
Depreciation and amortisation expense.	(87)	—	(35)	—	(122)
Other operating and administrative expenses	(400)	—	(123)	(92)	(615)
Operating expenses	—	(356)	356	—	—
Total operating and administrative expenses before impairment losses	**(720)**	**(356)**	—	**(92)**	**(1,168)**
Operating profit before impairment losses	**316**	**307**	—	**(92)**	**531**
Impairment losses on credit exposures	(48)	(44)	—	—	(92)
Profit on ordinary activities before tax	**268**	**263**	—	**(92)**	**439**
Tax expense	(86)	(71)	—	—	(157)
Profit for the year	**182**	**192**	—	**(92)**	**282**
Profit attributable to ordinary shareholders	146	192	—	(92)	246
Profit attributable to other equity holders	36	—	—	—	36
Profit for the year attributable to equity holders	**182**	**192**	—	**(92)**	**282**

(1) The CYBG Group's income statement for the year ended 30 September 2017 has been extracted, without material adjustment, from the CYBG Group 2017 annual financial statements, set out in the CYBG Annual Report 2017.

(2) The Virgin Money Group's income statement for the year ended 31 December 2017 has been extracted, without material adjustment, from the Virgin Money Group 2017 annual financial statements, set out in the Virgin Money Annual Report 2017.

(3) The following reclassifications were made to reflect the difference in accounting presentation under the CYBG Group's presentation as opposed to that of the Virgin Money Group:

(i) The Virgin Money Group discloses "Fee and commission income" separately on its income statements whereas the CYBG Group discloses this item within "Other operating income". This resulted in a £29 million reclassification between the aforementioned line items.

(ii) The CYBG Group discloses "Personnel expenses", "Depreciation and amortisation expense" and "Other operating and administrative expenses" separately on its income statement whereas the Virgin Money Group discloses these items within "Operating expenses". This resulted in a £356 million reclassification between the aforementioned line items.

(iii) The CYBG Group and the Virgin Money Group disclose equivalent Income Statement line items using different terms. The narrative used is summarised below:

Section B—Issuer		
Element	**Disclosure Requirement**	**Disclosure**

Narrative used by the CYBG Group	Narrative used by the Virgin Money Group
"Interest income and similar income"	"Interest and similar income"
"Interest expense and similar charges"	"Interest and similar expense"
"Gains less losses on financial instruments at fair value"	"Fair value losses on financial instruments"
"Non-interest income"	"Other income"
"Total operating income"	"Total income"
"Operating profit before impairment losses"	"Profit before tax from operating activities"
"Impairment losses on credit exposures"	"Impairment"
"Tax expense"	"Taxation"

(4) Adjustments not expected to have a continuing impact:

(i) Estimated transactions costs totalling £72 million (inclusive of VAT). The adjustments relate to estimated transaction costs of £39 million (inclusive of VAT), incurred by the CYBG Group, which includes stamp duty estimated to be £9 million, and £33 million (inclusive of VAT), incurred by the Virgin Money Group, all of which are expensed; and

(ii) As a result of the Offer, the Virgin Money Group will recognise an accelerated vesting charge, subsequent to 31 December 2017, in relation to its equity settled share based payment schemes of £20 million.

(5) No adjustments have been made for the following:

(i) The unaudited pro forma income statement does not reflect the effect of any fair value adjustments which may be recorded to acquired assets and liabilities. Upon completion of the purchase price allocation exercise, which will be finalised after Completion of the Combination, additional depreciation of property plant and equipment and amortisation of intangible assets, amongst other things, may be required in the Combined Group's financial statements.

(ii) No adjustment has been made to reflect any synergies that may arise after the transaction as these are dependent upon the future actions of management; and

(iii) No adjustment has been made to reflect the trading results of the CYBG Group since 30 September 2017 or the Virgin Money Group since 31 December 2017.

Section B—Issuer		
Element	**Disclosure Requirement**	**Disclosure**

Unaudited Pro Forma Net Assets Statement as at 31 March 2018

	CYBG Group as at 31 March 2018	Adjustments: Virgin Money Group as at 31 December 2017	Adjustments: Adjustments to conform to disclosures	Adjustments: Acquisition Adjustments	Unaudited Pro Forma Combined Group
			(£ million)		
	Note 6	Note 7	Note 8	Note 9	Note 11
Assets					
Cash and balances with central banks	6,150	2,579	—	(72)	8,657
Due from other banks	830	—	359	—	1,189
Financial assets available for sale	1,352	1,052	—	—	2,404
Other financial assets at fair value	421	—	—	—	421
Derivative financial instruments	334	79	—	—	413
Loans and advances to customers	32,137	—	36,741	—	68,878
Loans and receivables	—	37,100	(37,100)	—	—
Due from customers on acceptances	4	—	—	—	4
Property, plant and equipment	86	74	—	—	160
Investment properties	8	—	—	—	8
Intangible assets	371	128	—	440	939
Deferred tax assets	204	12	5	—	221
Defined benefit pension assets	222	—	—	—	222
Other assets	234	84	—	—	318
Total assets	**42,353**	**41,108**	**5**	**368**	**83,834**
Liabilities					
Due to other banks	2,683	5,379	—	—	8,062
Other financial liabilities at fair value	20	—	—	—	20
Derivative financial instruments	388	94	—	—	482
Due to customers	28,463	30,808	—	—	59,271
Liabilities on acceptances	4	—	—	—	4
Provision for liabilities and charges	458	—	8	—	466
Debt securities in issue	4,447	2,737	—	—	7,184
Retirement benefit obligations	3	—	—	—	3
Deferred tax liabilities	81	—	5	—	86
Current tax liabilities	—	24	(24)	—	—
Other liabilities	2,536	241	16	—	2,793
Total liabilities	**39,083**	**39,283**	**5**	**—**	**78,371**
Net assets	**3,270**	**1,825**	**—**	**368**	**5,463**

(6) The CYBG Group's net asset information as at 31 March 2018 has been extracted, without material adjustment, from the CYBG Group 2018 unaudited interim financial statements, as set out in the CYBG Interim Report 2018.

(7) The Virgin Money Group's net asset information as at 31 December 2017 has been extracted, without material adjustment, from the Virgin Money Group 2017 annual financial statements, as set out in the Virgin Money Annual Report 2017.

(8) The following reclassifications were made to reflect the difference in accounting presentation under the CYBG Group's presentation as opposed to that of the Virgin Money Group:

(i) The Virgin Money Group discloses "Loans and receivables" separately on its balance sheet, sub categorising this balance into: "Loans and advances to banks" (£359 million), Loans and advances to customers (£36,741 million) and Debt securities (£0.3 million). The CYBG Group discloses "Due from other banks" and "Loans and advances to customers" separately on its balance sheet. £37,100 million has been reclassified from "Loans and receivables," with £359 million reclassified into "Due from other banks", £36,741 million reclassified into "Loans and advances to customers", and £0.3 million reclassified into "Other assets".

(ii) The Virgin Money Group discloses "Deferred tax assets" on a net basis whereas the CYBG Group discloses "Deferred tax assets" and "Deferred tax liabilities" on a gross basis. This resulted in £5 million reclassification between the aforementioned line items.

Section B—Issuer

Element	Disclosure Requirement	Disclosure

(iii) Within line item "Other liabilities" the Virgin Money Group has included £8 million in relation to "provisions" whereas the CYBG Group includes such items separately on its balance sheet as "Provisions for liabilities and charges". This has been reclassified between the aforementioned line items.

(iv) The Virgin Money Group discloses "Current tax liabilities" separately on its balance sheet whereas the CYBG Group discloses such items in "Other liabilities". This resulted in a £24 million reclassification between the aforementioned line items accordingly.

(v) The CYBG Group and the Virgin Money Group disclose equivalent Balance Sheet line items using different terms. The narrative used is summarised below:

Narrative used by the CYBG Group	Narrative used by Virgin Money Group
"Cash and balances with central banks"	"Cash and balances at central banks"
"Financial assets available for sale"	"Available-for-sale financial assets"
"Property, plant and equipment"	"Tangible fixed assets"
"Due to other banks"	"Deposits from banks"
"Due to customers"	"Customer deposits"

(9) The adjustments arising as a result of the Offer are set out below:

(i) The equity consideration payable will be through an issuance of new ordinary shares by the CYBG Group (referred to as "consideration" in these notes). The consideration payable and the calculation of the adjustment to goodwill are set out below:

	(£ millions)
Estimated equity consideration	1,848
Net assets acquired of the Virgin Money Group (excluding intangible assets)	(1,697)
Estimated transaction costs incurred by the Virgin Money Group	33
Non-controlling interest—Additional Tier 1 Securities	384
Goodwill and other intangible assets arising on acquisition	**568**
Virgin Money Group intangible assets already recognised	(128)
Pro forma goodwill and other intangible assets adjustment	**440**

The consideration of £1,848 million has been calculated as the issuance of 546,954,891 New CYBG shares at a price of 338 pence per share being the Closing Price per CYBG Group Share as at the Latest Practicable Date. The consideration is calculated on a fully diluted basis and assumes 100 per cent. vesting of awards made under Virgin Money Share Plans, including awards where settlement is deferred. The consideration payable at completion will be different from the consideration included in this pro forma financial information as the number of shares to be issued and the share price will be calculated at the Effective Date.

The net assets acquired of £1,697 million comprise the net assets of the Virgin Money Group as at 31 December 2017 of £1,825 million net of Intangible assets of £128 million included in the Virgin Money Group balance sheet as at 31 December 2017.

The adjustment for non-controlling interest relates to the Virgin Money Additional Tier 1 securities ("**AT1 Securities**") listed on the Luxembourg Stock Exchange and included at a carrying value of the £384 million in the Virgin Money Group balance sheet as at 31 December 2017 and which have been assumed will be retained by the CYBG Group after Completion. These are classified within total equity by the Virgin Money Group and will continue to be classified within total equity by the Combined Group and will result in an adjustment in the calculation of goodwill attributable to the Transaction.

Under IFRS acquisition accounting, it is necessary to fair value the consideration paid and all the assets and liabilities of the acquired business. In the unaudited pro forma statement of net assets, no adjustments have been made to the fair values of the individual net assets of the Virgin Money Group to reflect any re-measurement to fair value that may arise as this exercise will not be undertaken until after the effective completion date.

(ii) Estimated transaction costs of £72 million (inclusive of VAT), of which £39 million (inclusive of VAT) incurred by the CYBG Group, which includes stamp duty estimated to be £9 million, and £33 million (inclusive of VAT) incurred by the Virgin Money Group, have been shown as an adjustment to "Cash and balances with central banks".

(10) No adjustment has been made to reflect the trading results of the CYBG Group since 31 March 2018 and the Virgin Money Group since 31 December 2017.

Element	Disclosure Requirement	Disclosure
B.9	Profit forecast and estimate	Not applicable; no profit forecast or estimate is included in this Prospectus.

Section B—Issuer		
Element	**Disclosure Requirement**	**Disclosure**
B.10	Qualifications in the audit reports	Not applicable; the audit and accountant's reports on the historical financial information contained in, or incorporated by reference into, this Prospectus are not qualified.
B.11	Working capital explanation	Not applicable; CYBG is of the opinion that the working capital available to the CYBG Group is sufficient for its present requirements, that is, for at least the next 12 months from the date of this Prospectus.

Section C—Securities		
Element	**Disclosure Requirement**	**Disclosure**
C.1	Type and the class of the securities	CYBG will issue up to 548,000,000 New CYBG Shares of £0.10 each in the capital of CYBG. The CYBG Shares are, and when admitted to trading, the New CYBG Shares will be, registered with ISIN number GB00BD6GN030 and SEDOL number BD6GN03 and will be traded on the London Stock Exchange under the ticker symbol "CYBG". CDIs representing the CYBG Shares are also quoted on the ASX under the ticker symbol "CYB". Steps will also be taken to allow for quotation of CDIs representing the New CYBG Shares on the ASX following Completion.
C.2	Currency of the securities issue	Pounds sterling
C.3	Shares issued / value per share	As at the Latest Practicable Date, CYBG has in issue 886,010,853 fully paid ordinary shares of £0.10 each.
C.4	Description of the rights attaching to the securities	The New CYBG Shares will be issued credited as fully paid and will rank *pari passu* in all respects with the CYBG Shares in issue at the time the New CYBG Shares are issued pursuant to the Offer, including in relation to any dividends or other distributions with a record date falling after the date of Completion. Subject to any special rights, restrictions or prohibitions as regards voting for the time being attached to any CYBG Shares (for example, in the case of joint holders of a share, the only vote which will count is the vote of the person whose name is listed before the other voters on the register for the share), CYBG Shareholders shall have the right to receive notice of and to attend and vote at general meetings of CYBG. Subject to the provisions of the 2006 Act, CYBG may from time to time declare dividends and make other distributions on the CYBG Shares. CYBG Shareholders are entitled to participate in the assets of CYBG attributable to their shares in a winding-up of CYBG or other return of capital, but they have no rights of redemption.
C.5	Restrictions on free transferability of the securities	Not applicable; there are no restrictions on the free transferability of CYBG Shares.
C.6	Admission / regulated markets where the securities are traded	Application will be made to the FCA and to the London Stock Exchange for the New CYBG Shares to be admitted to the premium listing segment of the Official List and to trading on the London Stock Exchange's main market for listed securities. It is expected that

Section C—Securities		
Element	**Disclosure Requirement**	**Disclosure**
		Admission will become effective, and that dealings in the New CYBG Shares will commence, on the Effective Date which, subject to the satisfaction of certain conditions, is expected to be in the fourth quarter of calendar year 2018. Steps will also be taken to allow for quotation of CDIs representing the New CYBG Shares on the ASX following Completion.
C.7	Dividend policy	The Directors and the Proposed Directors believe that CYBG Group will be able to support a progressive dividend distribution over time (after paying distributions on AT1 Securities).

Section D—Risks		
Element	**Disclosure Requirement**	**Disclosure**
D.1	Key information on the key risks that are specific to the company or its industry	The CYBG Group and, following Completion, the Combined Group's business will be subject to inherent risks arising from macro-economic conditions in the UK. In particular, levels of retail and small and medium-sized enterprise ("**SME**") borrowing are heavily dependent on consumer confidence, the UK property and mortgage market, employment trends, the level of inflation, market interest rates and the broader state of the UK economy. Any deterioration, uncertainty or volatility in relation to these factors could adversely impact the CYBG Group's and, following Completion, the Combined Group's business, results of operations, financial condition and prospects. In addition, changes in global economic conditions or circumstances (in particular in the Eurozone) may have secondary consequences that adversely impact the CYBG Group's and, following Completion, the Combined Group's results of operations and financial condition. The CYBG Group's primary activity is and, following Completion, the Combined Group's primary activity will be providing banking services to retail customers and to micro businesses and SMEs, including mortgage lending in the UK secured against residential property. The value of that security is influenced by UK house prices. A substantial proportion of the CYBG Group's net interest income is and, following Completion, the Combined Group's net interest income will be derived from interest paid on their mortgage portfolio. A fall in property prices could result in an increase in customer defaults, which could lead to higher impairment provisions and losses being incurred by the CYBG Group and, following Completion, the Combined Group. In addition, a significant increase in house prices could have a negative impact on the CYBG Group and, following Completion, the Combined Group by reducing the affordability of homes, which may reduce demand for new mortgages. Sustained volatility in UK house prices (which may partly result from the UK Government's intervention into the housing market) could also discourage purchases, thereby limiting the CYBG Group's and, following Completion, the Combined Group's ability to grow their mortgage portfolio in the UK. Furthermore, the introduction of provisions to limit the income tax relief on mortgage interest expense available on residential property to buy-to-let landlords from 6 April 2017, may also negatively affect mortgage demand. An increase in interest rates could lead to an increase in default rates among customers, reduce demand for mortgages and other loans

Section D—Risks		
Element	**Disclosure Requirement**	**Disclosure**
		generally or may result in other forms of financing becoming more attractive, thereby reducing the CYBG Group's and, following Completion, the Combined Group's lending and related income. In the event of sudden, large or frequent increases in interest rates, the CYBG Group and, following Completion, the Combined Group may not be able to re-price their floating rate assets and liabilities at the same time, giving rise to re-pricing gaps in the short term, which may negatively affect their net interest income and net interest margin. The UK's decision to leave the EU has brought political, legal, regulatory and market uncertainty and may have wider UK constitutional implications (including renewing constitutional debate in the UK, in particular with regards to a potential Scottish independence referendum), which could have a material adverse effect on the CYBG Group's and, following Completion, the Combined Group's business, prospects or results of operations. The UK referendum result has also led to downgrades of the UK sovereign by various ratings agencies and may lead to further downgrades in the future, which may result in downgrades of the CYBG Group's ratings and, following Completion, the Combined Group entities, which may increase their borrowing costs or challenge their access to wholesale funding from capital markets. The CYBG Group and, following Completion, the Combined Group face a variety of risks associated with the implementation of their medium term growth strategy. A failure to achieve their strategic objectives including driving sustainable customer growth, improving efficiency and optimising capital would have an adverse impact on the CYBG Group's and, following Completion, the Combined Group's ability to attract and retain customers, their reputation and their business, results of operations, financial condition and prospects, which in turn could have an adverse impact on the price of the Shares. The reputation of the CYBG Group and, following Completion, the Combined Group and their brands (including, following Completion, the "Virgin Money" brand) may be damaged by the actions, behaviour or performance of numerous persons (including Sir Richard Branson and his family or other companies which use the "Virgin" brand), which could have a material adverse effect on their business, results of operations, financial condition and prospects. In addition, the CYBG Group, and following Completion, the Combined Group, may lose the right to use the "Virgin Money" brand (which it will not own) in certain circumstances. Furthermore, the strength and recognition of the CYBG Group's existing brands may diminish following Completion. The market for financial services in the UK is highly competitive and the CYBG Group expects these pressures to continue in response to competitor behaviour, consumer expectations, technological changes, the impact of market consolidation and new market entrants, regulatory actions and other factors. Competition in the UK mortgage market including from challenger banks seeking scale and growth over a short period of time is continuing to create downward price pressure on mortgage and other lending rates. The pressure is expected to increase as ring-fencing legislation comes into force in the UK, with some ring-fenced competitor banks looking to deploy excess liquidity in the broker mortgage market. In addition, the CYBG Group intends to bid for a 'Pool A' award (in which there will be three grant amounts ranging from £60 million to £120 million) within the Capability and Innovation

Section D—Risks		
Element	**Disclosure Requirement**	**Disclosure**
		Fund and apply to be a participant in the Incentivised Switching Scheme, both of which make up the RBS Alternative Remedies Scheme put in place by HM Treasury in agreement with the European Commission as an alternative to the European Commission's original State Aid remedy arrangements that previously required RBS to divest the Williams & Glyn business. Failure to be accepted as a participant in the Incentivised Switching Scheme, successfully acquire RBS SME customers through the Incentivised Switching Scheme, and/or be awarded an amount from the Capability and Innovation Fund could weaken the CYBG Group's ability to further enhance its existing competitive capabilities against the existing incumbent UK banks and other firms in the banking and financial services sector. The CYBG Group's operations are and, following Completion, the Combined Group's operations will be heavily regulated and they must comply with numerous laws and regulations and may face enforcement action from regulators and others for any failure to comply. Regulatory enforcement actions pose a number of risks to the CYBG Group and, following Completion, the Combined Group, including substantial monetary damages or fines, the amounts of which are difficult to predict and may exceed the amount of provisions set aside to cover such risks. In addition, the CYBG Group and, following Completion, the Combined Group and/or their employees may be subject to other penalties and injunctive relief, civil or private litigation arising out of the same subject matters as a regulatory investigation, the potential for criminal prosecution in certain circumstances and regulatory restrictions, which could have a negative effect on the CYBG Group's and, following Completion, the Combined Group's reputation and the confidence of their customers, as well as taking a significant amount of management time and resources away from the execution of the CYBG Group's and, following Completion, the Combined Group's strategy and the operation of the business. The CYBG Group, the Virgin Money Group and the Combined Group are subject to UK structural reform legislation regarding ring-fencing. The impact of this on the CYBG Group and, following Completion, the Combined Group may result in increased compliance costs or restrictions in some areas of business that may have an adverse impact on the CYBG Group's and, following Completion, the Combined Group's financial condition and results of operations. The introduction of ring-fenced and non-ring-fenced banks may also affect the nature of competition within the UK market. Both the CYBG Group and the Virgin Money Group source a proportion of their funding from domestic and global capital markets. This includes TFS funding comprising in aggregate £8.7 billion, which represents 11 per cent. of total funding for the Combined Group. As part of its funding plan, the CYBG Group intends to continue to access the wholesale funding markets after Completion. Any dislocation in these funding markets or a reduction in investor appetite for holding their securities or other credit exposures to them may adversely affect the CYBG Group's and, following Completion, the Combined Group's ability to access funds or require them to access funds at a higher cost, or on unfavourable terms, or result in obtaining funding that does not efficiently match the maturity profile of their assets. The CYBG Group and, following Completion, the Combined Group are required to maintain minimum levels of capital and reserves relative to

Section D—Risks		
Element	**Disclosure Requirement**	**Disclosure**
		the balance sheet size and risk profile of their operations. Regulatory requirements are also subject to future change, for example to implement the finalisation of Basel III reforms. An actual or perceived shortage of capital could have a material adverse effect on the CYBG Group's and, following Completion, the Combined Group's business, which could, in turn, require the Combined Group to seek additional capital from shareholders and investors, and affect their capacity to pay future dividends or implement their business strategy, impacting future growth potential. The CYBG Group and, following Completion, the Combined Group face conduct, financial and reputational risks as a result of legal and regulatory proceedings, and complaints made to it directly or to the FOS or other relevant regulatory bodies, both against the CYBG Group and, following Completion, the Combined Group and against members of the UK banking industry more generally. The CYBG Group has now fully utilised the Capped Indemnity provided by NAB and exposure to claims relating to historic or future conduct matters may exceed the provisions on the CYBG Group and, following Completion, the Combined Group's balance sheet and such claims could therefore have a material adverse effect on the CYBG Group's and, following Completion, the Combined Group's business, results of operations, financial condition, capital and prospects. In addition, the CYBG Group may not be able to withdraw funds already paid by NAB under the Capped Indemnity into a designated account and, in certain circumstances, may be required to repay to NAB certain amounts received by it under the Capped Indemnity.
D.2	Key information on the key risks that are specific to the Offer	The implementation of the Offer is subject to the satisfaction, or, where permitted, waiver of certain conditions including, among other things, approvals of the CYBG Shareholders, the relevant Virgin Money Shareholders (including in respect of the Brand Licence Agreement) and receipt of certain regulatory clearances and approvals. There is no guarantee that these conditions will be satisfied and failure to satisfy any of these conditions may result in the Offer not being completed. If the Offer does not complete, the CYBG Group would nonetheless be obliged to pay approximately £12.2 million (excluding VAT) of transaction costs (primarily legal and advisory fees) incurred in connection with the Offer. The prospect of Completion could cause disruptions in the businesses of the CYBG Group and that of the Virgin Money Group. For example, either or both of the CYBG Group's or the Virgin Money Group's current and prospective customers may, in response to the announcement of the Offer, terminate, change or defer their custom, any such termination, change or deferral by current and prospective customers could materially and adversely impact the revenues, profits of the CYBG Group or the Virgin Money Group and/or any anticipated growth in the revenues could be lower than expected. Furthermore, both during the Offer process and if the Offer is completed, some current and prospective employees of the CYBG Group or the Virgin Money Group may experience uncertainty about their future roles within the Combined Group, which may adversely affect the CYBG Group's ability to retain or recruit key managers and other employees. Also, market reaction to and/or speculation regarding the likelihood of Completion could increase the volatility of the price of CYBG Shares.

Section D—Risks		
Element	**Disclosure Requirement**	**Disclosure**
		If the CYBG Group fails to manage these risks effectively, the business and financial results of the CYBG Group, and following Completion, the Combined Group could be adversely affected. The projected cost savings from the Offer may fail to materialise, including if the Offer is not completed as contemplated, or that they may be materially lower than have been estimated, which would have a significant impact on the profitability of the Combined Group in the future. The integration process following Completion may be more complex than anticipated. Successful integration will require a significant amount of management time and may affect or impair the ability of the management team of the Combined Group to run the business effectively during the period of integration and to execute the CYBG Group's existing strategic priorities. If the integration process proves more difficult or time consuming than is anticipated or if the Offer is not completed as contemplated, there is a risk to the operations of the Combined Group. The integration of the Virgin Money Group into the CYBG Group may cause disruptions or failures in the IT systems of the Combined Group, including, for example, from increasingly sophisticated attacks by cyber-crime groups or fraudulent activity in connection with customer accounts. Any such disruption could damage the reputation of the Combined Group, result in loss of customers and revenues and may adversely affect the integration process. It is possible that the costs of integration of the Virgin Money Group into the CYBG Group may be materially higher than anticipated, which would adversely affect the expected synergy benefits and in particular exceed anticipated cost savings as a result of the Offer.
D.3	Key information on the key risks that are specific to the securities	The market price of the New CYBG Shares and CYBG Shares could be subject to significant fluctuations due to a change in sentiment in the market regarding the value of such shares. The operating results and prospects from time to time of the CYBG Group, or, following Completion, the Combined Group may be below the expectations of market analysts and investors. Any of these events could result in a decline in the market price of the New CYBG Shares and CYBG Shares. The sale of CYBG Shares by substantial Shareholders (including Virgin Holdings) could depress the price of CYBG Shares. Application for Admission of the New CYBG Shares will be made prior to Completion. If Completion is delayed, the application for Admission will be delayed. Admission is subject to the approval (subject to satisfaction of any conditions which such approval is expressed) of the FCA. There can be no guarantee that any conditions to which Admission is subject will be met or that the FCA will approve Admission.

Section D—Risks		
Element	**Disclosure Requirement**	**Disclosure**
		Any future issue of CYBG Shares, including in connection with an offering, the conversion of AT1 Securities issued by the CYBG Group (including, following Completion, the Virgin Money AT1 Securities) or MREL eligible securities into CYBG Shares or any future acquisitions, any share incentive or share option plan or otherwise will further dilute the holdings of current Shareholders and could adversely affect the market price of CYBG Shares. Holders of CYBG Shares in overseas jurisdictions, in particular in the United States, may not be able to participate in future equity offerings of the CYBG Group or, if the Offer is completed, the Combined Group. Investors with a reference currency other than pounds sterling (including CDI Holders) will become subject to foreign exchange rate risk when investing in or holding the CYBG Shares (or CDIs). The CYBG Group's results of operations and financial condition are dependent on its trading performance and the trading performance of the members of the CYBG Group and, if the Offer is completed, the Combined Group and the ability of the CYBG Group to pay dividends is not guaranteed.

Section E—Offer		
Element	**Disclosure Requirement**	**Disclosure**
E.1	Total net proceeds and costs of the issue	The total costs, charges and expenses (including fees and commissions) (exclusive of VAT) payable by CYBG in connection with the Offer are estimated to amount to approximately £34.0 million (excluding VAT), including stamp duty of approximately £9 million. As set out below, CYBG is not receiving any proceeds for the issue of the New CYBG Shares.
E.2a	Reasons for the offer / use of the proceeds	Not applicable; neither this Prospectus nor the Offer constitutes an offer or invitation to any person to subscribe for or purchase any shares in CYBG or Virgin Money. CYBG and Virgin Money will not receive any proceeds as a result of the proposed Offer or issue of New CYBG Shares.
E.3	Terms and conditions of the offer	Not applicable; neither this Prospectus nor the Offer constitutes an offer or invitation to any person to subscribe for or purchase any shares in CYBG or Virgin Money. CYBG and Virgin Money will not receive any proceeds as a result of the proposed Offer or issue of New CYBG Shares.
E.4	Interests that are material to the issue / conflicting interests	Not applicable; there are no interests, known to CYBG, material to the issue of the New CYBG Shares or which are conflicting interests.
E.5	Selling shareholders / lock-up arrangements	Not applicable.
E.6	Dilution	If Completion occurs, it will result in the issue of 546,954,891 New CYBG Shares to the Virgin Money Shareholders, which would result in the Virgin Money Shareholders holding approximately 38 per cent. of

Section E—Offer		
Element	**Disclosure Requirement**	**Disclosure**
		the Company's enlarged share capital. If Completion occurs, the CYBG Shareholders will experience an immediate dilution as a result of the Offer following which they will hold approximately 62 per cent. of the issued share capital of CYBG.
E.7	Estimated expenses charged to the investor	Not applicable; no expenses will be directly charged to the investor by CYBG.

RISK FACTORS

Any investment in CYBG and the New CYBG Shares is subject to a number of risks. Prior to investing in such securities, prospective investors should consider carefully the factors and risks associated with any investment in the CYBG Shares or the New CYBG Shares, the business of the CYBG Group and, if the Offer is completed, the Combined Group and the industry in which they operate, together with all other information contained in this Prospectus including, in particular, the risk factors described below. Prospective investors should note that the risks summarised in the Part of this Prospectus headed "Summary" are the risks that the CYBG Directors and the Proposed Directors believe to be the most essential to an assessment by a prospective investor of whether to consider an investment in such securities. However, as the risks which the CYBG Group and, if the Offer is completed, the Combined Group face relate to events and depend on circumstances that may or may not occur in the future, prospective investors should consider not only the information on the key risks summarised in the Part of this Prospectus headed "Summary" but also, among other things, the risks and uncertainties described below.

The following is not an exhaustive list or explanation of all risks which prospective investors may face when making an investment in the securities and should be used as guidance only. Additional risks and uncertainties relating to the CYBG Group and, if the Offer completes, the Combined Group that are not currently known to the CYBG Directors or the Proposed Directors, or that the CYBG Directors or the Proposed Directors currently deem immaterial, may individually or cumulatively also have a material adverse effect on the business, results of operations or financial condition of the CYBG Group and, if the Offer completes, the Combined Group and, if any such risk should materialise, the price of such securities may decline and investors could lose all or part of their investment. Prospective investors should carefully consider whether an investment in the securities is suitable for them in the light of the information in this Prospectus and their personal circumstances.

The information given is as of the date of this Prospectus and, except as required by the FCA, the London Stock Exchange, the Listing Rules, the Prospectus Rules, the Market Abuse Regulation or any other applicable law, will not be updated. Any forward looking statements are made subject to the reservations specified under the section entitled "Forward Looking Statements" of this Prospectus.

None of the statements made in the risk factors that follow in any way qualify the Company's working capital statement set out in set out in paragraph 15 of Part XIII (Additional Information) of this Prospectus.

1. RISKS RELATING TO THE CYBG GROUP AND/OR THE VIRGIN MONEY GROUP AND, IF THE OFFER IS COMPLETED, THE COMBINED GROUP

1.1 The CYBG Group is and, following Completion, the Combined Group will be subject to risks arising from macro-economic conditions in the UK or globally

The CYBG Group and, following Completion, the Combined Group's business will be subject to inherent risks arising from macro-economic conditions in the UK. In particular, levels of retail and small and medium-sized enterprise ("**SME**") borrowing are heavily dependent on consumer confidence, the UK property and mortgage market, employment trends, the level of inflation, market interest rates and the broader state of the UK economy.

The evolution of the geo-political environment can also be expected to have a material impact on business performance with ongoing uncertainties around the potential impacts of the UK's withdrawal from the European Union (for further information, see the risk factor entitled "*Risks in relation to the UK's vote to leave the EU*"). The above will affect the future performance of the UK economy and subsequently the banking industry. The extent to which any or a combination of these events will have an impact on the performance of the economy will evolve over the medium term.

As the CYBG Group and, following Completion, the Combined Group's customer base will be predominantly based in the UK, they will be significantly exposed to the condition of the UK economy. In particular, factors such as UK house prices, levels of employment, interest rates, change in consumers' disposable income can each have a material impact on their business. Should macro-economic conditions in the UK deteriorate or should there be uncertainty and/or volatility in relation to these factors, this could adversely impact the CYBG Group's and, following Completion, the Combined Group's business, results of operations, financial condition and prospects.

The CYBG Group's operations are and, following Completion, the Combined Group's operations will be focussed in their core regions in the UK, including Scotland. These operations could be adversely affected by a lack of legal harmonisation across the UK, including through the further devolution of powers to the Scottish

Parliament. For example, differences in regulatory regimes or differing tax legislation between Scotland and England may result in additional compliance and other costs for the CYBG Group and, following Completion, the Combined Group or adversely impact the financial performance and prospects of their customers. Another referendum on Scottish independence which results in Scotland leaving the UK would exacerbate these issues and impact the CYBG Group's and, following Completion, the Combined Group's associated costs, business, results of operations, financial condition and prospects.

In addition, changes in global economic conditions or circumstances (in particular in the Eurozone) may have secondary consequences that adversely impact the CYBG Group's and, following Completion, the Combined Group's results of operations and financial condition. For example, central banks around the world have made efforts to increase liquidity in the financial markets, by taking measures such as increasing the amounts they lend directly to financial institutions and lowering interest rates. However, it is not certain how long or on what terms these central bank schemes will continue. There is some market expectation that certain central banks, including the Bank of England, may tighten their monetary policy to increase interest rates back to levels closer to historical norms. A prolonged period of low interest rates carries the risk that market participants may take on or have taken on more risk than they expected in a "search for yield", leaving them exposed to an earlier or more rapid than expected tightening in monetary policy. In June 2018, the European Central Bank announced that it would be reducing net asset purchases from €30 billion a month to €15 billion a month from September 2018, with its quantitative easing programme ending completely at the end of December 2018. The US Federal Reserve Board of Governors is also reducing the size of its asset purchases and the Bank of England brought its quantitative easing programme to a standstill in 2017. However, as at the Latest Practicable Date, the future interest rate framework has not been decided. An earlier than expected increase in interest rates or the divergence in the timing of tightening of monetary policy by the US Federal Reserve Board of Governors and other central banks, including the Bank of England and the European Central Bank, or the reduction in and/or unwinding of the US Federal Reserve Board of Governors', the European Central Bank's and/or the Bank of England's quantitative easing programmes may also result in volatility in capital flows, adverse fluctuations in currency markets, a suppression of demand and a reduction in the availability of credit, which may limit economic recovery in the UK or elsewhere.

In addition, volatility in credit, currency and equity markets globally may result in uncertainty that could affect all banks, including the CYBG Group and, following Completion, the Combined Group. Market volatility during the global financial crisis led to, and may in the future lead to, the following (amongst other factors):

(a) increased cost of funding and/or reduced availability of funding;

(b) deterioration in the value and liquidity of assets (including collateral);

(c) inability to price or difficulty in pricing certain assets;

(d) higher provisions for bad and doubtful debts;

(e) an increased likelihood of customer and counterparty default and credit losses;

(f) mark to market losses in the value of assets and liabilities;

(g) economic exposures from hedging activities;

(h) increased cost of insurance and/or lack of available insurance; and

(i) lower growth, business revenues and earnings.

The historical results of operations and financial condition of the CYBG Group have been, and the Combined Group's future results of operations and financial condition are likely to continue to be, affected by these factors, which should they have an adverse effect on consumer confidence, spending or demand for credit, could have a material adverse effect on the CYBG Group's and, following Completion, the Combined Group's business, capital position, financial condition, results of operations and prospects.

1.2 The CYBG Group and, following Completion, the Combined Group will be subject to risks related to volatility in UK house prices

The CYBG Group's primary activity is and, following Completion, the Combined Group's primary activity will be providing banking services to retail customers and to micro and SMEs, including mortgage lending in the UK secured against residential property. The value of that security is influenced by UK house prices. A substantial proportion of the CYBG Group's net interest income is and, following Completion, the Combined Group's net interest income will be derived from interest paid on their mortgage portfolio. As at 31 March 2018, 73.7 per cent. of the CYBG Group's customer loans by value were mortgages (both owner-occupied and buy-to-let). The Virgin Money Group's core lending activity is the provision of residential mortgages to individuals secured on residential properties located in the UK and represented 91.6 per cent. of gross loans and advances to customers as at 31 December 2017. Any deterioration in the quality of the CYBG Group's and, following Completion, the Combined Group's mortgage portfolio could have a material adverse effect on their business, financial condition, results of operations and prospects.

Historically, downturns in the UK economy have had a negative effect on the UK housing market. A fall in property prices could result in borrowers having insufficient equity to refinance their mortgage loans or being unable to sell the mortgaged property at a price sufficient to repay the amounts outstanding on the mortgage loan, which could lead to an increase in customer defaults. Increased defaults could lead to higher impairment provisions and losses being incurred by the CYBG Group and, following Completion, the Combined Group. Higher impairment provisions could reduce their capital and their ability to engage in lending and other income-generating activities. As a result, a decline in house prices could have a material adverse effect on the CYBG Group's and, following Completion, the Combined Group's business, financial condition, results of operations and prospects.

In addition, a significant increase in house prices could have a negative impact on the CYBG Group and, following Completion, the Combined Group by reducing the affordability of homes for first-time buyers or those looking to purchase more expensive properties and, if such increases were to result in a decrease in the number of customers that could afford to purchase houses, a reduction in demand for new mortgages. Sustained volatility in UK house prices could also discourage potential homebuyers from committing to a purchase, thereby limiting the CYBG Group's and, following Completion, the Combined Group's ability to grow their mortgage portfolio in the UK.

The UK Government's intervention into the housing market over the past few years, both directly through its "Help to Buy" programme and indirectly through the provision of liquidity to the banking sector under the "Funding for Lending" scheme ("**FLS**") and the "Term Funding Scheme" ("**TFS**"), may also contribute to volatility in house prices. Whilst it is not possible to confirm a direct link between the TFS, bank lending and mortgage rates, the rates offered by UK banks fell following the introduction of the TFS, which ran until February 2018 and the closure of the TFS may impact lending and therefore house prices. Similarly, as the TFS reaches its final maturity in 2022, UK banks will have to replace these funds from other sources which may be at a higher cost which could lead to lower lending and/or higher mortgage interest rates which could also contribute to volatility in house prices. This could occur, for example, as a result of the termination of the "Help to Buy" programme (or its Scottish equivalent scheme), which could lead to a decrease in house prices, or due to the continuation of the "Help to Buy" programme, which could lead to increases in house prices and a resultant "bubble" in the housing market. In addition, new rules promulgated by the FCA following the Mortgage Market Review that came into force in April 2014, and amended the existing rules on mortgage lending with changes centred on responsible lending, including increased verification of income, assessment of affordability, interest rate stress tests, and assessments of future changes of borrowers' income which together could make it more difficult for customers to borrow and reduce demand for mortgages.

For information on the Combined Group's exposure to the TFS, please refer to the risk factor entitled "*The CYBG Group is and, following Completion, the Combined Group, will be subject to risks relating to the availability of liquidity and funding at a commercially acceptable cost*".

Furthermore, the introduction of provisions to limit the income tax relief on mortgage interest expense available on residential property to buy-to-let landlords from 6 April 2017, may also negatively affect mortgage demand. As at 31 March 2018, 32 per cent. of the CYBG Group's outstanding mortgage balances were buy-to-let loans and 92 per cent. of such buy-to-let loans were on an interest-only basis. For the Virgin Money Group, the proportion of gross lending in the year ended 31 December 2017 to buy-to-let customers was 19 per cent. Borrowers of buy-to-let mortgages have benefitted in recent years from a combination of low interest rates, rising house prices and increasing rents. First time buyers have struggled to raise the required deposit to allow them to purchase their own homes. If rental rates were to decrease or remain stagnant, interest rates were to increase, further tax changes were to reduce the post-tax return on buy-to-let investments and/or the economy were to weaken and place pressure on employment, consumer incomes and/or house prices, the credit performance of the CYBG Group's and, following Completion, the Combined Group's buy-to-let mortgage book could deteriorate, which in turn could have a material adverse effect on the CYBG Group's and, following Completion, the Combined Group's business, financial condition, results of operations and prospects.

The future impact of these changes on the UK housing market and other regulatory changes or UK Government programmes, such as the UK implementation of the European Union Mortgage Credit Directive which came into force in March 2016, whether or not the CYBG Group and, following Completion, the Combined Group participates in them, is difficult to predict and plan for. Volatility in the UK housing market occurring as a result of such changes, such as a decrease in mortgage volumes due to stricter lending criteria, or for any other reason, could have a material adverse effect on the CYBG Group's and, following Completion, the Combined Group's business, financial condition, results of operations and prospects.

1.3 **The CYBG Group is and, following Completion, the Combined Group will be exposed to risks relating to the supply and affordability of property in the UK.**

The CYBG Group's and, following Completion, the Combined Group's owner-occupied and buy-to-let mortgage lending is and will be dependent on a number of factors related to the supply and affordability of property in the UK.

In October 2014, the PRA issued rules and the FCA issued guidance to limit the volume of new mortgage lending for owner-occupied housing for loans with a loan-to-income ratio of over 4.5 times to no more than 15 per cent. of new loans, implementing a recommendation made in June 2014 by the Financial Policy Committee ("**FPC**"), a Bank of England committee responsible for ensuring financial stability. For the CYBG Group and, following Completion, the Combined Group to maintain and grow their mortgage portfolio, the prices of new and existing properties must be at levels, relative to the income of purchasers, to allow them to borrow within the parameters of these regulatory restrictions on lending. If house prices are at too high a multiple of customer income, whether as a result of rising house prices and/or low customer income growth, potential customers will be unable to borrow and the supply of mortgages will decrease.

The CYBG Group's and, following Completion, the Combined Group's owner-occupied mortgage lending requires a supply of newly built or developed property coming to the market that relies on mortgage lending for financing, as well as transaction volumes within the market for existing property being at a sufficiently high level to support a profitable level of owner-occupied mortgage lending. A decrease in housing transaction volumes could lead to a reduction in demand for owner-occupied mortgages and a fall in related mortgage revenues, which could have a material adverse effect on the CYBG Group's and, following Completion, the Combined Group's business, financial condition, results of operations and prospects.

Average house prices in the UK have generally been on an upward trend since February 2009, but the annual rate of house price growth has generally slowed since the end of 2014. Whilst house prices are not expected to fall significantly over the short to medium term, if UK house prices were, in the future, to begin to follow a falling trend or if house prices in those regions that the CYBG Group and, following Completion, the Combined Group has significant exposure begin to follow a falling trend, in particular in Scotland, the North of England, the South East of England and London, this would be likely to result in an increase in the CYBG Group and, following Completion, the Combined Group's residential mortgage loan impairment charges as the value of the security underlying its mortgage loans is eroded. Higher impairment charges could reduce the CYBG Group and, following Completion, the Combined Group's profitability, capital and its ability to engage in lending and other income generating activities and, therefore, could have a material adverse effect on the CYBG Group and, following Completion, the Combined Group's business and potentially on its ability to implement its medium term growth strategy.

The CYBG Group's and, following Completion, the Combined Group's buy-to-let lending primarily targets lending to high and medium net worth clients looking to diversify their investments. The buy-to-let market in the UK is predominantly dependent upon yields from rental income to support mortgage interest payments and capital gains from capital appreciation. Falling or flat rental rates and decreasing capital values, whether coupled with higher mortgage interest rates or not, coupled with the introduction in 2017 of stricter affordability tests and the stress-testing of interest rate rises, could reduce the potential returns from buy-to-let properties. In addition, the introduction of provisions to limit the income tax relief on mortgage interest expense on residential property available to buy-to-let landlords from 6 April 2017, will result in lower net yields on mortgaged buy-to-let property investments. These factors, and the introduction of a 3 per cent. stamp duty surcharge on purchases of buy-to-let and second homes that applies to sales completed on or after 1 April 2016 have made the purchase of buy-to-let properties a less viable investment opportunity and may reduce the demand for buy-to-let mortgages.

1.4 The CYBG Group is and, following Completion, the Combined Group will be subject to risks associated with interest rate levels and volatility

Interest rates, which are impacted by factors outside of the CYBG Group's and, following Completion, the Combined Group's control, including the fiscal and monetary policies of governments and central banks, as well as UK and international political and economic conditions, affect the CYBG Group's and, following Completion, the Combined Group's results of operations, financial condition and return on capital in three principal areas: cost and availability of funding, impairment levels and net interest income and margins.

First, interest rates affect the cost and availability of the principal sources of the CYBG Group's and, following Completion, the Combined Group's funding, which is largely provided by customer deposits (in the form of personal current accounts ("**PCAs**"), business current accounts ("**BCAs**") and savings accounts) and wholesale funding from the capital markets, in the form of residential mortgage backed securities ("**RMBS**"), covered bonds and senior debt. The sustained low interest rate environment in recent years has resulted in the CYBG Group's absolute cost of funding remaining relatively low by historical standards, by reducing the interest payable on customer deposits. However, it has also reduced incentives for consumers to save and, in doing so, potentially affected the amount of funding from customer deposits that could be provided to banks, as consumers are incentivised to seek alternative investments offering returns higher than those offered by PCAs, BCAs or savings accounts. The sustained low interest rate environment in recent years has also reduced incentives for consumers to transfer balances to accounts. If and when interest rates increase, customers may increasingly transfer PCA and BCA balances, as well as other deposit balances, to higher rate products, which could result in increased interest expense and/or reduced deposit volumes for the CYBG Group and, following Completion, the Combined Group.

The CYBG Group raises funding from a number of wholesale sources, including secured funding through RMBS and covered bond programmes, senior debt from its medium term note programme and shorter-term wholesale funding. The Virgin Money Group also sources a proportion of its funding in the wholesale markets, including funding through its RMBS securitisations and its global medium term note programme, as well as shorter term wholesale funding. Any significant increase in interest rates could have a material adverse impact on the availability and interest cost of such funding.

Secondly, interest rates impact the CYBG Group's and, following Completion, will impact the Combined Group's impairment levels, particularly because (if passed on to customers) they affect customer affordability of mortgages, as well as the ability of individuals and SMEs to borrow and service loans. An increase in interest rates, without a comparable increase in customer income or SME revenues and profits, could, for example, lead to an increase in default rates among customers who can no longer afford their repayments, in turn leading to increased impairment charges and lower profitability for the CYBG Group and, following Completion, the Combined Group. A high interest rate environment may also reduce demand for mortgages and other loans generally, as individuals and SME customers may be less likely or less able to borrow when interest rates are high. A high interest rate environment may result in other forms of financing, such as equity capital for SMEs, becoming more attractive, thereby reducing the CYBG Group's and, following Completion, the Combined Group's lending and related income. In a low interest rate environment, there is a risk that borrowers at early levels of financial distress will not be identified in a timely manner, as they may continue to be able to service their loans, which may contribute to higher impairment levels in the future. This may be exacerbated when interest rates change frequently.

Thirdly, interest rates affect the CYBG Group's and, following Completion, the Combined Group's net interest income and margins. As at the date of this Prospectus, the Bank of England base rate was 0.50 per cent., having been held at 0.50 per cent. since March 2009 and reduced in August 2016 before being increased back to 0.50 per cent in November 2017. In the 30 years preceding December 2007, the lowest level of the base rate was 3.5 per cent. This low interest rate environment has impacted net interest income and margins throughout the UK banking industry, including at the CYBG Group.

Over the last few years, the sustained period of low interest rates resulted in lower returns on low interest bearing and non-interest bearing current accounts and capital, reducing the CYBG Group's net interest income and net interest margin. The CYBG Group's and, following Completion, the Combined Group's business and financial performance and net interest income and margin may continue to be adversely affected by the continued low interest rate environment.

In the event of sudden, large or frequent increases in interest rates, the CYBG Group and, following Completion, the Combined Group may not be able to re-price their floating rate assets and liabilities at the same time, giving rise to re-pricing gaps in the short term, which may negatively affect their net interest income and net interest margin.

As at 31 March 2018, 29 per cent. of the CYBG Group's customer deposits were variable rate savings accounts, which together with other floating rate liabilities exposes the CYBG Group and, following Completion, the Combined Group to the risk of increased costs if interest rates increase. In an increasing interest rate environment, the CYBG Group and, following Completion, the Combined Group may also be more exposed to re-pricing of their liabilities than competitors with a lower proportion of variable rate deposits or other liabilities.

If the CYBG Group and, following Completion, the Combined Group are unable to manage their exposure to interest rate volatility, whether through hedging, product pricing, monitoring of borrower credit quality or other means, such volatility could have a material adverse effect on their business, financial condition, results of operations and prospects.

1.5 Risks in relation to the UK's vote to leave the EU

On 23 June 2016, the UK voted to leave the EU in a referendum (the "**UK Referendum**"). On 29 March 2017, the UK Government exercised its right under Article 50 of the Treaty on the EU to leave the EU. At this stage both the terms and the timing of the UK's exit from the EU are unclear, and it could take considerable time to negotiate, draft and approve a withdrawal agreement in accordance with Article 50 of the Treaty on EU. Moreover, the nature of the relationship between the UK and the EU following the UK's exit (the "**EU27**") has yet to be agreed and negotiations with the EU on the terms of the exit have demonstrated the difficulties that exist in reaching such an agreement. In addition to the economic and market uncertainty this brings (see "*—(d) Market uncertainty*" below), there are a number of other potential risks which may arise as a result of the UK Referendum result. If any of these risks materialise, they could have a material adverse effect on the CYBG Group's and, following Completion, the Combined Group's business, prospects or results of operations:

(a) *Political uncertainty*

Following the UK Referendum, the UK has entered into a period of political uncertainty. Such uncertainty could lead to a high degree of economic and market disruption and legal uncertainty. It is not possible to ascertain how long this period will last and the impact it will have on the UK in general. CYBG cannot predict when or if political stability will return.

(b) *Legal uncertainty*

A significant proportion of English and Scots law currently derives from or is designed to operate in concert with EU law. This is especially true of English and Scots law relating to financial markets, financial services, prudential and conduct regulation of financial institutions, bank recovery and resolution, payment services and systems, settlement finality, market infrastructure and mortgage and consumer credit regulation. Depending on the timing and terms of the UK's exit from the EU, significant changes to English and Scots law in areas relevant to the CYBG Group and, following Completion, the Combined Group can be expected. CYBG cannot predict what any such changes will be. This could increase uncertainty and compliance costs for the CYBG Group and, following Completion, the Combined Group.

(c) *Regulatory uncertainty*

There is significant uncertainty about how EU27 financial institutions with assets (including branches) in the UK will be regulated and *vice versa*. At present, EU single market regulation allows regulated financial institutions (including credit institutions, investment firms, alternative investment fund managers, insurance and reinsurance undertakings) to benefit from a passporting system for regulatory authorisations required to conduct their businesses, as well as facilitating mutual rights of access to important elements of market infrastructure such as payment and settlement systems. EU law is also the framework for mutual recognition of bank recovery and resolution regimes.

Once the UK ceases to be an EU Member State, the current passporting arrangements will cease to be effective, as will the current mutual rights of access to market infrastructure and current arrangements for mutual recognition of bank recovery and resolution regimes. The ability of regulated financial institutions to continue to do business between the UK and the EU after the UK ceases to be an EU Member State would therefore be subject to separate arrangements between the UK and the EU, in respect of which negotiations have not yet begun. There can be no assurance that there will be any such arrangements concluded and, if they are concluded, on what terms. Following Completion, the Combined Group may therefore be at risk of losing the ability to passport into EU Member States. Currently, as set out in the Financial Services Register, Clydesdale Bank PLC has the ability to exercise passporting rights to certain EEA jurisdictions and exercises those rights.

According to the Financial Services Register, none of the regulated entities within the Virgin Money Group currently passports out into EEA countries. The loss of passporting would, therefore, impact the Combined Group's ability to carry out business in EEA countries. The Combined Group would be impacted by this to the extent that it proposes to carry out regulated activities in EEA countries, but its UK customer base and operations would not be directly impacted.

(d) ***Market uncertainty***

Since the UK Referendum, there has been volatility and disruption of the capital, currency and credit markets, including the market for debt and equity securities.

(e) ***Wider UK constitutional implications***

The UK Referendum has also caused renewed constitutional debate within the UK. Majorities of voters in both Scotland and Northern Ireland voted to remain in the EU. Senior political figures in both Scotland and Northern Ireland have suggested that they have a mandate from their voters to remain in the EU and might seek to leave the UK in order to achieve that outcome. On 28 March 2017, the Scottish Parliament gave approval for a motion to grant the Scottish Government a mandate to begin discussions with the UK Government over an independence referendum for Scotland. However, the UK Prime Minister has indicated that the UK Government does not support an independence referendum for Scotland prior to the UK exit from the EU. There is therefore inherent uncertainty surrounding the potential for a Scottish independence referendum.

A future departure of Scotland from the UK could impact the fiscal, monetary and regulatory landscape to which the CYBG Group is and, following Completion, the Combined Group will be subject and may create additional costs for them (including changes to pension arrangements, costs of regulatory compliance and, if deemed necessary, a change of headquarters to England). While the operational consequences of independence remain uncertain, it could (1) result in changes to the economic climate in Scotland and political and policy developments, (2) have an impact on Scots law, regulation accounting or administrative practice in Scotland, and/or (3) result in Scotland not continuing to use pounds sterling as its base currency.

Risks and uncertainties associated with a departure of Scotland from the UK could materialise both before any referendum for independence takes place and, in addition, in the case of a vote for independence, after the referendum but before independence.

(f) ***Rating actions***

The UK Referendum has resulted in downgrades of the UK sovereign by S&P, Fitch and Moody's Investors Service Ltd. S&P and Fitch have a negative outlook on the UK sovereign rating, suggesting a possibility of further negative rating action.

The rating of the sovereign may affect the ratings of entities operating in its territory, and in particular the ratings of financial institutions. Further downgrades of the sovereign rating may result in downgrades of the CYBG Group's ratings and, following Completion, the Combined Group entities, which may increase their borrowing costs or challenge their access to wholesale funding from capital markets.

1.6 The CYBG Group and, following Completion, the Combined Group face risks associated with the implementation of their medium term growth strategy.

The CYBG Group and, following Completion, the Combined Group face a variety of risks associated with the implementation of their medium term growth strategy. A failure to achieve their strategic objectives including driving sustainable customer growth, improving efficiency and optimising capital, as described in more detail in Part II (*Information on the CYBG Group*), would have an adverse impact on the CYBG Group's and, following Completion, the Combined Group's ability to attract and retain customers, their reputation and their business, results of operations, financial condition and prospects, which in turn could have an adverse impact on the price of the Shares.

Risks associated with the CYBG Group's and, following Completion, the Combined Group's strategy to drive sustainable customer growth in their loan portfolio and deposit base

In seeking to grow their mortgage, SME lending and unsecured personal lending books, the CYBG Group is and, following Completion, the Combined Group will be susceptible to the risk of reduced asset quality and increased impairment losses in their customer loan portfolio due to them broadening their target market (including to meet post-Completion targets) or loosening their underwriting or lending criteria in order to attract additional customers, or applying a broader interpretation of existing underwriting or lending criteria. As a result of the Offer, the CYBG Group may also inherit a higher risk portfolio than it currently has. The CYBG Group and, following Completion, the Combined Group are also subject to the risk of increased competition, including competition based on price, in seeking to grow their customer loan portfolio, which could adversely affect the CYBG Group's and, following Completion, the Combined Group's net interest margin and returns. Furthermore, banks seeking growth through increased lending volumes may also incur higher impairments and increased conduct risks, in particular those relating to the mis-selling of products or lending that is deemed irresponsible and/or services that are either poorly matched with, or superfluous to, customer needs. If the CYBG Group and, following Completion, the Combined Group fail to manage these risks adequately, it could result in legal or regulatory action against the CYBG Group and, following Completion, the Combined Group, reputational damage to their brands and adverse impacts on the implementation of their medium term growth strategy.

The CYBG Group's and, following Completion, the Combined Group's continued ability to maintain and grow their customer loan portfolio depends on continued access to customer deposits and other sources of funding in quantities sufficient to finance and refinance the portfolio at costs that the CYBG Group and, following Completion, the Combined Group considers to be commercially acceptable. A key component of the CYBG Group's and, following Completion, the Combined Group's medium term growth strategy is to grow their retail and SME deposits, and in particular to increase the volume of new PCA and BCA accounts, in order to fund the growth of their business and maintain the loans-to-customer deposits ratio ("**LDR**") at its targeted level. Access to customer deposits is subject to competition and market factors that are outside of the CYBG Group's and, following Completion, the Combined Group's control, and accordingly they may need to increase the interest rates they offer to customers in order to attract deposits, which may result in increased interest expense, reduced net interest income and reduced net interest margin. The CYBG Group and, following Completion, the Combined Group may not be able to obtain and maintain access to sufficient customer deposits, or other sources of funding at costs which are commercially acceptable, to finance their planned medium term growth.

Risks associated with the CYBG Group's and, following Completion, the Combined Group's digital strategy

A core part of the CYBG Group's and, following Completion, the Combined Group's medium term growth strategy is strengthening their digital platform to support the delivery of a consistent and seamless experience for customers through the CYBG Group's omni-channel distribution platform, creating new digital propositions to support new customer acquisition and customer retention, and simplifying their operating platform to drive efficiency, process simplification and customer acquisition. If the CYBG Group or, following Completion, the Combined Group fails to successfully execute its digital strategy, fails to invest sufficiently, fails to invest to the same extent as its competitors, fails to invest in appropriate technologies or customers (in particular SME customers), or fails to adopt the high-tech, light touch service model that the CYBG Group's medium term growth strategy anticipates, the CYBG Group's and, following Completion, the Combined Group's business, results of operations, financial condition and prospects could be materially adversely affected. The CYBG Group and, following Completion, the Combined Group also may be required to make further expenditure or investments (such as marketing, customer incentives or pricing changes) in order to achieve their strategic targets. Further innovation by competitors, for example through "digital disruption" of existing product or service markets causing changes in consumer demands and behaviours, or other changes in consumer behaviour, may require them to adapt their plans and/or revise their strategy, causing delay in their implementation or resulting in additional costs. There is a risk that the execution of the CYBG Group's and, following Completion, the Combined Group's digital strategy will increase the demands on their existing on-boarding, monitoring and screening IT systems. The failure of any of these IT systems to meet such increased requirements could have a material adverse effect on the CYBG Group's and, following Completion, the Combined Group's business, results of operations, financial condition and prospects. Any failure to successfully implement their digital strategy, delay in such implementation or failure to keep pace with further changes in the industry could have a material adverse effect on the CYBG Group's and, following Completion, the Combined Group's business, results of operations, financial condition and prospects.

A risk event, such as compliance breaches, cyber-enabled crime and fraud (for further information, see the risk factor entitled "*The CYBG Group and, following Completion, the Combined Group are exposed to risks associated with cyber-enabled crime and fraud*"), or a significant operational or technology failure, may adversely affect the execution of the CYBG Group's and, following Completion, the Combined Group's digital strategy, which could lead to a material adverse effect on the CYBG Group's and, following Completion, the Combined Group's business, results of operations, financial condition and prospects.

Execution and other risks associated with the CYBG Group's and, following Completion, the Combined Group's medium term growth strategy

The CYBG Group's and, following Completion, the Combined Group's ability to implement their medium term growth strategy successfully is subject to execution risks, including those relating to the management of their cost base and limitations in their management and operational capacity. The implementation of their medium term growth strategy will require management to make complex judgments, including anticipating customer needs and customer behaviour across a wide range of retail and SME banking products, and anticipating competitor activity, legal and regulatory changes and the likely direction of a number of macro-economic factors regarding the UK economy and the retail and SME banking sector. In addition, the CYBG Group and, following Completion, the Combined Group may fail to achieve management's guidance, targets or expectations in respect of the CYBG Group's and, following Completion, the Combined Group's net interest margin, operating and administrative expenses, standalone costs as a listed entity, return on tangible equity, dividends, growth in mortgage lending, total retail lending and/or SME lending, growth in mortgage market share, SME lending market share, PCA market share and/or BCA market share, or in the development of the CYBG Group's and, following Completion, the Combined Group's asset quality, cost-to-income, jaws, CET1 capital and/or LDR, or other financial or key performance indicators. Following Completion, there is a risk that additional spend will be required to align the information security control on Virgin Money's applications and infrastructure to CYBG's existing security posture, there is also a risk that a greater than expected level of complexity in the integration of Virgin Money's business and system with CYBG will be encountered, either of which could result in increased costs and could have a material adverse effect on the CYBG Group's and the Combined Group's business, results of operation, financial condition and prospects.

The risk that some or all of these targets and expectations may fail to be achieved may be a consequence of internal factors such as a failure to effectively manage their cost base. The risk may also be exacerbated or caused by a number of external factors, including a downturn in the UK, European or global economy, increased competition in the UK retail and SME banking sector and/or significant or unexpected changes in the regulation of the financial services sector in the UK or Europe or in relation to the payment of dividends. A failure to successfully manage the implementation of their medium term growth strategy for the foregoing could have a material adverse effect on the CYBG Group's and, following Completion, the Combined Group's business, results of operations, financial condition and prospects.

1.7 **The reputation of the CYBG Group and, following Completion, the Combined Group and their brands (including the "Virgin Money" brand) may be damaged by the actions, behaviour or performance of numerous persons**

The CYBG Group offers its full-service retail and SME banking proposition through its "Clydesdale Bank", "Yorkshire Bank" and "B" brands. CYBG has reached an agreement with Virgin Enterprises that, following Completion, the Combined Group will have, subject to certain exclusions and reservations of rights, exclusive and perpetual access to use of the "Virgin Money" brand in respect of all banking and financial services and products which are offered in the ordinary course of business by UK clearing banks, challenger banks, all investment or savings products and services, and all insurance products and services, as well as certain related non-exclusive rights to use the "Virgin" trade marks. Any event or circumstance that causes damage to the CYBG Group and, following Completion, the Combined Group or their brands could have a material adverse effect on their business, results of operations, financial condition and prospects.

The CYBG Group's and, following Completion, the Combined Group's brands may be damaged by the actions, behaviour or performance of their employees, affiliates, suppliers, counterparties, regulators, customers and/or other activists, or the financial services industry generally. A risk event, such as compliance breaches, cyber-enabled crime and fraud (for further information, see the risk factor below entitled "*The CYBG Group and, following Completion, the Combined Group are exposed to risks associated with cyber-enabled crime and fraud*"), or a significant operational or technology failure, or a fall in customer service levels, or demonstrations by customers and/or other activists, may cause business disruption or adversely affect the perceptions of the CYBG Group and, following Completion, the Combined Group held by the public, shareholders, investors, customers, employees, regulators or rating agencies. A risk event itself may expose the CYBG Group and, following Completion, the Combined Group to direct losses as a result of litigation, fines and penalties, remediation costs or loss of key personnel as well as potential impacts on CYBG's share price. There is also a risk that customers may not support or be deterred by the rebranding of CYBG's business and/or the ongoing use of the "Virgin Money" brand, which may adversely impact the CYBG Group or, following Completion, the Combined Group.

In particular, the "Virgin" brand is used in a wide range of different economic sectors in the UK and internationally. Following Completion, the Combined Group will be exposed to the risk that others associated with the "Virgin" brand, including Sir Richard Branson and his family or other companies which use the "Virgin" brand, may bring the brand into disrepute. The "Virgin" brand is positioned as an innovative brand and many of the ventures to which it is attached are in the public eye. Following completion, the Combined Group faces the risk that should any of such innovative activities not be successful, this will be heavily reported and there may be a negative effect on the reputation and the strength of the "Virgin" brand which may have similar consequences on the "Virgin Money" brand or the Combined Group and its brands generally. Furthermore, should Sir Richard Branson cease to be connected to the "Virgin" brand, for example, through exiting the business or upon his death, the goodwill of the "Virgin" brand, especially the brand's popularity with consumers, may suffer a decline which may have similar consequences on the "Virgin Money" brand.

Reputational damage to the CYBG Group or its brands may adversely impact the CYBG Group's and, following Completion, the Combined Group's ability to attract and retain customers or employees in the short and long-term and the ability to pursue new business opportunities. It may also result in a higher risk premium being applied to the CYBG Group and, following Completion, the Combined Group, which could adversely impact the cost of funding their operations and their financial condition.

1.8 The CYBG Group, and following Completion, the Combined Group, may lose the right to use the "Virgin" and "Virgin Money" brands (which it will not own)

Following Completion, in order for the Combined Group to use the "Virgin" and "Virgin Money" names and brands (which it will not own), the Combined Group will be required to comply with certain obligations under the brand licence agreement entered into between CYBG and Virgin Enterprises Limited ("**Virgin Enterprises**") (the "**Brand Licence Agreement**"). The Brand Licence Agreement has a perpetual term. Virgin Enterprises will have the right to terminate the Brand Licence Agreement in certain circumstances, including amongst other things: (i) if CYBG challenges Virgin Enterprises' ownership of, entitlement to license and/or the validity of the licensed trade marks; (ii) on CYBG's insolvency; (iii) upon CYBG's material, unremedied breach of the Brand Licence Agreement; (iv) if CYBG undergoes a change of control and the acquirer is a direct competitor of Virgin Enterprises (or any of its licensees) in the UK, or an entity involved in any business or activity, or possessing a reputation or financial standing which would be reasonably likely to materially damage the value or reputation of the "Virgin Money" or "Virgin" brands; and (v) CYBG's failure to comply with the must-use requirement under the Brand Licence Agreement (which requires, following the rebranding period, at least 80 per cent. of the Combined Group's turnover to be generated under the marks licensed by Virgin Enterprises). In certain circumstances, the termination of the Brand Licence Agreement by Virgin Enterprises for cause entitles it to receive a termination fee from CYBG in lieu of a damages claim. Loss of the Combined Group's rights to use the "Virgin" and "Virgin Money" names and brands under the Brand Licence Agreement could have a material adverse effect on the Combined Group's business, financial condition, results of operations and/or prospects. Further information on the Brand Licence Agreement is set out in paragraph 13.3 of Part XIII (*Additional Information*).

Virgin Enterprises may allow other Virgin Enterprises licensees to use the "Virgin" name and brand for financial products and services in certain defined circumstances. The use by any other Virgin Enterprises licensee of the "Virgin" name in relation to financial services and products may represent a dilution of the Combined Group's exclusivity in the financial services field, and could: (i) cause customer confusion and (ii) create potential reputational damage if the Virgin Enterprises licensee providing the ancillary financial products or services does anything that damages the goodwill of the brand.

1.9 The strength and recognition of the CYBG Group's existing brands may diminish following Completion

As, following the rebranding period, at least 80 per cent. of the Combined Group's turnover is required to be generated under the marks licensed by Virgin Enterprises, there is a risk that the strength and recognition of CYBG Group's existing "B", "Clydesdale Bank" and/or "Yorkshire Bank" brands could be diminished.

Whilst the CYBG Group intends to use the "Virgin Money" brand for its retail operations and the CYBG Directors believe that the brand has potential in the SME market, particularly in light of its entrepreneurial spirit, a decision as to whether to use the "Virgin Money" brand for SME operations will only be made following a period of testing with existing CYBG Group SME customers. If the CYBG Group decides not to use the "Virgin Money" brand for its SME operations and to continue to use its existing "B", "Clydesdale Bank" and/or "Yorkshire Bank" brands, there is a risk that the strength of those brands and their recognition in the market could be diminished due to the CYBG Group's other products and operations no longer carrying the same brands.

Furthermore, in the event that the CYBG Group is required to (or decides to) cease use of the "Virgin" or "Virgin Money" brands in the future, there is a risk that its existing "B", "Clydesdale Bank" and "Yorkshire Bank" brands will no longer benefit from the same level of customer recognition in the market which they currently receive, which could affect the CYBG Group's competitive position and dampen growth prospects. In addition, if CYBG ceases to use its current brands for a period of five years, the trade mark registrations for those brands will become vulnerable to revocation and the CYBG Group will lose the ability to enforce them against third parties.

1.10 **The CYBG Group and, following Completion, the Combined Group face risks from the highly competitive environment in which they operate**

The market for financial services in the UK faces many competitive pressures and the CYBG Group expects these pressures to continue in response to competitor behaviour, consumer expectations, technological changes, the impact of market consolidation and new market entrants, regulatory actions and other factors. In combination, these forces are placing increasing pressure on the CYBG Group's results of operations, digital capability, margins and returns through price pressure, reductions in fees and charges, increased marketing and other related expenses, investment demands, regulatory requirements and changes to capital requirements.

The UK banking industry continues to be dominated by the biggest five banks with a lack of a material shift in market share to challenger and specialist lenders, particularly in relation to the PCA and BCA markets. There is, however, some variation between each of the five largest banks with some increasing and others decreasing their market shares as they manage balance sheet growth in the context of their wider strategic agendas.

As the financial services markets in which the CYBG Group operates and, following Completion, the Combined Group will operate are generally mature, growth by any bank typically requires winning market share from competitors.

The CYBG Group and the Virgin Money Group face competition from established financial services providers as well as new market entrants, including "challenger banks" and "neo banks" with specific areas of market focus, and non-bank competitors which, in some cases, have lower cost operating models and are therefore capable of generating better returns from asset growth. Competition in the UK mortgage market including from challenger banks seeking scale and growth over a short period of time is continuing to create downward price pressure on mortgage and other lending rates. The pressure is expected to increase as ring-fencing legislation comes into force in the UK, with some ring-fenced competitor banks looking to deploy excess liquidity in the broker mortgage market.

Further intervention in the UK banking industry is anticipated from regulators and authorities who are increasingly focusing on competition and market effectiveness. Low levels of switching in the UK current account market have been seen as a major barrier to competition between banks and an impediment to customers receiving a potentially better service from a new supplier. In order to address this issue, the Payments Council implemented the seven-day Current Account Switch Service in the second half of 2013. However, switching volumes remain subdued. PSD2 regulation has been implemented from January 2018, with a view to further opening up the competitive landscape in addition to enhanced protection for consumers. This creates an increased risk for traditional financial services firms and a specific material risk for the CYBG Group, and following Completion, the Combined Group of disintermediation by third parties. In the UK, open banking regulation requires the nine largest banks (which does not include CYBG or Virgin Money, and will not include the Combined Group) to provide access to certain information via a standardised set of application programming interfaces ("**APIs**"). It also introduces a risk for the CYBG Group, and following Completion, the Combined Group should it fail to adapt in a fast-changing environment. The CYBG Group is well placed to meet the new requirements and is actively adapting its strategy in light of the increased competition and disintermediation risk. Customer acquisition and retention strategies are expected to focus increasingly on developing compelling and broad reaching propositions centred on specific customer needs or journeys, creating ecosystems of interlinked products, services, features and functionality that increase ease and convenience for customers.

As technology evolves and customer needs and preferences change, there is an increased risk of disruptive innovation or a failure by the CYBG Group and, following Completion, the Combined Group to introduce new products and services to keep pace with industry developments and meet customer expectations. They are also subject to the risk of not appropriately responding to increased threats of cyber-crime associated with digital expansion (for further information, see the risk factor entitled "*The CYBG Group and, following Completion,* *the Combined Group are exposed to risks associated with cyber-enabled crime and fraud*") and the industry-wide risk of traditional banking information technology infrastructure and digital technologies becoming obsolete. The CYBG Group expects to increasingly collaborate with innovative market players in order to develop compelling and secure customer propositions and to enhance operational performance; however, the CYBG Group's and, following Completion, the Combined Group's financial and operational performance may be materially adversely affected by an inability to keep pace with industry trend and customer expectations.

In seeking to price products competitively for the purpose of attracting and retaining new customers, the CYBG Group and, following Completion, the Combined Group must consider capital requirements and the overall credit quality of proposed loans and advances. The amount of capital required is based on the risk weighting of the asset in question. The methodology to determine the amount of capital required to be held by UK banks is based on the PRA's interpretation of the Basel capital framework. There are two approaches of calculating the risk weighting attributed to a bank's assets. The approach adopted by the CYBG Group is known as the "standardised approach", which requires relatively specific amounts of capital to be held for certain types of assets based on set criteria. Banks that develop their own empirical models to quantify required capital for risk and have such models approved by the PRA are permitted to use the "Internal Ratings Based" ("**IRB**") approach. The IRB approach can be either under the "foundation" or "advanced" approach, each of which provides more flexibility in assessing the risk weighting of particular types of assets. Although there are Basel Committee proposals which may, amongst other things, narrow the gap between the standardised approach and the IRB approach to calculating risk weighted assets, currently, banks that have adopted the IRB approach would have a lower capital requirement for certain products, in particular, certain types of mortgages. The CYBG Group is seeking IRB accreditation, which CYBG believes will enhance the competitiveness of the CYBG Group in relation to its capital requirements. Failure to achieve IRB accreditation for any reason may mean that it will continue to be difficult for the CYBG Group and, following Completion, will be difficult for the Combined Group to compete with those banks on pricing for some of these products, which could have a material adverse effect on the CYBG Group's and, following Completion, the Combined Group's business, results of operations, financial condition, capital impact and prospects.

The credit card issuing business is highly competitive. The CYBG Group and the Virgin Money Group compete, and following Completion, the Combined Group will compete with other credit card issuers on the basis of a number of factors, including products and services, brand, network, reputation and pricing. This competition affects the ability of the CYBG Group and the Virgin Money Group to obtain applicants for credit cards, encourage card members to use their credit cards, maximise the revenue generated by card usage and generate card member loyalty and satisfaction so as to minimise the number of card members switching to other credit card brands. If the CYBG Group, or following Completion, the Combined Group, are unable to compete successfully, the CYBG Group's and, following Completion, the Combined Group's business, financial condition, results of operations and/or prospects could be materially adversely affected.

1.11 The CYBG Group may fail to be accepted as a participant in the Incentivised Switching Scheme, successfully acquire RBS SME customers through the Incentivised Switching Scheme, and/or receive funds from the Capability and Innovation Fund, which could have an adverse impact on the CYBG Group's ability to further enhance the Bank's competitiveness in the business banking market.

Competitive pressures in the business banking market remain high, with the large incumbent banks with full service capabilities and scale advantages continuing to account for significant portions of the market share amongst SME customers. The alternative package proposed by the UK authorities to replace the commitment for The Royal Bank of Scotland ("**RBS**") to divest Williams & Glyn ("**W&G**"), required as part of RBS's restructuring plan (the "**RBS Alternative Remedies Scheme**"), has received significant focus across the sector since its announcement in September 2017. It is currently expected that in November 2018, eligible "challenger banks" can apply to participate in an incentivised switching scheme (the "**Incentivised Switching Scheme**") through which certain RBS SME customers (former W&G customers) will be financially incentivised to switch their BCAs from RBS to participating "challenger" banks. The RBS Alternative Remedies Scheme has been designed to facilitate the divestment of three per cent. of the BCA market share in the UK SME banking market from RBS to "challenger" segment. In addition, it is currently expected that in November and December 2018, eligible "challenger banks" and other small financial services and FinTech firms offering SME banking and financial services (or with ambitions to offer such services) will be able to apply to a Capability and Innovation Fund which will provide a range of awards (split across different categories with pre-determined eligibility criteria) that could be used to invest in delivering sustainable long-term improvements to firms' propositions and services for SME clients. Applicant firms will be required to set out how potential investments would improve their own SME banking proposition and enhance competition across the wider UK SME banking market.

The CYBG Group intends to play a material part in both the Incentivised Switching Scheme and to bid for a 'Pool A' award under the Capability and Innovation Fund (which has three amounts available: £60 million; £100 million; and £120 million). There is no guarantee that the CYBG Group and, following Completion, the Combined Group, will be accepted as a participant in the Incentivised Switching Scheme, successfully acquire large numbers of RBS SME customers through the Incentivised Switching Scheme, and/or receive funds from the Capability and Innovation Fund. Whilst the CYBG Group has a well-established SME banking proposition, with ahead of market rate new SME customer acquisition and SME asset growth, and a clear plan for further growth within its existing strategy, any failure by the CYBG Group and, following Completion, the Combined Group to be accepted as a participant in the Incentivised Switching Scheme, successfully acquire RBS SME customers through the Incentivised Switching Scheme, and/or be awarded an amount from the Capability and Innovation Fund could weaken the CYBG Group's and, following Completion, the Combined Group's ability to compete at the same level as, and further enhance its existing competitive capabilities against, the existing incumbent UK banks and other firms in the banking and financial services sector.

Furthermore, the CYBG Group has incurred costs in preparing for its participation in both the Incentivised Switching Scheme and the Capability and Innovation Fund. Following Completion, the Combined Group may continue to incur such costs. There is no guarantee that the CYBG Group and, following Completion, the Combined Group, will recover these costs through the Incentivised Switching Scheme and/or the Capability and Innovation Fund. Such costs could therefore have a material adverse effect on the CYBG Group's and, following Completion, the Combined Group's business, results of operations, financial condition and prospects.

1.12 The CYBG Group is and, following Completion, the Combined Group will be subject to risks associated with compliance with a wide range of laws and regulations

The CYBG Group's operations are and, following Completion, the Combined Group's operations will be heavily regulated and they must comply with numerous laws and regulations and may face enforcement action from regulators and others for any failure to comply. Regulatory compliance risk arises from a potential failure or inability to comply fully with the laws, regulations and codes applicable to the financial services industry. For example, UK financial institutions, including the CYBG Group and, following Completion, the Combined Group, are subject to a high level of scrutiny by regulatory bodies (including the Bank of England, the FCA, the UK Prudential Regulation Authority, the Payment Systems Regulator, the UK Competition and Markets Authority (the "**CMA**"), the Pensions Regulator and the UK Information Commissioner's Office (the "**ICO**")) regarding the treatment of customers and also by the press and politicians. Financial institutions, including the CYBG Group, and following Completion, the Combined Group, and their employees, have also been subject to customer complaints and regulatory investigation and/or enforcement action regarding mis-selling of financial products, adequacy of systems and controls, handling of customers in arrears and conduct leading to customer detriment and the mishandling of related complaints which has resulted in disciplinary action and/or requirements to amend sales processes, withdraw products and/or provide restitution to affected customers, all of which result in costs and may require provisions in addition to those already taken. In particular, and in common with the wider UK retail and SME banking sector, the CYBG Group continues to deal with complaints and redress issues arising out of historic sales of payment protection insurance ("**PPI**"), the historic sales of certain interest rate hedging products ("**IRHP**") which includes standalone interest rate hedging products and certain tailored business loans, with additional features such as interest rate protection functionality, structured collars, collars or caps and fixed rate tailored business loans to SMEs and other conduct-related matters. Further information is provided in "*—The CYBG Group and, following Completion, the Combined Group faces risks relating to complaints and redress issues from sales of historic financial products. Existing provisions for such issues may not cover all potential costs and losses and do not cover all or future conduct issues*" below.

Regulatory enforcement actions pose a number of risks to the CYBG Group and, following Completion, the Combined Group, including substantial monetary damages or fines, the amounts of which are difficult to predict and may exceed the amount of provisions set aside to cover such risks. In addition, the CYBG Group and, following Completion, the Combined Group and/or their employees may be subject to other penalties and injunctive relief, civil or private litigation arising out of the same subject matters as a regulatory investigation, the potential for criminal prosecution in certain circumstances and regulatory restrictions. For further details of risks arising from regulations applicable to the CYBG Group and, following Completion, the Combined Group, see "*Regulatory Risks*" below. All of these issues could have a negative effect on the CYBG Group's and, following Completion, the Combined Group's reputation and the confidence of their customers in the CYBG

Group and, following Completion, the Combined Group, as well as taking a significant amount of management time and resources away from the execution of the CYBG Group's and, following Completion, the Combined Group's strategy and the operation of their business.

The CYBG Group and, following Completion, the Combined Group may settle litigation or regulatory proceedings prior to a final judgment or determination of liability to avoid the cost, diversion of management time and effort or negative business, regulatory or reputational consequences of continuing to contest liability or when the potential consequences of failing to prevail would be disproportionate to the costs of settlement. Furthermore, the CYBG Group and, following Completion, the Combined Group may, for similar reasons, reimburse counterparties for their losses even in situations where there are no litigation proceedings and the CYBG Group and, following Completion, the Combined Group do not believe that they are legally compelled to do so. Failure to manage these risks adequately could have a material adverse effect on the CYBG Group's and, following Completion, the Combined Group's, reputation, business, results of operations, financial condition and prospects.

1.13 The CYBG Group is and, following Completion, the Combined Group, will be subject to risks relating to the availability of liquidity and funding at a commercially acceptable cost

Funding risk is the risk that the CYBG Group and, following Completion, the Combined Group are unable to raise short and/or long-term funding at a commercially acceptable cost in the retail and wholesale markets to support their ongoing operations, strategic plans and objectives. Although the CYBG Group expects to have sufficient funding over the next 12 months and beyond to execute its strategy and to have sufficient liquidity over the next 12 months and beyond, liquidity risk is nevertheless inherent in banking operations and may be heightened by a number of factors, including an over-reliance on, or an inability to access, a particular source of funding, changes in credit ratings or market-wide phenomena, such as financial market instability. As well as relying on retail and business deposits, the CYBG Group accesses domestic and global capital markets to help fund its businesses. Credit markets worldwide have in recent years experienced, and may continue to experience, a reduction in liquidity and long-term funding as a result of global economic and financial factors. Any dislocation in these funding markets or a reduction in investor appetite for holding their securities or other credit exposures to them may adversely affect the CYBG Group's and, following Completion, the Combined Group's ability to access funds or require them to access funds at a higher cost, or on unfavourable terms, or result in obtaining funding that does not efficiently match the maturity profile of their assets.

The CYBG Group has a diversified funding base, with the majority of the CYBG Group's funding generated through customer liabilities in the form of current accounts and savings accounts, funding obtained through RMBS securitisation programmes, a covered bond programme and a medium term note programme as well as short-term wholesale funding, with securitised and covered bond funding being dependant on the availability of a sufficient supply of mortgages of adequate quality for the purposes of supporting further issuance. The Virgin Money Group also sources a proportion of its funding in the wholesale markets, primarily through RMBS securitisations, a global medium term note programme and a regulated covered bond programme (although the Virgin Money Group has not yet issued any covered bonds under such programme). Both the CYBG Group and the Virgin Money Group have also drawn funding from the Bank of England's TFS, with TFS funding comprising in aggregate £8.7 billion, which represents 11 per cent. of total funding for the Combined Group and will mature in 2021–2022.

As part of its funding plan, the CYBG Group and, following Completion, the Combined Group intends to continue to access the wholesale funding markets following Completion. If during periods of acute economic or market disruption the wholesale funding markets were to be partially or fully closed, it is likely that wholesale funding would prove more difficult to obtain on commercially acceptable terms. Under such circumstances, the CYBG Group and, following Completion, the Combined Group may incur additional costs and may be unable to successfully deliver their medium term growth strategy. Profound curtailments of central bank liquidity to the financial markets in connection with other market stresses, though unlikely, might have a material adverse effect on the CYBG Group's and, following Completion, the Combined Group's business, financial position and results of operations, depending on their funding position at that time.

Whilst the Combination is not expected to be negative from a ratings' perspective and the risk is therefore highly unlikely in the short to medium term, any downgrade in the credit rating of CYBG, the CYBG Group, any member of the CYBG Group, and, following Completion, the Combined Group's RMBS issuance vehicles or their respective securities, or a downgrade in the sovereign rating of the UK, may increase the CYBG Group's and, following Completion, the Combined Group's borrowing costs or limit their access to the capital markets, which may increase the re-financing risk, and, consequently, have a material adverse effect on their business, results of operations, financial condition and prospects. For further information please see the risk factor entitled "*A downgrade in the credit rating of CYBG, Clydesdale Bank PLC, the CYBG Group's and, following Completion, the Combined Group's secured funding programmes, the UK banking sector or the UK Government may have an adverse effect on the CYBG Group's and, following Completion, the Combined Group's business, results of operations, financial condition and prospects*" below.

The CYBG Group aims to maintain a prudent customer LDR, which means that the majority of its lending is funded by retail and business deposits. As at 31 March 2018, the CYBG Group's LDR was 115 per cent. Medium-term growth in the CYBG Group's and, following Completion, the Combined Group's lending activities will depend, in part, on the availability of retail and business deposit funding on commercially acceptable terms, for which there may be increased competition and which is dependent on a variety of factors outside the CYBG Group's and, following Completion, the Combined Group's control. These factors include general macro-economic conditions and market volatility, the confidence of retail and business depositors in the economy, in the financial services industry, in new market entrants and in the CYBG Group and, following Completion, the Combined Group. Availability of deposit funding may also be impacted by increased competition from other deposit takers as a result of their strategies or factors that constrain the volume of liquidity in the market, including, for example, the end of the TFS in February 2018. Increases in the cost of deposit funding would impact the CYBG Group's and, following Completion, the Combined Group's net interest margin and affect their results of operations, and a lack of availability of deposit funding could have a material adverse effect on their future growth.

Any loss in consumer confidence in the CYBG Group and, following Completion, the Combined Group could significantly increase the amount of deposit withdrawals that may occur in a short space of time. Should they experience an unusually high and/or unforeseen level of deposit withdrawals, the CYBG Group and, following Completion, the Combined Group may require greater non-retail sources of other funding in the future, which it may be unable to access, which could in turn have a material adverse effect on their business, financial condition, results of operations and prospects.

Any initiative to raise additional deposits through price leadership could have an adverse impact on the CYBG Group's and, following Completion, the Combined Group's net interest income and margin through the cost of both paying higher interest rates to new customers and existing customers switching to these higher-rate products.

Failure to manage these or any other risks relating to the availability of liquidity and funding at a commercially acceptable cost may compromise the CYBG Group's and, following Completion, the Combined Group's ability to deliver their growth strategy and have a material adverse effect on their business, financial condition, results of operations and prospects.

1.14 The amount and quality of the CYBG Group's and, following Completion, the Combined Group's capital is subject to regulatory requirements and market influence

Capital risk is the risk that the CYBG Group and, following Completion, the Combined Group does not have sufficient capital and reserves of sufficient quality to meet prudential regulatory requirements, achieve their medium term growth strategy, cover the risks to which they are exposed or protect against unexpected losses. The CYBG Group and, following Completion, the Combined Group are required to maintain minimum levels of capital and reserves relative to the balance sheet size and risk profile of their operations.

The Combined Group plans to satisfy incremental increases in capital required to support balance sheet growth by way of retained earnings and plans to access the wholesale markets to refinance various existing capital instruments and to issue new instruments from time to time. The CYBG Group is seeking IRB accreditation, which CYBG believes will enhance the competitiveness of the CYBG Group in relation to its capital requirements. If during periods of acute economic or market disruption the wholesale markets were to be fully or partially closed, it is likely that such refinancing would prove more difficult to obtain on commercially acceptable terms. Under such circumstances, the CYBG Group and, following Completion, the Combined Group may be required to take other appropriate management actions and incur additional costs.

An actual or perceived shortage of capital could have a material adverse effect on the CYBG Group's and, following Completion, the Combined Group's business, which could, in turn, affect their capacity to pay future dividends or implement their business strategy, impacting future growth potential. If, in response to any such shortage, CYBG raises additional capital through the issuance of share capital or capital instruments, existing shareholders may experience a dilution of their holdings or reduced profitability and returns.

CYBG may experience a depletion of its capital resources through increased costs or liabilities incurred as a result of the crystallisation of any of the other risk factors described elsewhere in this section. The CYBG

Group and, following Completion, the Combined Group may also experience an increased demand for capital as a result of regulatory requirements. For further information, see "*—Regulatory risks—The CYBG Group and, following Completion, the Combined Group are subject to substantial and changing prudential regulation*" below. Additional capital may also be required to redress issues from historical sales of financial products. Further information is provided in "*—The CYBG Group and, following Completion, the Combined Group faces risks relating to complaints and redress issues from sales of historic financial products. Existing provisions for such issues may not cover all potential costs and losses and do not cover all or future conduct issues*" below.

The CYBG Group expects to be impacted by the implementation of international financial reporting standards IFRS 9 "Financial Instruments", which is currently expected in October 2018. IFRS 9 will require the CYBG Group to move from an incurred loss model to an expected loss model requiring the CYBG Group and, following Completion, the Combined Group to recognise not only credit losses that have already occurred but also losses that are expected to occur in the future. IFRS 9 may lead to a one-off increase in impairment allowances for certain financial assets in their balance sheet at the time of adoption, and, depending on its interpretation by the relevant regulators, could lead to a negative impact on their regulatory capital position. In addition, it is expected that the complexity of the CYBG Group's and, following Completion, the Combined Group's impairment modelling under IFRS 9 will increase and credit losses will be recognised earlier than under IAS 39 which is likely to lead to an increase in total provisions.

The CYBG Group and, following Completion, the Combined Group may also be impacted by certain revisions for calculating regulatory capital, including revisions to the regulatory capital treatment of interest rate risk in the banking book and the standardised approaches for credit risk and operational risk, as described further under "*—Regulatory risks—The CYBG Group and, following Completion, the Combined Group are subject to substantial and changing prudential regulation*" on which the Basel Committee on Banking Supervision (the "**Basel Committee**") is consulting.

The CYBG Group sets its internal target amount of capital by taking account of its own assessment of the risk profile of the business, market expectations and regulatory requirements. If market expectations as to capital levels increase, driven by, for example, the capital levels or targets amongst peer banks or if new regulatory requirements are introduced, then the CYBG Group and, following Completion, the Combined Group may be required to increase their capital held. If they are unable to do so, their business, financial condition, results of operations and prospects may be materially adversely affected. Ultimately if there is a significant shortfall in the amount of capital held, it may lead to the Bank of England exercising its recovery and resolution powers over CYBG. If the Bank of England, as resolution authority, were to exercise such powers in respect of CYBG, then existing shareholders may experience their holdings becoming cancelled or diluted, and may not receive any compensation for their losses, see *"—Regulatory risks—The CYBG Group and, following Completion, the Combined Group are subject to substantial and changing prudential regulation" below.*

1.15 **The CYBG Group and, following Completion, the Combined Group face risks relating to complaints and redress issues from sales of historic financial products, which may not be covered by existing provisions**

The CYBG Group and, following Completion, the Combined Group face conduct, financial and reputational risks as a result of legal and regulatory proceedings, and complaints made to it directly or to the Financial Ombudsman Service (the "**FOS**") or other relevant regulatory bodies, both against the CYBG Group and, following Completion, the Combined Group and against members of the UK banking industry more generally.

These conduct issues relate to *inter alia*: (a) PPI; (b) standalone interest rate hedging products; (c) voluntary scope tailored business loans; (d) fixed rate tailored business loans; (e) packaged bank accounts; and (f) investment advice.

In addition, the CYBG Group, and following Completion, the Combined Group may also face financial and reputational risks as a result of customer complaints, which might arise from matters such as inadequate communications or historic or current pricing levels in relation to certain products offered by the CYBG Group and the Virgin Money Group.

As part of the demerger from the National Australia Bank Limited ("**NAB**") group of companies (the "**NAB Group**"), NAB and the Company entered into a conduct indemnity deed on 2 December 2015 under which NAB agreed to provide the CYBG Group with an indemnity in respect of certain costs and liabilities (including financial penalties imposed by a regulator) resulting from certain historic conduct liabilities in the period prior to completion of the demerger (the "**Capped Indemnity Deed**" and the "**Capped Indemnity**", respectively) relating to the business of the CYBG Group. As at the completion of the demerger, the cover provided by the Capped Indemnity stood at £1.115 billion.

In line with the rest of the industry, the CYBG Group experienced a sustained period of elevated PPI complaints in the six months to 31 March 2018. As a result of the announcement of the time bar on new PPI complaints and the requirement for a customer contact exercise in respect of previously rejected complainants who are now eligible to complain in light of the case of Plevin v Paragon Finance (please see risk factor 2.2 (*PPI final deadline and guidance on "Plevin" cases*) for further detail on this), and accordingly reassessed the level of provision that was considered appropriate to meet current and future expectations in relation to the mis-selling of PPI policies. As a result, in its unaudited accounts for the six months to 31 March 2018, the CYBG Group increased its provisions for legacy PPI costs by £350 million, fully utilising the remaining undrawn amount of £148 million of the Capped Indemnity and recognising a charge of £202 million (pre-tax). The CYBG Group also recognised additional costs of £18 million for other less significant conduct related matters.

Notwithstanding the Capped Indemnity has now been fully utilised, £645 million (being £497 million balance on the account at 31 March 2018 plus the remaining £148 million subsequently drawn down) of funds paid by NAB under the Capped Indemnity remain deposited in a designated account, the withdrawal of which by CYBG is subject to certain conditions. Under the Capped Indemnity Deed, NAB has the benefit of certain information, consultation and audit rights in relation to relevant conduct matters and claims and in particular, the Capped Indemnity is subject to a dispute resolution procedure which may result in any unresolved issues being determined by a third-party expert or by court proceedings. If the dispute relates to a matter which is determined to be a continuing material breach by the Company of its obligations under the Capped Indemnity Deed to, among others, provide information to NAB to enable it to review the validity of claims made under the Capped Indemnity and withdrawals from the designated account, the Company will be prohibited from withdrawing the relevant amount of any such disputed payment from such designated account for so long as such breach is continuing. In such circumstances, CYBG may be required to fund the costs of claims relating to certain historical conduct matters, which it would otherwise expect to be funded by amounts paid by NAB under the Capped Indemnity, from its own capital resources which may not be sufficient to settle or discharge some or all of any such claims.

In certain circumstances contemplated by the Capped Indemnity Deed, the Company may also be required to repay to NAB certain amounts received by it under the Capped Indemnity. The likelihood of this situation arising is expected to reduce with the passage of time as withdrawals are made from the designated account. As at the date of this Prospectus, NAB has not required the Company to repay amounts received under the Capped Indemnity previously and should such a circumstance arise then these funds may be applied to other qualifying conduct costs which have not been subject to the Capped Indemnity before being repaid to NAB. However, if CYBG is required to repay to NAB amounts received by it under the Capped Indemnity, it would likely need to fund such repayments from its own capital resources (to the extent the Company is unable to make such repayments from the designated account).

It is possible that the CYBG Group and, following Completion, the Combined Group will be subject to further claims relating to historic or future conduct matters which amount to a material capital exposure for the CYBG Group and, following Completion, the Combined Group. Exposure to such claims may exceed the provisions of the CYBG Group and, following Completion, the Combined Group, which could have a material adverse effect on the CYBG Group and, following Completion, the Combined Group's balance sheet. Such claims could therefore have a material adverse effect on the CYBG Group's and, following Completion, the Combined Group's business, results of operations, financial condition and prospects.

It is also possible that two recent developments may increase the costs associated with PPI-related complaints generally. In the first development, a decision of the Manchester County Court, claimants in a PPI claim were awarded an amount that exceeded the amount they would have been awarded under relevant FCA guidelines. The second development, an FCA consultation paper, proposes guidelines that could (amongst other things) increase the number of PPI complaints that would be brought within the scope of the FCA complaints handling rules. Whilst the impact of these developments is not expected to be material on the CYBG Group or, following Completion, the Combined Group, the effect of both developments remains to be seen.

1.16 The CYBG Group is and, following Completion, the Combined Group will be subject to risks associated with their dependence on mortgage intermediaries and third-party service providers for certain functions

The CYBG Group depends and, following Completion, the Combined Group will depend on a number of third-party providers for a variety of functions including, inter alia, for mortgage intermediation, information technology ("**IT**") software and platforms, "automated teller machine" ("**ATM**") services, payment system services, mobile application services, debit and credit card production and operational services and cheque processing services. Consequently, the CYBG Group relies and, following Completion, the Combined Group will rely on the continued availability and reliability of these service providers. If their contractual arrangements with any of these providers are terminated for any reason or any third-party service provider becomes otherwise unavailable or unreliable in providing the service to the required standard, they will be required to identify and implement alternative arrangements and they may not find an alternative third-party provider or supplier for the services, on a timely basis, on equivalent terms or without incurring a significant amount of additional costs or at all. Virgin Money's credit card business is currently reliant on a number of Virgin Money's key relationships, including with Total System Services, Inc. (which provides customer servicing capabilities). In addition, Virgin Money's investments and pensions business is reliant on a number of key relationships, including DST Financial Services (which provides fund administration) and State Street (which provides fund management and custodial services). Following Completion, the Combined Group could be impaired in the event of a failure of these third party systems or technology platforms, which could cause temporary service outage. These factors could cause a material disruption in the CYBG Group's and, following Completion, the Combined Group's operations and ability to service customers and could have a material adverse financial or reputational impact on them. It may result in a higher risk premium being applied to the CYBG Group and, following Completion, the Combined Group, and adversely impact the cost of funding their operations, or their financial condition and could give rise to claims by customers for financial loss experienced and/or regulatory sanctions.

In maintaining and growing their mortgage portfolio, the CYBG Group relies and, following Completion, the Combined Group will rely on a number of intermediaries in the mortgage lending market, which exposes them to the risk of deterioration of the commercial, financial or operational soundness of those organisations. If a major intermediary partner goes out of business or switches allegiance to other lenders, this may adversely affect the CYBG Group's or, following Completion, the Combined Group's lending volume. The CYBG Group is and, following Completion, the Combined Group will be also exposed to the risk that their relationships with one or more intermediaries may deteriorate for a variety of reasons, including competitive factors. Intermediaries may not support or may be deterred by the rebranding of CYBG's business and/or the ongoing use of the "Virgin Money" brand, which may adversely impact the CYBG Group or, following Completion, the Combined Group. In addition, the intermediaries' incentives may not always align with the CYBG Group's or following Completion, the Combined Group's, which could lead to a deterioration in the quality and performance of the CYBG Group's or the Combined Group's mortgage book. As the CYBG Group and, following Completion, the Combined Group seek to actively grow the volume of mortgages introduced by intermediaries, their exposure to those risks increases.

In addition, the structure of the intermediary market is also subject to change, for example, there may be a change in customer sentiment or regulation which favours customers dealing directly with financial institutions which would reduce the flow of business from intermediaries which may have an adverse impact on the CYBG Group or, following Completion, the Combined Group if this business cannot be substituted. Also, there may be consolidation in the intermediary market which may change the behaviour of the residual intermediaries in ways which may adversely impact the CYBG Group or, following Completion, the Combined Group. Any of these factors could have a negative impact on the CYBG Group's or, following Completion, the Combined Group's ability to meet its strategic objectives for its asset base and, consequently, its business, financial condition, results of operations and/or prospects.

In addition, if mortgage intermediaries are found to have violated applicable conduct regulations or standards in the sale of CYBG Group's or, following Completion, the Combined Group's mortgage products, CYBG Group's or, following Completion, the Combined Group's brands and/or reputation could be harmed as a result. Reputational damage to the CYBG Group's and, following Completion, the Combined Group's brands caused by the failure of a third-party supplier may also adversely impact the CYBG Group's and, following Completion, the Combined Group's ability to attract and retain customers or employees in the short and long-term and the ability to pursue new business opportunities.

1.17 The CYBG Group and, following Completion, the Combined Group are subject to risks associated with customer and counterparty non-performance

Credit risk is the risk of loss of principal or interest stemming from a borrower's failure to meet contractual obligations to the CYBG Group and, following Completion, the Combined Group in accordance with the terms agreed. The CYBG Group has exposures to many different products, counterparties and obligors whose credit quality can have a significant adverse impact on the CYBG Group's and, following Completion, the Combined Group's business, results of operations, financial condition and prospects. Retail and SMEs lending activities account for most of the CYBG Group's and, following Completion, the Combined Group's credit risk. As at

31 March 2018, mortgage lending comprised 73.7 per cent. of the CYBG Group's customer loan portfolio, SME loans comprised 22.7 per cent. and unsecured personal lending (including personal loans, credit cards and overdrafts) comprised the balance. At 31 December 2017, retail secured credit accounted for 83 per cent. of the Virgin Money Group's maximum exposure to credit risk, before taking into account any collateral held or other credit enhancements.

Other sources of credit risk include but are not limited to the extension of credit commitments and guarantees, the holding of investments for liquidity purposes (including UK gilts), inter-bank transactions, letters of credit and trade financing, derivative transactions entered into for hedging purposes, foreign exchange transactions, placing of deposits, acceptances and the settlement of transactions. As at 31 March 2018, the CYBG Group's maximum exposure to credit risk was £49,299 million.

Less favourable business or economic conditions, whether generally or in a specific industry sector or geographic region, could cause counterparties and customers (especially those concentrated in areas experiencing less favourable business or economic conditions) to experience an adverse financial situation. This exposes the CYBG Group and, following Completion, the Combined Group to the increased risk that those customers will fail to meet their obligations in accordance with agreed terms. A deterioration in the economic conditions in the UK could have an adverse impact on the CYBG Group's and, following Completion, the Combined Group's financial performance and position. Other factors that could have an adverse impact include further financial market dislocation which could lead to falling confidence, increasing refinancing risk and contagion risk amongst market participants, counterparties and customers.

In the ordinary course of its operations, the CYBG Group estimates and establishes provisions for credit risks and the potential credit losses inherent in these exposures. This process, which is critical to the CYBG Group's and, following Completion, the Combined Group's results and financial condition, requires complex judgements, including forecasts of how changing macro-economic conditions might impair the ability of customers to repay their loans. The CYBG Group and, following Completion, the Combined Group may fail to adequately identify the relevant factors or accurately estimate the impact and/or magnitude of identified factors, which could materially adversely affect their business, results of operations, financial condition and prospects.

Further, there is a risk that, despite the CYBG Group's belief that it conducts an accurate assessment of customer credit quality, customers are unable to meet their commitments as they fall due as a result of customer-specific circumstances, macro-economic factors or other external factors. The failure of customers to meet their commitments as they fall due may result in higher impairment charges or a negative impact on fair value in the CYBG Group's and, following Completion, the Combined Group's lending portfolio. A deterioration in customer credit quality and the consequent increase in impairments could have a material adverse effect on the CYBG Group's and, following Completion, the Combined Group's business, results of operations, financial condition and prospects.

1.18 The CYBG Group and, following Completion, the Combined Group are exposed to the risk of customers who have interest-only owner-occupied mortgage loans are unable to repay their loans in full at maturity.

The CYBG Group provides and, following Completion, the Combined Group will provide mortgages to customers to enable them to purchase property for owner occupation. Such mortgages may be provided on a capital repayment basis, where the loan is repaid during its life, or on an interest-only basis, in which case the customer pays interest during the term of the mortgage loan with the principal balance being required to be repaid in full at maturity. As at 31 March 2018, capital repayment mortgages comprised 71 per cent. or £11,627 million of the CYBG Group's owner-occupied mortgage loan portfolio and interest-only loans comprised 29 per cent., or £4,747 million. As at 31 December 2017, capital repayment mortgages comprised 71.3 per cent. or £24,003 million of the Virgin Money Group's owner-occupied mortgage loan portfolio and interest-only loans comprised 25.6 per cent., or £8,627 million. In respect of owner occupied interest-only mortgage customers, assessments of capital repayment strategies may be incomplete or out-of-date and consequently, the CYBG Group and, following Completion, the Combined Group may lack information to accurately evaluate the related repayment risk. As a result, they may have reduced visibility of future repayment issues in respect of their interest-only residential mortgages, which could limit the CYBG Group's and, following Completion, the Combined Group's ability to estimate and establish provisions to cover exposures resulting from these mortgages.

While property sale is an acceptable method of repayment for buy-to-let mortgages, owner-occupied mortgage customers taking out interest-only mortgages are required by regulation to have capital repayment strategies. Where such repayment strategies are inadequate or have not been executed as planned, the CYBG Group and, following Completion, the Combined Group are exposed to the risk that the outstanding principal balance on interest-only loans for owner-occupied mortgages is not repaid in full at the contractual maturity date. The CYBG Group and, following Completion, the Combined Group provide a variety of solutions to support customers in such instances, but these solutions may not always result in customers being able to repay their loans or to continue to service the interest payments where the capital sum remains outstanding. Where the solutions are unsuccessful there may be increased impairment charges on the CYBG Group's and, following Completion, the Combined Group's owner-occupied mortgage portfolio which could have a material adverse effect on their profitability. The risk increases if, at the maturity of the loan, the customer is no longer in paid employment and is relying on reduced sources of income, such as pension income or unemployment benefits, to continue to meet the loan interest payments and agreed capital repayments.

1.19 Concentration of credit risk could increase the CYBG Group's and, following Completion, the Combined Group's potential for significant losses

As at 31 March 2018, substantially all of the CYBG Group's assets and business is related to customers in the UK, and in the case of mortgages, there are concentrations in Greater London, the rest of the South of England, the North of England and Scotland. Mortgage lending in London and the South of England accounted for approximately 58 per cent. of total lending as at 31 March 2018. As of 31 December 2017, 53 per cent. of the Virgin Money Group's mortgages were concentrated in Greater London and the South East. Each geographic region within the United Kingdom has different economic features and prospects. Any downturn in a local economy or particular industry may adversely affect regional employment levels and consequently the repayment ability of borrowers in respect of mortgage or other loans in a region that relies to a greater extent on that industry. In the event of adverse economic conditions, including interest rates and levels of unemployment, in regions within the UK where the CYBG Group and, following Completion, the Combined Group have significant business or assets, concentrations of credit risk could cause them to experience greater losses than some competitors.

In addition, the CYBG Group faces concentration risks relating to its agricultural lending, which as at 31 March 2018 amounted to approximately 20 per cent. of the CYBG Group's total business lending and 4.5 per cent. of the CYBG Group's total customer loans. The CYBG Group could be disproportionately impacted compared to some competitors by a deterioration of market conditions in the agricultural sector due to, for example, adverse seasonal weather patterns, falling land prices, global oversupply and volatility in commodity markets, changes in government policy such as reductions to farming subsidies (including, after the UK's withdrawal from the EU, those provided via the EU Common Agricultural Policy), dairy price pressure reducing the profitability of dairy producers or an outbreak of livestock disease such as foot and mouth disease. While the CYBG Group regularly monitors its credit portfolios to assess potential concentration risk, efforts to divest, diversify or manage the CYBG Group's and, following Completion, the Combined Group's credit portfolio against concentration risks may not be successful. Concentration of credit risk could result in a material adverse effect on the CYBG Group's and, following Completion, the Combined Group's business, results of operations, financial condition and prospects.

1.20 The CYBG Group is and, following Completion, the Combined Group will be exposed to risks associated with their IT systems

The CYBG Group's IT systems are critical to the operation of its business and the delivery of products and services to its customers. Any disruption in a customer's access to account information, delays in making payments, an inability to make cash withdrawals at the CYBG Group's and, following Completion, the Combined Group's ATMs or a failure of online or mobile banking platforms could have a significant negative effect on their reputation and could also lead to potentially large costs both to rectify the issue and to reimburse losses incurred by customers. In addition, any defect in the CYBG Group's standard documentation or defect in its electronic banking applications or mainframe could be replicated across a large number of transactions before the defect is discovered and corrected. This could significantly increase the cost of remediating the defect.

A range of standard form documentation and automatic banking systems are widely used in the CYBG Group's business to process high volumes of transactions. There can be no assurance that the CYBG Group's and, following Completion, the Combined Group's IT systems would support a significant increase in online or mobile traffic or volumes of its operations which are dependent on IT in the short term. In the future, the CYBG Group and, following Completion, the Combined Group may need to upgrade their IT systems and staffing to meet such demand, which may cause delays to customers and adversely affect their customer service.

As the CYBG Group depends on a number of third-party providers for a variety of functions, including payment service provider systems, any disruption in such systems could have a disruptive effect on the CYBG Group's and, following Completion, the Combined Group's operations.

Further, the CYBG Group regularly conducts IT system upgrades. Should these upgrades not be completed as planned, or become subject to significant delays or suffer from cost overruns, operational performance may suffer. Delays or cost overruns could have a material adverse effect on the CYBG Group's and, following Completion, the Combined Group's business, financial condition, results of operations and prospects.

The Combined Group will also face risks related to the integration of the CYBG Group's and the Virgin Money Group's IT systems. For more details, please refer to the risk factor entitled "*Integration of the Virgin Money Group into the CYBG Group may be more time consuming and costly than expected and unforeseen difficulties may arise*".

1.21 The CYBG Group and, following Completion, the Combined Group are exposed to risks associated with cyber-enabled crime and fraud

The CYBG Group is and, following Completion, the Combined Group will be subject to the risk of actual or attempted IT security breaches from parties with criminal or malicious intent. Should their intrusion detection and anti-penetration software not anticipate, prevent or mitigate a network failure or disruption, or should an incident occur in a system for which there is no duplication, there may be a material adverse effect on their business, financial condition, results of operations and prospects.

The CYBG Group continues to invest in its information security controls in response to emerging threats, such as cyber-enabled crime and fraud, and to seek to ensure that controls for known threats remain robust. The risks associated with cyber-attacks, where an individual or group seeks to exploit vulnerabilities in IT systems for financial gain or to disrupt services, are a material risk to the CYBG Group and, following Completion, the Combined Group and the UK financial system, which has a high degree of interconnectedness between market participants, centralised market infrastructure and in some cases complex legacy IT systems. The CYBG Group and, following Completion, the Combined Group cannot be certain that their infrastructure and controls will prove effective in all circumstances and any failure of the controls could result in significant financial losses and a material adverse effect on the CYBG Group's and, following Completion, the Combined Group's operational performance and reputation. The CYBG Group and, following Completion, the Combined Group's strategy to increase their digital presence may expose the CYBG Group and, following Completion, the Combined Group to increased risks associated with cyber-enabled crime and fraud. For information on their digital strategy, please refer to the risk factor entitled "*Risks associated with the CYBG Group's and, following Completion, the Combined Group's digital strategy*".

Any breach in security of the CYBG Group's and, following Completion, the Combined Group's systems, for example from increasingly sophisticated attacks by cyber-crime groups or fraudulent activity in connection with customer accounts, could disrupt their business, result in the disclosure of confidential information, create significant financial and/or legal exposure and damage their reputation and/or brands.

1.22 The CYBG Group's and, following Completion, the Combined Group's reliance on transitional services arrangements with NAB for treasury services exposes the CYBG Group and, following Completion, the Combined Group to a range of potential operational and regulatory risks

In connection with the CYBG Group's demerger from NAB, on 29 January 2016, Clydesdale Bank PLC entered into an arm's-length transitional services agreement ("**TSA**") with NAB for the continued provision of a range of certain key services to the CYBG Group on a transitional basis. Whilst most services provided under the TSA have now been removed, NAB continues to provide treasury services to the CYBG Group. The TSA expires in December 2018, subject to the exercise of any extension provisions in the TSA.

While NAB is bound by arm's-length contractual obligations under the TSA (including with respect to service performance, recovery of service, change management, confidentiality/data security and disaster recovery), events impacting NAB's ability to honour its contractual commitments to the CYBG Group under the TSA, such as human error, unauthorised access, events of force majeure, insolvency or other triggers for intervention by prudential authorities or any failure by NAB to procure continued service performance from any of NAB's sub-contractors, or any failure of the underlying systems or infrastructure used by NAB or its sub-contractors, could result in significant disruptions (including in the delivery of services to the CYBG Group) and costs that adversely affect the overall operational performance, financial performance, financial position or prospects of the CYBG Group's and, following Completion, the Combined Group's business, as well as harm the CYBG

Group's and, following Completion, the Combined Group's reputation and/or attract increased regulatory scrutiny.

1.23 The CYBG Group and, following Completion, the Combined Group are subject to risks associated with their hedging and treasury operations, including potential negative fair value adjustments

The CYBG Group and, following Completion, the Combined Group face risks related to their hedging and treasury operations. The CYBG Group engages in hedging activities, for example in relation to interest rate risk, to limit the potential adverse effect of interest rate fluctuations on its results of operations. The CYBG Group's treasury operations have responsibility for managing the interest rate risk that arises through its customer facing business, management of its liquid asset buffer and investment of free reserves and interest rate insensitive deposit balances. Interest rate hedges for both customer assets and liabilities are calculated using a behavioural model. However, the CYBG Group does not hedge all of its interest rate, foreign exchange and other risk exposures and cannot guarantee that its hedging strategies will be successful because of factors such as behavioural risk, unforeseen volatility in interest rates or other market prices or, in times of market dislocation, the decreasing credit quality, or unavailability, of hedge counterparties. The CYBG Group also has cross currency hedging instruments in place for cross currency funding. If their hedging strategies are not effective, the CYBG Group and, following Completion, the Combined Group may be required to record negative fair value adjustments. Material losses from the fair value of financial assets would also have an adverse impact on the CYBG Group's and, following Completion, the Combined Group's capital held.

Through its treasury operations, the CYBG Group holds liquid assets portfolios potentially exposing the CYBG Group and, following Completion, the Combined Group to interest rate risk, basis risk and credit spread risk. To the extent that volatile market conditions occur, the fair value of the CYBG Group's and, following Completion, the Combined Group's liquid assets portfolios could fall and cause the CYBG Group and, following Completion, the Combined Group to record mark to market losses. In a distressed economic or market environment, the fair value of certain of the CYBG Group's and, following Completion, the Combined Group's exposures may be volatile and more difficult to estimate because of market illiquidity. Valuations in future periods, reflecting then-prevailing market conditions, may result in significant negative changes in the fair value of the CYBG Group's and, following Completion, the Combined Group's exposures, which could have a material adverse effect on the CYBG Group's and, following Completion, the Combined Group's business, financial condition and results of operations.

Interest-rate insensitive deposit balances form a significant part of the CYBG Group's funding. The current, historically low, level of GBP interest rates, coupled with the probability of these rates increasing in advance of any increase in the Bank of England base rate, means that these balances may generate a higher level of income in the future than they do currently. However, if customer behaviours were to change significantly, these deposit balances may become more volatile and may no longer be suitable for swaps of the current duration, which could have a material adverse effect on the income generated by these balances.

1.24 The CYBG Group and, following Completion, the Combined Group could be negatively affected by actual or perceived deterioration in the soundness of other financial institutions and counterparties

Given the high level of interdependence between financial institutions, the CYBG Group is and will be and, following Completion, the Combined Group will be subject to the risk of actual or perceived deterioration of the commercial and financial soundness, or perceived soundness, of other financial services institutions. Whilst highly unlikely, concerns about, or a default by, one institution could lead to significant liquidity problems, losses or defaults by other institutions because the commercial and financial soundness of many financial institutions may be closely related as a result of their credit, trading, clearing or other relationships. Even the perceived lack of creditworthiness of, or questions about, a counterparty may lead to market-wide liquidity problems and losses or defaults by the CYBG Group and, following Completion, the Combined Group or by other institutions. This risk is sometimes referred to as "systemic risk" and may adversely affect financial intermediaries, such as clearing agencies, industry payment systems, clearing houses, banks, securities firms and exchanges with whom the CYBG Group interacts on a daily basis. Whilst this risk is highly unlikely to materialise, systemic risk could have a very material adverse effect on the CYBG Group's and, following Completion, the Combined Group's ability to raise new funding and on their business, financial condition, results of operations and prospects.

The CYBG Group routinely executes transactions with counterparties in the financial services industry, including brokers and dealers, commercial banks and other institutional counterparties, resulting in large daily settlement amounts that may give rise to significant credit exposure. In particular, the CYBG Group interacts with these financial institutions through a variety of interbank electronic payments systems that underpin clearing and settlement amongst financial institutions. As a result, the CYBG Group and, following Completion, the Combined Group face concentration risk with respect to specific counterparties including payment system participants and operators. In addition, the CYBG Group has counterparty and operational risk with LCH.Clearnet Limited that acts as a clearing provider, on an arm's-length basis, for central clearing of derivative transactions. A default by, or concerns about, the creditworthiness of these companies or one or more other financial services institutions could therefore adversely impact the CYBG Group and, following Completion, the Combined Group.

1.25 **A downgrade in the credit rating of CYBG, Clydesdale Bank PLC, the CYBG Group's and, following Completion, the Combined Group's secured funding programmes, the UK banking sector or the UK Government may have an adverse effect on the CYBG Group's and, following Completion, the Combined Group's business, results of operations, financial condition and prospects**

Credit ratings are an important reference for market participants in evaluating the CYBG Group and its products, services and securities. Credit rating agencies conduct ongoing review activity which can result in changes to credit rating settings and outlooks for the CYBG Group and, following Completion, the Combined Group and/or the UK banking sector, or for the UK Government. Review activity is based on a number of factors including the CYBG Group's and, following Completion, the Combined Group's financial strength and outlook, the assumed level of UK Government support for the CYBG Group and, following Completion, the Combined Group in a crisis and the strength of the UK Government, and the condition of the financial services industry and of the markets generally.

Whilst the combination of the CYBG Group and the Virgin Money Group is not expected to be negative from a ratings perspective and therefore this risk is highly unlikely to materialise in the short to medium term, any future downgrade in the credit rating of CYBG, Clydesdale Bank PLC, Virgin Money or their securities, or the UK banking sector generally, or a downgrade in the sovereign rating of the UK could:

(a) adversely affect the CYBG Group's and, following Completion, the Combined Group's liquidity and competitive position;

(b) undermine confidence in the CYBG Group and, following Completion, the Combined Group;

(c) increase the CYBG Group's and, following Completion, the Combined Group's borrowing costs;

(d) require amendments to the CYBG Group's and, following Completion, the Combined Group's secured funding programmes; or

(e) limit the CYBG Group's and, following Completion, the Combined Group's access to wholesale funding from capital markets at commercially acceptable costs or limit the range of counterparties willing to enter into transactions with the CYBG Group and, following Completion, the Combined Group (including under the CYBG Group's and, following Completion, the Combined Group's secured funding programmes), as many institutions require their counterparties to satisfy minimum ratings requirements,

and consequently, have a material adverse effect on the CYBG Group's and, following Completion, the Combined Group's business, financial condition, results of operations and prospects.

1.26 **The CYBG Group and, following Completion, the Combined Group's risk management policies and procedures may not be effective in protecting them against all the risks faced by their business, and any failure to manage properly the risks that they face could harm the CYBG Group and, following Completion, the Combined Group and their prospects**

The management of risks requires, among other things, robust policies and procedures for the accurate identification and control of a large number of transactions and events. Such policies and procedures may not always prove to be adequate in practice against the wide range of risks that the CYBG Group and, following Completion, the Combined Group face in their business activities. There is a risk that existing CYBG policies may not adequately cover the nature of the Combined Group's operations due to the introduction of processes or practices that are not currently part of the CYBG Group's operating model, thereby leading to losses or a deterioration in performance, which could have a material adverse effect on the CYBG Group and, following Completion, the Combined Group's business, financial condition, results of operations and prospects.

The CYBG Group has a range of systems designed to measure and manage the various risks which it faces. Some of these methods are based on historic market behaviour and may therefore prove to be inadequate for predicting future risk exposure, which may prove to be significantly greater than what is suggested by historic experience. Historical data may also not adequately allow prediction of circumstances arising due to UK Government interventions and stimulus packages, which increase the difficulty of evaluating risks. Other methods for risk management are based on evaluation of information regarding markets, customers or other information that is publicly known or otherwise available to the CYBG Group. Such information may not always be correct, updated or correctly evaluated. In addition, even though the CYBG Group constantly measures and monitors its exposures, there can be no assurance that its risk management methods will be effective, including in unusual or extreme market conditions. It is difficult to predict with accuracy changes in economic or market conditions and to anticipate the effects that such changes could have on the CYBG Group's and, following Completion, the Combined Group's business, financial condition, results of operations and prospects.

For further information on the CYBG Group's risk management policies, please refer to paragraph 2 of Part II (*Information on the CYBG Group*) of this Prospectus.

1.27 **The CYBG Group and, following Completion, the Combined Group must comply with anti-money laundering, counter terrorist financing, anti-bribery and sanctions regulations, and a failure to prevent or detect any illegal or improper activities fully or on a timely basis could negatively impact customers and expose the CYBG Group and, following Completion, the Combined Group to liability**

The CYBG Group is and, following Completion, the Combined Group will be subject to laws regarding money laundering and the financing of terrorism, as well as laws that prohibit them, their employees or intermediaries from making improper payments or offers of payment to foreign governments and their officials and political parties for the purpose of obtaining or retaining business, including the UK Bribery Act 2010. Monitoring compliance with anti-money laundering and anti-bribery rules can put a significant financial burden on banks and other financial institutions and requires significant technical capabilities. In recent years, enforcement of these laws and regulations against financial institutions has increased, resulting in several landmark fines against UK financial institutions. In addition, the CYBG Group and, following Completion, the Combined Group cannot predict the nature, scope or effect of future regulatory requirements to which they might be subject or the manner in which existing laws might be administered or interpreted. Although the CYBG Group believes that its current policies and procedures are sufficient to comply with applicable anti-money laundering, anti-bribery and sanctions rules and regulations, it cannot guarantee that such policies completely prevent situations of money laundering or bribery, including actions by the CYBG Group's and, following Completion, the Combined Group's employees, mortgage intermediaries or third party service providers, for which they might be held responsible. Any of such events may have severe consequences, including sanctions, fines and reputational consequences, which could have a material adverse effect on the CYBG Group's and, following Completion, the Combined Group's business, financial condition and results of operations.

1.28 **The CYBG Group is and, following Completion, the Combined Group will be exposed to operational risks related to inadequate or failed internal processes, people and systems and from external events**

The CYBG Group's business is and, following Completion, the Combined Group's business will be exposed to operational risks related to inadequate or failed internal processes, people and systems and from external events. Operational risks are inherent in the day-to-day operational activities of the CYBG Group and, following Completion, the Combined Group, which may result in direct or indirect losses and could adversely impact the CYBG Group's and, following Completion, the Combined Group's business, financial condition, results of operations and prospects. These losses may result from both internal and external events, and risks. Internal risks include, but are not limited to, process error or failure, inadequate process design, poor product development and maintenance, poor change management, ageing infrastructure and systems, system failure, failure of security and physical protection (including the health and safety of employees), fraud, deficiencies in employees' skills and performance or human error, or other idiosyncratic components of operational risk that are related to the CYBG Group's and, following Completion, the Combined Group's particular size, nature and complexity. External events include, but are not limited to, operational failures by third-party providers (including offshored and outsourced providers), actual or attempted external IT security breaches from parties with criminal or malicious intent, natural disasters, extreme weather events, political, security and social events and failings in the financial services industry. The CYBG Group is and, following Completion, the Combined Group will be exposed to extreme but plausible events that are unpredictable and may result in a material or systemic loss, business interruption or significant reputational damage. Operational risks may be increased as a direct consequence of the process of integrating Virgin Money into the Combined Group, in particular due to problems with migrating data, systems (such as IT systems) or processes. For more details, please refer to the risk factor above entitled "*Integration of the Virgin Money Group into the CYBG Group may be more time consuming and costly than expected and unforeseen difficulties may arise*".

The CYBG Group is and, following Completion, the Combined Group will be dependent on their information systems and technology from a system stability, data quality and information security perspective. The CYBG Group and, following Completion, the Combined Group are also dependent on payments systems and technology that interface with wider industry infrastructure; for example, the CYBG Group is, and, following Completion, the Combined Group, in common with other banks, will be dependent on various industry payment systems and schemes (including CHAPS, BACS, Faster Payments and SWIFT) for making payments between different financial institutions on behalf of customers. Internal or external failure of these systems and technology (including if such systems cannot be restored or recovered in acceptable timeframes, or be adequately protected) could adversely impact the CYBG Group's and, following Completion, the Combined Group's ability to conduct their daily operations and their business, financial condition, results of operations and prospects.

In addition, financial models are used extensively in the conduct of the CYBG Group's business; for example, in calculating capital requirements and measuring and stressing exposures. If the models used prove to be inadequate or are based on incorrect or invalid assumptions and judgements, this may adversely affect the CYBG Group's and, following Completion, the Combined Group's business, financial condition, results of operations and prospects.

The CYBG Group and, following Completion, the Combined Group may look to implement new operational processes and systems to assist in responding to market developments, such as the move towards Open Banking which is designed to enable personal customers and small businesses to share their data securely with other banks and with third parties, allowing them to compare products on the basis of their own requirements and to manage their accounts without having to use their bank, or to reflect changes in regulations, such as the General Data Protection Regulation whereby the CYBG Group and, following Completion, the Combined Group must be able to report at any time to the ICO all locations where personal identifiable information is stored (for example within systems and databases) and provide a justification of why such personal identifiable information is needed. Due to the scale and complexity of such projects, the CYBG Group and, following Completion, the Combined Group may be required to invest significant management attention and resources, which may divert attention away from normal business activities and other ongoing projects. Additionally, where changes are undertaken in an environment of economic uncertainty and increased regulatory activity and scrutiny, operational and compliance risks are magnified, which may impact the reputation and financial condition of the CYBG Group and, following Completion, the Combined Group. There is also a risk that implementation may not be completed within expected timeframes or budget, or that such changes do not deliver some or all of their anticipated benefits.

While the CYBG Group does have operational resilience, IT disaster recovery and business continuity contingency plans in place, these are not, and are not intended to be, a full duplication of the CYBG Group's operational systems and premises. Additionally, the CYBG Group is and, following Completion, the Combined Group, will be exposed to risks associated with an increase in the cost or lack of available insurance provision for the Combined Group (including any run-off policies), which could have an adverse impact on profitability. The occurrence of a serious disaster resulting in interruptions, delays, the loss or corruption of data or the cessation of the availability of systems or premises could have a material adverse effect on the CYBG Group and, following Completion, the Combined Group' business, financial condition, results of operations and prospects. Any actual or perceived inadequacies, weaknesses or failures in the CYBG Group and, following Completion, the Combined Group systems or processes could have a material adverse effect on their business, financial condition, results of operations and prospects.

1.29 The CYBG Group and, following Completion, the Combined Group may be exposed to losses if critical accounting judgements or estimates are subsequently found to be incorrect or inaccurate

The preparation of the CYBG Group's and the Virgin Money Group's financial statements require management to make estimates and assumptions and to exercise judgement in selecting and applying relevant accounting policies, each of which may directly impact the reported amounts of assets, liabilities, income and expenses, to ensure compliance with IFRS as adopted by the EU. Some areas involving a higher degree of judgement, or where assumptions are significant to the financial statements, include financial assets and liabilities at fair value through profit or loss, impairment provisions on credit exposures, deferred tax, PPI redress provision and other conduct related matters, retirement benefit obligations and effective interest rate assumptions. For information on the CYBG Group's critical accounting policies, see note 1.8 to the financial statements in the CYBG Annual Report 2017, which is incorporated by reference into this Prospectus.

If the judgements, estimates and assumptions used by the CYBG Group and, following Completion, the Combined Group in preparing their consolidated financial statements are subsequently found to be incorrect there could be a significant loss to them beyond that anticipated or provided for or an adjustment to those consolidated financial statements, which could have a material adverse effect on the CYBG Group's and, following Completion, the Combined Group's business, financial condition and results of operations. For information on the Virgin Money Group's critical accounting policies, see note 1.9 to the audited consolidated financial statements in the Virgin Money Annual Report 2017 set out in Part VII (*Historical Financial Information Relating to the Virgin Money Group*) of this Prospectus.

The adoption of new accounting standard IFRS 9 'Financial Instruments' is expected to impact all UK financial institutions, including the CYBG Group and, following Completion, the Combined Group, and is expected to have a material effect on financial statements. The new standard applies to all accounting periods beginning on or after 1 January 2018 and will be implemented by the CYBG Group and the Combined Group with effect from 1 October 2018.

1.30 The CYBG Group and, following Completion, the Combined Group may fail to attract or retain executives, senior managers or other key employees

The CYBG Group's and, following Completion, the Combined Group's success depends on the continued service and performance of their key employees, particularly their executives and senior managers, and their ability to attract, retain and develop high calibre talent. The CYBG Group and, following Completion, the Combined Group may not succeed in attracting new talent and retaining key personnel for a variety of reasons, including if they do not identify or engage with the CYBG Group's and, following Completion, the Combined Group's brand and values, which represents a major component of their overall strategy, or they do not wish to be located or relocate to the CYBG Group's and, following Completion, the Combined Group's key locations. The CYBG Group competes and, following Completion, the Combined Group will compete for talented people with skills that are in relatively short supply and they may not have sufficient scale to offer employees rates of compensation or opportunities to advance within the organisation comparable to their larger competitors, particularly at more senior levels. The CYBG Group and, following Completion, the Combined Group may also allocate resources improperly within their newly developed standalone functions or otherwise which could create operational inefficiencies and risks and/or lead to de-motivated senior employees. Each of these factors could have an adverse effect on the CYBG Group's and, following Completion, the Combined Group's ability to recruit new personnel and retain key employees, which could, in turn, adversely affect the CYBG Group's and, following Completion, the Combined Group's business. In addition, external factors such as macro-economic conditions, the regulatory environment developing to increase direct liabilities for bank employees, regulatory restrictions on incentivisation and/or continued negative media attention on the financial services industry may adversely affect employee retention, sentiment and engagement. Any failure to attract and retain key employees, including executives and senior managers, could have a material adverse effect on the CYBG Group's and, following Completion, the Combined Group's business, financial condition, results of operations and prospects.

There will be a period of uncertainty for individuals, and therefore an increased retention risk, during the pre-completion integration planning phase, during which both the CYBG Group and the Virgin Money Group continue to be bound by the strict requirements limiting its or their confirmation, communication or publication of the proposed post-Completion organisational structure, plans and potential impact on roles. Following the Completion, there may be other factors during the integration phase, until 'end state' model and synergies are achieved, that may also impact retention. Internal restructuring, transfer of employees under TUPE or measures arising from a transfer, collective consultation involving assessment and selection, cultural factors and leadership behaviour or other 'interim' arrangements, may all potentially impact the Combined Group's ability to retain key talent.

1.31 The CYBG Group and, following Completion, the Combined Group face risks associated with a failure to manage changes in taxation rates or applicable tax laws, or from a misinterpretation of such tax laws

The CYBG Group and, following Completion, the Combined Group face risks associated with changes in taxation rates or applicable tax laws, or misinterpretation of such tax laws, any of which could result in increased charges, financial loss, including penalties, and reputational damage. Any misinterpretation of tax laws that creates the perception that the CYBG Group and, following Completion, the Combined Group are avoiding or evading tax, or if they are associated with customers that do so, could adversely affect their reputation. The CYBG Group operates wholly within the UK. Future actions by the UK Government to adjust tax rates or to impose additional taxes (including particular taxes and levies targeted at the banking industry) could reduce the CYBG Group's and, following Completion, the Combined Group's profitability. Revisions to tax legislation or to its interpretation might also affect the CYBG Group's and, following Completion, the Combined Group's results of operations and financial condition in the future. In addition, the UK has a predominantly self-assessment system for filing of tax returns. All tax returns have been filed by the CYBG Group within statutory deadlines, but Her Majesty's Revenue & Customs ("**HMRC**") has the right to enquire into those returns post filing. Generally an enquiry must be started within 12 months of filing. It is possible that an enquiry may result in a further liability to tax, which, if material, could have a material adverse effect on the CYBG Group's and, following Completion, the Combined Group's business, financial condition, results of operation and prospects.

Further details on recent changes to tax laws and tax rates and their impact on the CYBG Group is given in notes 2.5 and 3.4 to the financial statements in the CYBG Interim Report 2018, which is incorporated by reference into this Prospectus.

The CYBG Group is not presently subject to the UK bank levy, introduced by the Finance Act 2011, as many of its liabilities are covered by the FSCS deposit protection scheme and accordingly are not within the scope of liabilities subject to the levy. Growth in eligible liabilities, or developments in bank levy legislation, may mean that the CYBG Group and, following Completion, the Combined Group is required to pay the UK bank levy in the future.

1.32 The CYBG Group may be required to increase its contributions to the Yorkshire and Clydesdale Bank defined benefit pension scheme (the "DB Scheme") to fund deficits

The CYBG Group is the sponsoring employer of the DB Scheme. This is a defined benefit pension scheme and assets of the DB Scheme are held in a trustee administered fund, operated separately from the CYBG Group. Under the DB Scheme, benefits provided are based on employees' years of service and their salaries using either a career average formula or final salary formula. Risk arises from the DB Scheme because from time to time there may be insufficient assets to cover the defined benefit liabilities already built up in the scheme (i.e. there is a deficit in the scheme) and the CYBG Group and, following Completion, the Combined Group are obliged by legislation and the governing documents of the scheme to fund the liabilities.

Following agreement from the trustees, the DB Scheme closed to new entrants in 2004 and is now closed to the future build-up of benefits for the majority of employees. As of 1 August 2017, the principal pension savings vehicle available to new employees is "Total Pension!", a defined contribution pension scheme under which members now benefit from increased employer contributions. However, a small minority of members of the Yorkshire section of the DB Scheme, who did not provide their individual consent to the changes as at 31 July 2017, remain active members of the DB Scheme and are required to make a minimum contribution of 15 per cent. of pensionable salary.

Despite these restrictions to new entrants and future accrual, the ongoing financial commitment of the CYBG Group to the DB Scheme may increase over time, either because the cost of providing benefits in the future for the remaining active members will increase or because the actuarial funding deficit increases. The actuarial funding deficit of the DB Scheme and the financial commitments of the CYBG Group to the DB Scheme are assessed at regular actuarial valuations. Agreement was reached with the DB Trustee on the valuation of the actuarial funding deficit at 30 September 2016, with a calculated deficit of £290 million. In the recovery plan dated 31 July 2017 the CYBG Group agreed to contribute £50 million per annum until 31 March 2022 and £55 million in the year to 31 March 2023 to eliminate this deficit. For future valuations it is open to the trustees of the DB Scheme to call for valuations at an earlier date. The assumptions used for the statutory valuation would generally need to be agreed between the CYBG Group and the trustees of the DB Scheme although the regulator established under Part 1 of the Pensions Act 2004 (as amended) in the UK has the power to set these in certain circumstances.

The actuarial funding deficit in the DB Scheme can increase because of many factors outside the control of the CYBG Group and, following Completion, the Combined Group (for example, changes in market conditions or member longevity). If the actuarial funding deficit increases, the CYBG Group could be obliged to make additional contributions to the scheme, and/or pay in lump sums and/or set aside additional capital in respect of pensions risk. This could have a material adverse effect on the CYBG Group's and, following Completion, the Combined Group's business, financial condition, results of operations and prospects.

2. REGULATORY RISKS

The CYBG Group's and, following Completion, the Combined Group's business is subject to ongoing regulation and associated regulatory risks, including the effects of new and changing laws, rules, regulations, policies, voluntary codes of practice and interpretations of such in the UK and the EU. These laws, rules, and regulations include: (A) prudential regulatory developments; (B) increased regulatory oversight in respect of conduct issues; and (C) industry-wide codes, guidance and initiatives. Each of these has costs associated with it, may significantly affect the way that the CYBG Group and, following Completion, the Combined Group does business and may restrict the scope of their existing businesses, limit their ability to expand their product offerings or make their products and services more expensive for clients and customers. Developments across any of these three regulatory areas, discussed in greater detail below, could materially adversely affect the CYBG Group's and, following Completion, the Combined Group's access to liquidity, increase their funding costs, increase their compliance costs, delay, limit or restrict their strategic development and have a material adverse effect on the CYBG Group's and, following Completion, the Combined Group's business, financial condition, results of operations and prospects.

2.1 The CYBG Group and, following Completion, the Combined Group are subject to substantial and changing prudential regulation

The CYBG Group and, following Completion, the Combined Group faces risks associated with an uncertain and evolving prudential regulatory environment, pursuant to which it is required, among other things, to maintain adequate capital resources and to satisfy specified capital ratios at all times. The CYBG Group's and, following Completion, the Combined Group's borrowing costs and capital requirements could be affected by these prudential regulatory developments, which include: (A) the legislative package implementing the proposals of the Basel Committee (known as Basel III, as updated up to the final reform package issued in December 2017) in the EU and amending and supplementing the existing Capital Requirements Directive ("**CRD IV**") and other regulatory developments impacting capital, leverage and liquidity positions; and (B) European Union directive 2014/59/EU of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms of 15 May 2014, as amended ("**BRRD**"). The EU's implementation of CRD IV and BRRD is supported by level 2 measures (delegated acts and implementing acts, including Regulatory Technical Standards ("**RTS**") and Implementing Technical Standards ("**ITS**")) which the European Commission is empowered to adopt. This includes new delegated acts and RTS proposed as part of proposals to amend CRD IV in November 2016. These measures provide detail to firms on how to comply with obligations under CRD IV and BRRD and are supplemented by level 3 measures (guidelines) issued by the European Banking Authority. Some of these measures are still to be finalised or amended and may have an impact on the CYBG Group, and, following Completion, the Combined Group, which could include increasing the costs of compliance.

On 7 December 2017, the Basel Committee published the final instalments of its Basel III reforms (sometimes referred to as Basel IV). These are intended to enhance risk sensitivity and robustness of standardised approaches, clarify the role of internal models in the capital framework and to implement changes to the design and calibration of the leverage ratio and capital floors. As such, the final Basel III reforms package includes changes to the standardised approach to credit risk and new capital floor requirements. These reforms have a 5-year implementation period, commencing in January 2022.

Any future prudential regulatory developments could have a material adverse effect on the CYBG Group's and, following Completion, the Combined Group's business, results of operations and financial condition.

(a) ***CRD IV***

CRD IV introduced significant changes in the prudential regulatory regime applicable to banks and bank holding companies with effect from 1 January 2014, including: increased minimum levels of capital and additional minimum capital buffers; enhanced quality standards for qualifying capital; increased risk weighting of assets, particularly in relation to market risk and counterparty credit risk; and the introduction of a minimum leverage ratio (being the capital measure (the numerator) divided by the exposure measure (the denominator) calculated in accordance with relevant EU legislation) (the "**Leverage Ratio**"). CRD IV provides for some of these measures to be phased in over a transitional period to 2018. The capital conservation buffer and the countercyclical capital buffer currently apply to the CYBG Group, along with a PRA capital buffer which is not prescribed under CRD IV. The countercyclical capital buffer was introduced in the UK in May 2014 and rose from 0 per cent. to be 0.5 per cent. of a bank's total risk weighted assets ("**RWAs**") in June 2018, and will rise to 1 per cent. from November 2018. The primary objective of the countercyclical capital buffer is to use a buffer of capital to achieve the broader macro-prudential goal of protecting the banking sector from periods of excess aggregate credit growth that have often been associated with the build-up of system-wide risk. Consequently, the Bank of England would be expected to change countercyclical capital buffer requirements if it determines that the strength of the UK economy warrants such change. The capital conservation buffer is set at 2.5 per cent. of RWAs and needs to be met with an additional amount of CET1 capital. As set out above, the final Basel III proposals will change the calculation of RWAs.

In the UK, the capital conservation buffer is subject to a transitional implementation that ends on 31 December 2018. The capital conservation buffer sits on top of the 4.5 per cent. minimum requirement for CET1 capital prescribed by CRD IV. If a bank breaches the capital conservation buffer, automatic safeguards apply to limit the amount of dividend and bonus payments it can make. The PRA capital buffer (also known as Pillar 2B requirements) is set by the PRA on a bank-by-bank basis using supervisory judgement informed by the impact of stress scenarios on a bank's capital requirements and resources, and taking account where appropriate of other factors including leverage, systemic importance and weaknesses in the bank's risk management and governance. Any increase in the countercyclical capital buffer, capital conservation buffer or the PRA capital buffer would increase the capital requirements of the CYBG Group which could have a material adverse effect on the CYBG Group's and, following Completion, the Combined Group's business, results of operations and financial condition.

CRD IV requirements adopted in the UK may change, whether as a result of further changes to CRD IV agreed by EU legislators (such as those proposed in November 2016 – see "— *Minimum requirement for own funds and eligible liabilities*" for further information), binding regulatory technical standards to be developed by the European Banking Authority, changes to the way in which the PRA interprets and applies these requirements to UK banks and bank holding companies, following the UK's exit from the EU or otherwise. Such changes, either individually and/or in aggregate, may lead to further unexpected requirements in relation to the CYBG Group's and, following Completion, the Combined Group's capital, leverage, liquidity and funding ratios or alter the way such ratios are calculated.

A market perception or actual shortage of capital issued by the CYBG Group and, following Completion, the Combined Group could result in regulatory actions, including requiring CYBG to issue additional CET1 securities, requiring CYBG to retain earnings or suspend dividends or issuing a public censure or the imposition of sanctions. This may affect the CYBG Group's and, following Completion, the Combined Group's capacity to continue their business operations, generate a return on capital, pay future dividends or pursue acquisitions or other strategic opportunities, impacting future growth potential. If, in response to any such shortage, the CYBG Group and, following Completion, the Combined Group raises additional capital through the issuance of share capital or capital instruments, existing shareholders may experience a dilution of their holdings or reduced profitability and returns.

(b) ***Recovery and resolution***

The BRRD contains requirements relating to recovery and resolution plans, early supervisory interventions and the resolution of firms (including the introduction of a bail-in tool).

The BRRD (including the bail-in tool), together with the majority of associated FCA and PRA rules, was implemented in the UK in January 2015. PRA rules requiring contractual clauses in certain debt instruments and unsecured liabilities came into force on 19 February 2015, and PRA rules on contractual recognition of bail-in came into force on 1 January 2016. On 14 October 2016, rules specifying the minimum set of information on financial contracts that should be contained in detailed records came into force in the EU. On 5 April 2017, the European Banking Authority issued three sets of final guidelines on bail-in provisions under the BRRD, which provide guidance on the use of conversion rates, treatment of shareholders and the treatment of financial instruments recognised under the BRRD.

The powers referred to in the BRRD include certain powers which overlapped in part with those that were already available in the UK under the Banking Act 2009. The BRRD provides, among other things, for resolution authorities to have stabilisation powers to require institutions and groups to make structural changes to ensure legal and operational separation of "critical functions" from other functions where necessary or to require institutions to limit or cease existing or proposed activities in certain circumstances (the PRA issued requirements relating to operational continuity in resolution in July 2016 and further clarified the reporting requirements on this topic in April 2017). These changes are due to be implemented on 1 January 2019. In addition, it provides for preferential ranking on insolvency for certain deposits that are eligible for protection by deposit guarantee schemes (including the uninsured element of such deposits and, in certain circumstances, deposits made in non-EEA branches of EEA credit institutions) in priority to deposits that are not similarly eligible, and introduces a bank funded resolution fund. It also provides write-down or conversion powers to resolution authorities for such authorities to ensure that relevant capital instruments absorb losses upon, amongst other events, the occurrence of the non-viability of the relevant institution or its parent company or group, as well as a bail-in tool comprising a more general power for resolution authorities to write down (including to zero) the claims of unsecured creditors of a failing institution and to convert unsecured debt claims to equity. If the Bank of England, as resolution authority, were to exercise such powers in respect of CYBG, then existing shareholders may experience dilution of, or losses on, their holdings and may not receive any compensation for their losses. In addition, in a resolution situation, financial public support will only be available to CYBG as a last resort after the resolution authorities have assessed and exploited, to the maximum extent practicable, the resolution tools, including the bail-in tool. Given that the purpose of resolution tools is to minimise any reliance on financial public support, there can be no assurance that any such financial public support will be forthcoming.

(c) ***Banking Reform Act and structural reform***

The Financial Services (Banking Reform) Act 2013 (the "**Banking Reform Act**"), which implements the measures recommended by Sir John Vickers' Independent Commission on Banking (the "**ICB**"), received Royal Assent on 18 December 2013. The UK Government has completed the secondary legislation required under the Banking Reform Act, including The Financial Services and Markets Act 2000 (Excluded Activities and Prohibitions) Order 2014 and The Financial Services and Markets Act 2000 (Ring fenced Bodies and Core Activities) Order 2014, in July 2014. The remaining secondary legislation and the PRA and FCA rules required in connection with the Banking Reform Act have subsequently been released with an implementation date of 1 January 2019. The rules are typically referred to as "ring-fencing". Both CYBG and, following Completion, the Combined Group are in scope for ring-fencing.

The Banking Reform Act introduces a ring-fence around retail deposits held by UK banks with the aim of separating certain core banking services critical to individuals and SMEs from wholesale and investment banking services. The ring-fencing regime is intended to implement the core recommendation of the ICB that UK banks should ring-fence their retail and SME deposit-taking businesses in certain financially independent legal entities which are separate and distinct from certain designated trading and banking activities. The impact of ring-fencing on the CYBG Group and, following Completion, the Combined Group may result in increased compliance costs or restrictions in some areas of business that may have an adverse impact on the CYBG Group's and, following Completion, the Combined Group's financial condition and results of operations. The introduction of ring-fenced and non-ring-fenced banks may also affect the nature of competition within the UK market.

Ring-fencing compliance plans to accommodate the Combined Group must also be implemented by 1 January 2019. Both the CYBG Group and the Virgin Money Group have been working on compliance with the legislation. The timing of the Offer being close to the ring-fencing compliance date leads to additional operational risk in successfully meeting all requirements in a compressed period.

(d) ***FSCS and depositor guarantee scheme***

The FSCS pays compensation, up to certain limits, to eligible customers of financial services firms that are unable, or likely to be unable, to pay claims against them. As well as compensating customers when regulated firms fail, the FSCS's aim is to promote confidence in the financial system by limiting the system risk that the failure of a single firm might trigger a wider loss of confidence in the relevant financial sector.

The CYBG Group is responsible for contributing to the FSCS. The FSCS has estimated levies due to 31 March 2018 for the interest on borrowings and an accrual of £2 million is held for the CYBG Group's calculated liability to that date. Further provisions in respect of these costs are likely to be necessary in the future. The ultimate cost to the industry, which will also include the cost of any compensation payments made by the FSCS and, if necessary, the cost of meeting any shortfall after recoveries on the borrowings entered into by the FSCS, remains uncertain but may be significant and may have a material adverse effect on the CYBG Group's and, following Completion, the Combined Group's business, financial condition and results of operations.

The EU directive on deposit guarantee schemes (the "**DGSD**") was adopted by the European Parliament and European Council in April 2014 and implemented into national law by the Deposit Guarantee Schemes Regulations 2015 and certain amendments made to the PRA's depositor protection rules with effect from July 2015. The DGSD ensures that all deposits up to €100,000 are protected through their national deposit guarantee scheme. It introduces requirements on banks to contribute to their national deposit guarantee scheme at least annually and to have reached a target pre-funded level of at least 0.8 per cent. of deposits covered by the DGSD held by the relevant bank by 3 July 2024. In cases where this pre-funded level is insufficient to cover payments to depositors, the deposit guarantee scheme will collect immediate post-event contributions from the banking sector and, as a last resort, will have access to alternative funding arrangements such as loans from third parties. The rules make provision for, amongst other things, post-event levies with access to funds collected from the UK bank levy, changes to the UK FSCS which introduced, from 3 July 2015, temporary high balance deposit protection up to £1 million for up to six months for certain types of deposits, and increased speed of pay-out. The rules are intended to enable depositors protected by the FSCS to have continuity of access to their accounts during resolution, as well as changes to the existing Single Customer View ("**SCV**") rules. Under the present regime, most depositors are eligible for protection. In contrast to the previous PRA rules, where only retail deposits and deposits of small corporates were eligible for protection by the FSCS, all deposit taking firms subject to the regime are required to produce SCV files in a shortened time period for verification purposes and in the event of default. Firms are also required to update their SCV systems and mark eligible deposits in a way that allows immediate identification of them. Several DGSD disclosure requirements apply to firms as of 1 January 2016, and the rules on SCV and Continuity of Access took effect from 1 December 2016. In October 2016, the PRA introduced a new method for assessing individual banks' FSCS levies. Banks are attributed an "individual risk score" based on various factors (including e.g. their leverage ratio, CET1, liquidity coverage ratio, etc.). This score then drives a risk adjustment applied to individual bank's levy calculation. It is possible, as a result of the DGSD and subsequent UK implementation, that future FSCS levies on the CYBG Group and, following Completion, the Combined Group may differ from those at present, and such reforms could result in the CYBG Group and, following Completion, the Combined Group incurring additional costs and liabilities, which may have a material adverse effect on their profitability.

In November 2015, the European Commission proposed the creation of a European deposit insurance scheme ("**EDIS**"), which would develop the current provisions under the DGSD, to create a pan-European deposit insurance scheme for deposits below €100,000, to which banks would be required to contribute. This would work alongside the current national deposit guarantee schemes. The proposals for this are not yet finalised, and the legislative process on these measures is unlikely to start until 2019. The extent to which these proposals will impact UK banks is therefore currently unclear, given the timeline for the UK's exit from the EU.

(e) ***Minimum requirement for own funds and eligible liabilities***

The Bank of England has published its policy to implement the BRRD requirement for firms to meet the minimum requirement for own funds and eligible liabilities ("**MREL**"). These rules are designed to ensure firms have sufficient loss absorbing capacity and to ensure continuity of critical functions without making recourse to public funds. MREL is set annually on a case by case basis by the Bank of England and the requirement for firms to meet MREL is being phased in between 2016 and 2022.

On 13 June 2018, the Bank of England published indicative data on the MREL requirements for the UK's systemically important banks and building societies, as well as indicative data on the average MREL requirements for certain other non-systemic UK banks and building societies, including CYBG and Virgin Money. The PRA requires these banks and building societies to meet an interim MREL requirement from 1 January 2020 and a final MREL requirement from 1 January 2022 (although the UK's systemically important banks and building societies will need to comply with the minimum requirements set out in the Financial Stability Board's total loss absorbing capacity term sheet from 1 January 2019). The average interim MREL requirement for the named non-systemic UK banks and building societies (including capital conservation and countercyclical capital buffers) is 18 per cent. and the average final MREL requirement for the named non-systemic UK banks and building societies (including capital conservation and countercyclical capital buffers) is 24.4 per cent. The MREL requirements set for each bank and building society will depend on a number of factors, including (but not limited to) changes to the bank or building society and its balance sheet, the preferred resolution strategy applicable to the relevant bank or building society and any change in PRA or international policy that changes the way RWAs or the exposure measure of the leverage ratio is assessed. Final MREL requirements will require consultation with competent authorities and relevant European Union resolution authorities. Accordingly, the indicative MREL requirements published by the Bank of England are not binding or a definitive determination of future consolidated MREL requirements. Consequently, it is difficult to predict the full effect MREL may have on the CYBG Group and, following Completion, the Combined Group until MREL has been fully implemented. An increase in the amount of own funds or eligible liabilities required to be issued by CYBG and/or other members of the CYBG Group and, following Completion, the Combined Group may increase compliance costs, delay, limit or restrict the execution of the CYBG Group's and, following Completion, the Combined Group's strategy and may have a material adverse effect on the CYBG Group's and, following Completion, the Combined Group's capital structure, business, financial condition and results of operations. MREL will have an impact across the market including potentially affecting the credit rating of the securities issued by the CYBG Group and, following Completion, the Combined Group and their competitors and there is a risk that the relative impact may give rise to a reduction in competitiveness of the CYBG Group and, following Completion, the Combined Group.

(f) ***Operational risk capital***

In December 2017, the Basel Committee issued its finalised revisions to the standardised approach for measuring operational risk capital which is used by the CYBG Group. The Basel Committee is introducing a statistically superior measure of operational risk, termed the "Business Indicator", which will replace gross income as a key input for determining operational risk capital. In addition, the Basel Committee has removed the differentiation by business-line, which was found not to be a significant risk-driver. Instead, the size of the relevant bank is found to be a significant risk-driver and is incorporated into the new methodology. The changes will have to be transposed into European law (which may continue to apply notwithstanding the result of the UK Referendum) and UK law and so are not expected to apply to the CYBG Group until 2022 at the earliest.

These changes, including regulatory changes arising from the Basel capital adequacy reforms, may require the CYBG Group and, following Completion, the Combined Group to hold additional operational risk Pillar 1 capital which could materially adversely affect the CYBG Group's and, following Completion, the Combined Group's access to liquidity, increase their funding costs, increase their compliance cost, delay, limit or restrict the execution of their strategy and have a material adverse effect on the CYBG Group's and, following Completion, the Combined Group's business, financial condition, results of operations and prospects.

(g) ***Credit risk and risk-weighting of assets***

In December 2017, the Basel Committee published the final version of the measures it is taking to improve consistency and comparability in bank capital ratios, and thereby to restore confidence in risk-weighted capital ratios. These measures include: a revision to the standardised (non-modelled) approaches for calculating regulatory capital ratios that will also provide the basis for a capital floor; and reducing the modelling choices in the capital framework when determining internal-model based estimates of credit, market and operational RWAs. The measures form part of the Basel Committee's broader work on reducing variability in RWAs and aim to reduce reliance on external credit ratings; increase risk sensitivity; reduce national discretions; strengthen the link between the standardised approach and the IRB approach; enhance comparability of capital requirements across banks; and overall ensure the standardised approach continues to be suitable for calculating the capital requirements for credit risk exposures.

At the date of this Prospectus, the finalised standards are still required to be transposed into European and UK law and so it is not possible to say with definitive certainty what impact the changes will have on the CYBG Group's capital requirements, capital structure, business, financial condition and results of operations. The initial consultative publications were supported by quantitative impact studies which showed that if the proposals were implemented without any mitigation action, as would be expected to be the case for other banks, it would significantly increase the CYBG Group's or, following Completion, the Combined Group's RWAs and subsequent capital held. The publication issued in December 2017 has incorporated several factors that will alter the outcome should a further quantitative impact study be completed and the increasing certainty around the requirements enables market participants, including the CYBG Group to introduce mitigating actions to offset areas where the calculation of RWAs may see an increase. In March 2018, the European Commission published a targeted exploratory consultation on the final reforms.

The main implementation date given by the Basel Committee is 2022. The Basel Committee has also published its final revisions to capital floors, designing a capital floor framework based on standardised approaches. The aim of the proposals being to enhance comparability of capital outcomes, mitigate model risk from banks' internal model approaches and to ensure there is a minimum level of capital across the banking system. As was widely anticipated, the Basel Committee confirmed that the output floor would be set at 72.5 per cent. Implementation of the floor is from 2022, with a 5 year transitional period running to 2027.

The final implementation of these final standards may increase the CYBG Group's and, following Completion, the Combined Group's capital requirements which may have a material adverse effect on the CYBG Group's and, following Completion, the Combined Group's capital structure, business, financial condition and results of operations.

(h) ***Interest rate risk in the banking book and market risk***

The Basel Committee has consulted on supervisory approaches to interest rate risk in the banking book. The updated standard released in April 2016 applies an enhanced disclosure approach based on qualitative statements and the use of six standardised scenarios. The European Commission has made proposals to introduce a revised framework for capturing interest rate risks for banking book positions (within the package of amendments to CRD IV proposed in November 2016). In line with the Basel Committee's final standard the amendments include the introduction of: (A) a common standardised approach that institutions might use to capture these risks or that competent authorities may require the institution to use when the systems developed by the institution to capture these risks are not satisfactory, (B) an improved outlier test and (C) disclosure requirements.

The CYBG Group is also monitoring the Basel Committee's approach to traded market risk in view of the risk that, although the CYBG Group's operations are all related to "banking book" activity, the Basel Committee may require different treatments to be applied to certain products. This is also subject to how Basel Committee requirements are applied in the UK and to all firms rather than just large internationally active banks. The package of proposals on amendments to CRD IV also contained changes to the European framework for market risk, in order to align this with the outcomes of the Basel Committee's review of its approach to traded market risk. The proposals include changes in relation to: derivatives which are classified as "held as trading"; products which are presumed to be included in the trading book; and, treatment of foreign exchange. Institutions are allowed to deviate from the presumption that certain products are trading book instruments but to do so must satisfy the competent authorities that the position is not held with trading intent or does not hedge positions with trading intent.

In March 2018, the Basel Committee published a further consultative document proposing a number of revisions to its January 2016 standard and setting out proposals for a simplified alternative to the revised standardised approach to market risk.

Any such regulation may increase compliance costs which may have a material adverse effect on the CYBG Group's and, following Completion, the Combined Group's business, financial condition and results of operations.

(i) ***Firms' assessment of Pillar 2 risks***

The PRA published a policy statement on its approach to setting Pillar 2 capital requirements for the banking sector in July 2015. Various updates to this policy statement have been published, with the most recent update published in December 2017. The supervisory statement contains requirements in relation to Pillar 2A methodologies, including the approaches the PRA will use for assessing Pillar 2A capital for credit risk, operational risk, credit concentration risk and pension obligation risk, alongside the existing approaches for market risk, counterparty credit risk and interest rate risk in the non-trading book. It also details the associated data requirements. The PRA also published rules in 2017 to address some of the concerns on differences between the standardised approach and IRB risk weights. The changes allow firms to offset variable Pillar 2A add-ons.

The principal consequence of the new rules could be an increase in compliance costs for the CYBG Group which may have a material adverse effect on the CYBG Group and, following Completion, the Combined Group's capital structure, business financial conditions and results of operations.

The PRA's framework of final rules and supervisory expectations (which implement the CRD IV rules on liquidity in the UK) have been in place since June 2015. These rules have been supplemented by PRA proposals to establish a UK Pillar 2 liquidity regime, which will work in a similar way to Pillar 2 add-ons for capital. In February 2018, the PRA published a policy statement and statement of policy on Pillar 2 liquidity. The statement of policy outlines the PRA's approach to: the level of application of Pillar 2 liquidity guidance; assessing cash flow mismatch risk; assessing franchise viability risks; assessing intraday liquidity risks; and, assessing Pillar 2 liquidity risks. The policy statement also includes final reporting instructions for Pillar 2 liquidity.

The PRA's final proposals may result in increased liquidity requirements that may have an adverse impact on the CYBG Group's and following Completion, the Combined Group's financial condition and results of operations.

(j) ***Leverage***

The Financial Policy Committee directed the PRA to implement a leverage ratio framework on 1 July 2015. Following a consultation period, the PRA published policy statement PS27/15 ("Implementing a UK leverage ratio framework") in December 2015. This determined that any PRA regulated bank or building society with retail deposits equal to (or more than) £50 billion (on an individual or consolidated basis) would be in scope. In scope firms are required to meet a 3 per cent. minimum leverage ratio requirement. They are also required to confirm that they hold an amount of CET1 capital that matches (or exceeds) their countercyclical leverage ratio buffer. In scope firms are also subject to disclosure and reporting requirements in relation to their leverage ratio.

In October 2017, the PRA published Policy Statement 21/17 ("UK leverage ratio: treatment of claims on central banks"). This increased the minimum leverage ratio requirement to 3.25 per cent. of total exposures. It also contained changes to the disclosure and reporting requirements (which came into effect in December 2017). Additionally, in scope firms may exclude central bank claims that are matched by deposits in the same currency (and of the same or longer maturity) from the calculation of total exposure, in relation to leverage ratio calculations.

In July 2018, the PRA published Consultation Paper 14/18 ("UK leverage ratio: applying the framework to systemic ring-fenced bodies and reflecting the systemic risk buffer"). This includes a proposal to apply leverage ratio requirements on a sub-consolidated basis to those ring-fenced bodies whose groups are already required to meet leverage requirements on a consolidated basis.

The Combined Group will cross the PRA threshold by receiving more than £50 billion in retail deposits, and will therefore be in scope of the leverage ratio framework. This may lead to additional costs in relation to compliance and ongoing monitoring that reporting and disclosure obligations are being met.

2.2 The CYBG Group is and, following Completion, the Combined Group will be subject to substantial conduct regulations and regulatory oversight in respect of conduct issues

The CYBG Group and, following Completion, the Combined Group are exposed to many forms of conduct and/or regulatory risk, which may arise in a number of ways. In particular:

(a) certain aspects of the CYBG Group's and, following Completion, the Combined Group's current or past business may be determined by their regulators including the FCA, the PRA, the Payment Systems Regulator ("**PSR**"), Her Majesty's Treasury ("**HMT**"), the FOS, the CMA, the UK ICO or the courts, as not being conducted in accordance with applicable local or potentially, overseas laws or regulations, or, in the case of the FOS, with what is fair and reasonable in the FOS's opinion. If the CYBG Group and, following Completion, the Combined Group fails to comply with any relevant regulations, there is a risk of an adverse impact on their business and reputation due to sanctions, fines or other actions imposed by the regulatory authorities. In particular, regulatory and/or other developments in respect of PPI and interest rate hedging products have had, and are likely to continue to have, a material impact on the CYBG Group's and, following Completion, the Combined Group's business;

(b) the CYBG Group and, following Completion, the Combined Group may be subject to further allegations of mis-selling of financial products, including as a result of having sales practices and/or reward structures in place that are determined to have been inappropriate, which may result in disciplinary action (including significant fines) or requirements to amend sales processes, withdraw products or provide restitution to affected customers, any or all of which could result in significant costs, which may require provisions to be recorded in the CYBG Group's and, following Completion, the Combined Group's financial statements and could adversely impact future revenues from affected products. See "*—The CYBG Group and, following Completion, the Combined Group faces risks relating to complaints and redress issues from sales of historic financial products. Existing provisions for such issues may not cover all potential costs and losses and do not cover all or future conduct issues*" for further information in relation to complaints and redress from historical sales of financial products and details of the existing provisions;

(c) the CYBG Group and, following Completion, the Combined Group may be liable for damages to third parties harmed by the manner in which the CYBG Group and, following Completion, the Combined Group has conducted one or more aspects of their business.

PPI final deadline and guidance on "Plevin" cases

On 2 March 2017, the FCA published its final rules and guidance on PPI complaints and has confirmed that it will introduce a deadline of 29 August 2019 for making new PPI complaints. To encourage consumers to decide whether to complain about PPI before the deadline, the FCA is running a two-year consumer communications campaign, which was launched in August 2017. The final rules and guidance also include rules about how firms should handle complaints in light of the Supreme Court Judgement in *Plevin v Paragon Personal Finance Ltd [2017] UKSC 23* ("**Plevin**"). The Plevin decision means that consumers may complain about PPI because of the amount of commission that the providers received and that the failure to disclose that commission made the relationship unfair. The FCA's approach refers to a 50 per cent. commission "tipping point" at which firms should presume that the failure to disclose commission gave rise to an unfair relationship. Profit share must be included in the firm's calculation of commission. Redress will be calculated as the excess commission over the 50 per cent. tipping point (although in light of the recent case of *Doran v Paragon Personal Finance (unreported)*, in which it was determined that the entire undisclosed commission should be repaid plus interest, rather than anything above the 50 per cent tipping point as stated in *Plevin* it may be possible for claimants to recover more than this amount). Guidelines proposed in an FCA Consultation Paper published on 4 July 2018 may also increase the costs incurred by firms in relation to PPI complaints. In line with the industry, the CYBG Group is experiencing an increased volume of complaints both from customers and via claims management companies as a result of the announcement of the time bar. In addition, a customer contact exercise has been undertaken in respect of previously rejected complainants who are now eligible to complain in light of Plevin. The new rules have been implemented by the CYBG Group. As the FCA's communication campaign progresses and the time bar approaches, (a) there may be a need for the CYBG Group and, following Completion, the Combined Group, to significantly increase resources, and (b) the ability of the CYBG Group and, following Completion, the Combined Group, to handle complaints within prescribed regulatory timescales may be affected.

Consumer credit regime

The CYBG Group is subject to the consumer credit regime under FSMA, which regulates a wide range of credit agreements. The regulation of consumer credit pursuant to the Consumer Credit Act 1974 and its related secondary legislation (the "**CCA**") was transferred from the Office of Fair Trading (the "**OFT**") to the FCA in April 2014. Certain secondary legislation, made pursuant to the CCA, as well as OFT guidance, has been replaced by FCA rules and guidance set out within the FCA Handbook, although some secondary legislation remains. The FCA has greater powers of enforcement than the OFT had and looks to be taking a more proactive and intrusive approach to the regulation of consumer credit. Along with other credit providers that will need to comply with the FCA requirements applicable to the provision of consumer credit, the CYBG Group and, following Completion, the Combined Group may come under a greater degree of scrutiny from the FCA, incur additional compliance costs and be subject to potential penalties and other sanctions for non-compliance. In addition, the courts have wide powers to look again at a credit agreement, when the borrower alleges an aspect of it was "unfair", and render such arrangement unenforceable. The FCA conducted a credit card market study (MS 14/6), published in July 2016, in which they established persistent debt as being an endemic problem for UK consumers. Following a consultation (CP 17/10) on this in 2017, the FCA have now published Policy Statement 18/4, which outlines their approach to this. This includes requirements for firms to implement earlier intervention policies for customers prone to persistent debt, and provision of assistance to those customers

Adoption of a risk free rate to replace LIBOR

Although the CYBG Group is not a submitter of data for the purposes of LIBOR quotations, the CYBG Group does use this benchmark in various types of commitment documents covering, amongst others, derivative and customer loan transactions. As part of on-going work to promote the fair and effective operation of financial markets, on 27 July 2017 the FCA gave support to moves to enable a transition by the end of 2021 to a new market standard based firmly on transactions rather than judgements. The FCA stated that work must begin in earnest on planning the transition to alternative reference rates. These changes have the potential to lead to additional compliance and transaction costs for the CYBG Group and, following the Completion, the Combined Group. There is a risk that there will be impacts on the CYBG Group's customers due to the manner in which a new reference rate may operate compared to LIBOR resulting in financial loss and subsequent complaints and remediation, which could have a material adverse effect on the CYBG Group and, following Completion, the Combined Group' business, financial condition, results of operations and prospects.

Asset Management

The FCA launched a market study into the asset management sector in November 2015, publishing its interim findings in November 2016 and a final report in June 2017. The final report identified a number of concerns in relation to the UK asset management industry, including a concern that there is weak competition in a number of areas in the market. The FCA also expressed concerns as to how asset managers communicate their objectives to customers. The final report also concluded that investors' awareness of charges is often poor and that sustained, high profits have been generated by firms from such charges in this market over a number of years. The FCA has proposed remedies to address some of these concerns and on 5 April 2018 published a policy statement regarding the implementation of final rules and guidance. The remedies included measures to strengthen the rules on authorised fund managers to act in their investors' best interests, governance reforms to hold asset managers to greater account, a requirement for more independent directors on fund management boards, and more express regulatory requirements on fund managers to consider value for money. Depending on the outcome of the consultation and form of the final guidance / rules, there is a risk that Virgin Money's and, following Completion, the Combined Group's asset management business, financial condition, results of operations or prospects may be negatively impacted in the future.

2.3 **The CYBG Group and, following Completion, the Combined Group are subject to the potential impacts of UK and European banking and financial services reform initiatives**

(a) ***General Data Protection Regulation***

The European Commission's General Data Protection Regulation came into force on 25 May 2018 and provides a single set of rules on data protection, directly applicable in all EU Member States. The main provisions include a requirement to notify regulators of breaches within 72 hours of identification, increased sanctions including fines of up to four per cent. of an enterprise's annual worldwide turnover and reduced timelines within which firms must respond to subject access requests (within 30 calendar days). In some circumstances, consumers are also able to request deletion of all personal data held by the data controller and third party recipients. The CYBG Group has established a project and is employing a third party to provide peer comparison. This change has significantly increased the regulatory burden in relation to processing personal customer, employee and other data in the course of business and ensuring ongoing compliance with the regime.

(b) ***CMA—Retail Banking Remedies***

The CMA identified features of the personal and business current account and SME lending markets that were not working well and having an adverse effect on competition. On 2 February 2017, the CMA published the Retail Banking Market Investigation Order 2017 which implements the remedies identified in the CMA Retail Banking Market Investigation final report. These include overdraft alerting, prompts to switch accounts, enhanced service quality and account comparison information. The CYBG Group experienced a delay of one month in the implementation of one part of the Order in respect of which it received a Direction by the CMA. The CYBG Group has now implemented all the mandatory parts of the CMA order. Whilst not mandated to implement the Open Banking remedy element of the CMA order, non-participation by the CYBG Group in this aspect may have an adverse impact on strategic positioning in relation to sales of personal current accounts. Therefore, the CYBG Group is looking to progress elements of the Open Banking remedy as part of a wider suite of digital enhancements (see the paragraph entitled "*Payment Services Directive 2*" below).

(c) ***Payment Services Directive 2***

EU Member States were required to transpose the Payment Services Directive 2 ("**PSD2**") into national law by 13 January 2018. A key element of PSD2 is that it promotes the emergence of new parties, such as Third Party Payment Providers ("**TPPs**") and requires account servicing payment providers, such as banks, to provide appropriate access and information to these new parties to enable customers to access the new and innovative services TPPs will provide (e.g. account aggregation). Other elements of PSD2 include increased security for online payment transactions, increased consumer rights when sending monies outside Europe and in non-EU currencies and 15 day complaint handling timescales for any complaint relating to the rights and obligations covered by PSD2.

HMT published the UK Payment Services Regulations ("**PSRs**") on 19 July 2017 (the PSRs came into in full effect on 13 January 2018 with certain provisions having taken effect on 13 August 2017). The FCA's updated approach to regulating the PSRs and its final handbook changes were published in September 2017. The changes which were introduced are material and the introduction of new players brings a risk of disintermediation. The CYBG Group is currently considering its strategic options in relation to the opportunities and threats presented.

(d) ***Payment Accounts Directive***

The Payment Accounts Directive ("**PAD**"), which came into force in September 2014, introduced measures that banks and other payment service providers must comply with including facilitation of account switching and ensuring basic bank accounts are available to all EU consumers. These elements were implemented on time in September 2016. The residual elements of PAD require the introduction of new customer facing documents and the use of standard terminology in relation to payment accounts. These changes require to be implemented by 31 October 2018. The level of documentation that requires to be reviewed and amended to comply with this element is extensive.

(e) ***Mortgage Credit Directive***

The Mortgage Credit Directive (the "**MCD**") came into effect on 20 March 2014 and Member States were required to transpose it into national law by 21 March 2016. The MCD introduced changes to the way in which residential mortgages and consumer buy-to- let mortgages were to be sold, how the annual percentage rate of interest was to be calculated, advertising rules and further requirements for qualifications. The CYBG Group delivered the first set of mandatory elements by the 21 March 2016 regulatory deadline. As at the date of this Prospectus, work was underway to deliver the remaining elements of the MCD. By 21 March 2019, the CYBG Group must switch from the Key Facts Illustration (the sales illustration document for regulated mortgage contracts) to the European Standardised Information Sheet (so-called "**ESIS**"). This will require changes to systems and new training for staff. By March 2019, the CYBG Group will also be required to demonstrate that it has ceased to rely on experience alone as an indicator of competency for staff who do not already hold relevant qualifications but are involved in the manufacture or granting of regulated mortgage contracts. As at the date of this Prospectus, the impact of these requirements could not be fully ascertained until the remaining rules are implemented but they could have a material impact on the CYBG Group's and, following Completion, the Combined Group's financial condition and operations.

(f) ***Markets in Financial Instruments Directive II***

The Markets in Financial Instruments Directive has been comprehensively revised to improve the functioning of financial markets in light of the financial crisis and to strengthen investor protection. The Markets in Financial Instruments Directive II ("**MiFID II**") imposes significant changes in a number of areas including commodity derivatives, transparency, market structure, organisational requirements, conduct of business rules and transaction reporting. MiFID II came into force on 3 January 2018. Should the CYBG Group's implementation of requirements prove ineffective, there is an increased risk of non-compliance, which could have a material adverse effect on the CYBG Group's and, following Completion, the Combined Group's business, financial condition, results of operations and prospects.

(g) ***Packaged Retail and Insurance-Based Investment Products Regulation***

The Packaged Retail and Insurance-Based Investment Products ("**PRIIPs**") Regulation requires those producing or selling packaged retail investment products and insurance based investment products to produce key information documents (so-called "**KIDs**") to make it easier for retail investors to compare products. The PRIIPs Regulation came into force on 1 January 2018. Should the CYBG Group's implementation of requirements prove ineffective, there is an increased risk of non-compliance which could have a material adverse effect on the CYBG Group's and, following Completion, the Combined Group's business, financial condition, results of operations and prospects.

(h) ***European Market Infrastructure Regulation***

The European Market Infrastructure Regulation ("**EMIR**") was adopted by the European Parliament and European Council on 4 July 2012. It provides a regulatory framework for reporting of information about derivative transactions to trade repositories, mandatory clearing of standardised over-the-counter ("**OTC**") derivatives, margin posting and other risk mitigation obligations in respect of OTC derivatives, authorisation and supervision of central counterparties used for mandatory clearing, and registration and supervision of trade repositories used for reporting. The CYBG Group is subject to reporting, clearing and margining obligations which are in force and implemented. Changes to reporting obligations came into force and were implemented on 1 November 2017.

3. RISKS RELATING TO THE OFFER

3.1 There are risks that the Offer will not be implemented on a timely basis or at all. The implementation of the Offer is subject to the satisfaction of certain conditions and those conditions may not be satisfied.

The implementation of the Offer is subject to the satisfaction, or, where permitted, waiver of certain conditions including among other things, approvals of the CYBG Shareholders, the relevant Virgin Money Shareholders (including in respect of the Brand Licence Agreement), sanction of the Scheme by the court, and receipt of certain regulatory clearances and approvals. Further information on the conditions to implementation of the Offer are set out in Part I (*Information about the Offer*) of this Prospectus. The conditions to Completion are to be satisfied by 31 January 2019 (or, where permitted, waived) (or such later date as may be agreed). However, the Offer is currently expected to complete during the fourth quarter of calendar year 2018.

There is no guarantee that these conditions will be satisfied (or, where permitted, waived). In granting their consent, the regulatory authorities have discretion in imposing conditions and restrictions to their consent which could result in a delay in completion of, or a decision not to complete, the Offer or could have a material adverse effect on the business and results of operations of the Combined Group following Completion. Failure to satisfy any of these conditions may result in the Offer not being completed. In particular, certain of the conditions cannot be waived by CYBG. If the Offer does not complete, the CYBG Group would nonetheless be obliged to pay approximately £12.2 million (excluding VAT) of transaction costs (primarily advisory and legal fees) incurred in connection with the Offer. Failure to complete the Offer may also have an adverse impact on the financial condition, future operating results and/or prospects of the CYBG Group and the trading price of CYBG Shares may be adversely affected.

3.2 The prospect of Completion could cause disruptions in the businesses of the CYBG Group and/or the Virgin Money Group, which could have material adverse effects on their business, financial condition, results of operations and prospects, as well as on the business, financial condition, results of operations and prospects of the Combined Group

The prospect of Completion could cause disruptions in the businesses of the CYBG Group and that of the Virgin Money Group. For example, either or both of the CYBG Group's or the Virgin Money Group's current and prospective customers may, in response to the announcement of the Offer, terminate, change or defer their custom, any such termination, change or deferral by current and prospective customers could materially and adversely impact the revenues, profits of the CYBG Group or the Virgin Money Group and/or any anticipated growth in the revenues could be lower than expected. Furthermore, both during the Offer process and if the Offer is completed, some current and prospective employees of the CYBG Group or the Virgin Money Group may experience uncertainty about their future roles within the Combined Group, which may adversely affect the CYBG Group's and the Virgin Money Group's abilities to retain or recruit key managers and other employees. Also, market reaction to and/or speculation regarding the likelihood of Completion could increase the volatility of the price of CYBG Shares and Virgin Money Shares.

If the CYBG Group and the Virgin Money Group fail to manage these risks effectively, the business and financial results of the CYBG Group, the Virgin Money Group and the Combined Group could be adversely affected. The CYBG Group may incur higher than expected transaction and Offer related costs. CYBG will incur legal, accounting and transaction fees and other costs related to the Offer, which are expected to amount to approximately £34 million (excluding VAT, including stamp duty of approximately £9 million), in aggregate. Some of these costs are payable regardless of whether the Offer is completed, and such costs may be higher than anticipated.

3.3 Synergy benefits resulting from the Offer may fail to materialise or be materially lower than have been estimated

CYBG believes the combination of the businesses of the CYBG Group and the Virgin Money Group will achieve significant operational cost savings for the Combined Group. However, there is a risk that the projected cost savings will fail to materialise, including if the Offer is not completed as contemplated, or that they may be materially lower than have been estimated, which would have a significant impact on the profitability of the Combined Group in the future.

3.4 Integration of the Virgin Money Group into the CYBG Group may be more time consuming and costly than expected and unforeseen difficulties may arise

The integration process following Completion may be more complex than anticipated. Successful integration will require a significant amount of management time and may affect or impair the ability of the management team of the Combined Group to run the business effectively during the period of integration and to execute the CYBG Group's existing strategic priorities. If the integration process proves more difficult than is being anticipated or if the Offer is not completed as contemplated, there is a risk to the operational performance of the Combined Group.

The integration of the Virgin Money Group into the CYBG Group exposes, if the Offer is completed, the Combined Group to the following risks:

(a) ***Retention of key staff***

The success of the Combined Group will in part depend on its ability to retain, but also attract hire and train qualified management as well as qualified technical and sales personnel. In the course of the integration process, key staff may leave the Combined Group in favour of competing entities. The inability to retain key staff could impair the ability of the Combined Group to properly execute the integration of the Virgin Money Group with the Combined Group.

(b) ***Integration of employee groups***

The merger of the employee groups of the CYBG Group and the Virgin Money Group will include, amongst other things, integration of unionised and non-unionised employees, restructuring of staff structures and possibly harmonisation of employment terms. Such merger and integration may result in labour related actions and employees terminating their employment with the Combined Group which may in turn disrupt the integration process.

(c) ***Disruption or failure of systems***

The integration of the Virgin Money Group into the CYBG Group may cause disruptions or failures in the IT systems of the Combined Group. Such disruptions or failures could damage the reputation of the Combined Group, result in loss of customers and revenues and may adversely affect the integration process. In addition, integration of the networks and IT systems of the Virgin Money Group into the CYBG Group could be subject to risks caused by cyber-enabled crime and fraud (for further information, see the risk factor below entitled "*The CYBG Group and, following Completion, the Combined Group are exposed to risks associated with cyber-enabled crime and fraud*") and misappropriation, misuse, leakage and accidental release or loss of information maintained in the IT systems, which may be in breach of personal data legislation, and which may result in loss of customers, customer dissatisfaction or financial claims.

(d) ***Disruption to management***

The integration of the businesses could divert management's time and focus from operating the business of the CYBG Group and the Virgin Money Group and, following Completion, the Combined Group. Any negative impact on management's ability to focus on running the respective businesses could have a material adverse effect on the CYBG Group, and following Completion, the Combined Group's business, results of operations, financial condition or prospects.

(e) ***Integration of brands and legal entities***

The integration of businesses including assets, businesses and their operations, technologies and employees may expose the CYBG Group and, following Completion, the Combined Group to operating difficulties and expenditure associated with integrating the "Virgin Money" brand. As a result, there is a risk of customer confusion, in particular during the transition period and merging of the brands may expose the Combined Group to increased regulatory scrutiny.

(f) ***Impact on customer growth***

The integration of the Virgin Money Group into the CYBG Group may result in the Combined Group having a higher risk portfolio due to either (i) changes in its customer base as a result of the Combination, or (ii) by targeting a more diverse set of segments following Completion. Any such negative impact on the Combined Group's risk portfolio could lead to a material adverse effect on the CYBG Group, the Virgin Money Group and, following Completion, the Combined Group's rate of medium term customer growth.

As a result of the above and/or other risks, it is possible that the costs of integration of the Virgin Money Group into the CYBG Group may be materially higher than anticipated, which would adversely affect the expected synergy benefits and in particular exceed anticipated cost savings as a result of the Offer. In addition, the integration may take longer than is expected, or difficulties relating to the integration, including of which the Board are not yet aware, may arise. In such circumstances, the profitability of the Combined Group might be detrimentally affected, which could have a negative impact on the price of the CYBG Shares as well as a material adverse effect on the business, financial condition and result of operations of the Combined Group.

3.5 Change of control provisions in the CYBG Group's and the Virgin Money Group's agreements may be triggered upon Completion and may lead to adverse consequences

The CYBG Group and the Virgin Money Group are party to contracts, agreements and instruments that contain change of control provisions that may be triggered upon Completion. Usually these provisions, if any, may be waived with the consent of the other party, and the CYBG Group and Virgin Money Group will consider whether they will seek such waivers. In absence of these waivers, the operation of the change of control provisions, if any, could result in the loss of significant contractual rights and benefits, the termination of significant agreements or the payment of a termination fee. In addition, employment agreements or other employee benefit arrangements with the CYBG Group's and the Virgin Money Group's employees may contain change of control provisions providing for additional payments following a change of control.

3.6 Shareholders in CYBG will experience a dilution of their ownership of the Combined Group

Pre-emption rights do not apply to the issue of the New CYBG Shares to the Virgin Money Shareholders pursuant to the Offer. Following Completion, Existing CYBG Shareholders will experience dilution in their proportionate ownership and voting interest in the Combined Group compared to their proportionate ownership and voting interest in CYBG immediately prior to Completion because of the issue of the New CYBG Shares to the Virgin Money Shareholders.

4. RISKS RELATING TO THE CYBG SHARES AND THE NEW CYBG SHARES

4.1 The value of the New CYBG Shares and CYBG Shares may go down as well as up and any fluctuations may be material and may not reflect the underlying asset value

The market price of the New CYBG Shares and CYBG Shares could be subject to significant fluctuations due to a change in sentiment in the market regarding such shares. The fluctuations could result from national and global economic and financial conditions, the market's response to the Offer, market perceptions of the CYBG Group, and various other factors and events, including but not limited to regulatory changes affecting the Combined Group's operations, variations in the Combined Group's operating results, business developments of the Combined Group and/or its competitors and the liquidity of the financial markets. Furthermore, the operating results and prospects from time to time of the CYBG Group, or, following Completion, the Combined Group may be below the expectations of market analysts and investors. Any of these events could result in a decline in the market price of the New CYBG Shares and CYBG Shares.

4.2 The sale of CYBG Shares by substantial Shareholders (including Virgin Holdings) could depress the price of CYBG Shares

Following Admission, sales of a substantial number of CYBG Shares by substantial Shareholders, including Virgin Holdings (which, following Completion, will in aggregate hold approximately 13 per cent. of the Company's enlarged issued share capital), may significantly reduce the price of the CYBG Shares. Also, any perceived view that any such shareholder might sell substantial numbers of CYBG Shares could depress the price of CYBG Shares for an unknown period of time.

4.3 Admission of the New CYBG Shares may not occur when expected

Application for Admission of the New CYBG Shares will be made prior to Completion. If Completion is delayed, the application for Admission will be delayed. Admission is subject to the approval (subject to satisfaction of any conditions which such approval is expressed) of the FCA. There can be no guarantee that any conditions to which Admission is subject will be met or that the FCA will approve Admission. See the "*Expected Timetable of Principal Events*" for further information on the expected dates of these events.

4.4 Any future issue of CYBG Shares, including in connection with an offering, the conversion of AT1 Securities issued by the CYBG Group (including, following Completion, the Virgin Money AT1 Securities) or MREL eligible securities into CYBG Shares or any future acquisitions, any share incentive or share option plan or otherwise will further dilute the holdings of the then current CYBG Shareholders and could adversely affect the market price of CYBG Shares

CYBG may issue additional CYBG Shares in the future for a number of reasons. Any such future issue will further dilute the holdings of the then current CYBG Shareholders and could adversely affect the market price of CYBG Shares.

Other than pursuant to the Offer, CYBG has no current plans for an offering of CYBG Shares. However, it is possible that CYBG may decide to offer additional CYBG Shares in the future either to raise capital or for other purposes. If the then current CYBG Shareholders did not take up such offer, or were not eligible to participate in such offer, their proportionate ownership and voting interests in CYBG would be reduced.

Both the CYBG Group and the Virgin Money Group have issued AT1 Securities to meet their respective capital requirements. AT1 Securities issued by a company are subordinated obligations of that company but would rank ahead of the company's shares in any winding-up of that company. Any such securities issued include a provision whereby if the CET1 ratio of that company falls below a specified percentage, distributions accrued and unpaid on the AT1 Securities would be cancelled and converted into the company's shares (depending on the terms of the instrument issued). Similarly, any MREL eligible securities issued by the CYBG Group, or following Completion, the Combined Group, must enable the Bank of England to convert them into equity in the event of resolution of the CYBG Group or the Combined Group (as the case may be). As a result, CYBG's then existing shareholders could suffer dilution in their percentage ownership upon any conversion of convertible securities such as AT1 Securities, MREL eligible securities or similar securities issued by the CYBG Group (including, following Completion, the Virgin Money AT1 Securities) into CYBG Shares.

The CYBG Group may also seek to raise financing to fund future acquisitions and other growth opportunities. CYBG may, for these and other purposes, such as in connection with share incentive and share option plans, issue additional equity or convertible equity securities. CYBG's then existing shareholders would suffer dilution in their percentage ownership if they did not participate, or were not eligible to participate in any such issues *pro rata* to their existing holdings.

4.5 Holders of CYBG Shares in overseas jurisdictions may not be able to participate in future equity offerings of the CYBG Group or, if the Offer is completed, the Combined Group

Securities laws of certain jurisdictions may restrict the ability of CYBG to allow participation by certain Shareholders in any future issue of CYBG Shares. In particular, Shareholders who are located in the United States may not be able to exercise their rights in a future issue of CYBG Shares unless a registration statement under the US Securities Act is effective with respect to such rights or an exemption from the registration requirements is available thereunder. There is no current intention to seek such registration and it would be evaluated, at the time of any proposed issue, whether the offer would qualify for an exemption, as well as the indirect benefits to the CYBG Group or, if applicable, the Combined Group of enabling US shareholders to exercise rights and any other factors it considers to be appropriate at the time, prior to making a decision on whether to utilise an exemption, if available, from the registration requirements of the US Securities Act. Similar issues may arise in relation to other overseas jurisdictions.

4.6 Investors with a reference currency other than pounds sterling will become subject to foreign exchange rate risk when investing in or holding the CYBG Shares

The CYBG Shares are, and any dividends that may be declared in respect of the CYBG Shares will be, denominated in pounds sterling. An investment in the CYBG Shares by an investor whose reference currency or reporting currency is not pounds sterling exposes the investor to currency exchange rate risk. Such currency exchange rate risk may impact the value of an investment in the CYBG Shares or any dividends.

4.7 The ability of the CYBG Group and, if the Offer is completed, the Combined Group to pay dividends is not guaranteed

The CYBG Group's results of operations and financial condition are dependent on its trading performance and the trading performance of the members of the CYBG Group and, if the Offer is completed, the Combined Group. As a matter of applicable company law, CYBG may only pay dividends if and to the extent that, among other requirements, it has distributable reserves and sufficient cash available for this purpose. Any decision to declare and pay dividends in the future will be made at the discretion of the Board and will depend on, among other things, applicable law, regulation, restrictions, the CYBG Group's and, if the Offer is completed, the Combined Group's financial position, regulatory capital requirements, working capital requirements, finance costs, dividend policy, general economic conditions and other factors the CYBG Directors and the Proposed Directors deem significant from time to time. CYBG's ability to pay dividends will also depend on the level of distributions, if any, received from its operating subsidiaries and regulatory restrictions in relation to the extent to which it can distribute its distributable reserves. As a result, there can be no assurance that CYBG will pay dividends in the future.

IMPORTANT INFORMATION

FORWARD LOOKING STATEMENTS

Certain statements contained in this Prospectus constitute "forward looking statements". These forward-looking statements are subject to a number of risks and uncertainties, many of which are beyond CYBG's control and all of which are based on the CYBG Directors' and the Proposed Directors' current beliefs and expectations about future events. In some cases, these forward looking statements can be identified by the use of forward looking terminology, including the terms "targets", "believes", "estimates", "plans", "prepares", "anticipates", "expects", "intends", "may", "will" or "should" or, in each case, their negative or other variations or comparable terminology.

Such forward looking statements are based on numerous assumptions regarding CYBG's present and future business strategies and the environment in which the CYBG Group, the Virgin Money Group and/or the Combined Group will operate in the future. By their nature, such forward looking statements involve known and unknown risks, uncertainties and other factors because they relate to events and depend on circumstances which may or may not occur in the future. Forward-looking statements are not guarantees of future performance. Actual results, performance or achievements of CYBG, Virgin Money and/or the Combined Group, or industry results, may be materially different from any future results, performance or achievements expressed or implied by such forward looking statements. In addition, even if actual performance, results of operations, internal rate of return, financial condition, distributions to Shareholders and the development of its financing strategies are consistent with the forward-looking statements contained in this Prospectus, those results or developments may not be indicative of results or developments in subsequent periods.

Key risks, uncertainties and other factors that could cause actual results to differ from those expected are set out more fully in the Part of this Prospectus headed "*Risk Factors*". Investors should specifically and carefully consider these factors, which could cause actual results to differ, before making an investment decision.

Each forward-looking statement speaks only as of the date of the particular statement and is not intended to provide any representations, assurances or guarantees as to future events or results. To the extent required by the Listing Rules, the Prospectus Rules, the Market Abuse Regulation, the Disclosure Guidance and Transparency Rules and other applicable regulation, CYBG will update or revise the information in this Prospectus. Otherwise, CYBG undertakes no obligation to update or revise any forward-looking statements or other information, and will not publicly release any revisions it may make to any forward-looking statements or other information that may result from events or circumstances arising after the date of this Prospectus.

The statements above relating to forward-looking statements should not be construed as a qualification on the opinion as to working capital set out in paragraph 15 of Part XIII (*Additional Information*) of this Prospectus.

FINANCIAL INFORMATION RELATING TO THE CYBG GROUP

All financial information relating to the CYBG Group contained in this Prospectus, unless otherwise stated, has been extracted from the audited financial statements as of and for the financial years ended 30 September 2017 and 30 September 2016 as set out in the CYBG Annual Report 2017 and the CYBG Annual Report 2016, the historical financial information as of and for the financial year ended 30 September 2015 as set out in the CYBG IPO Prospectus, and from the unaudited interim financial statements as of and for the six month periods ended 31 March 2018 and 31 March 2017 as set out in the CYBG Interim Report 2018 or from the CYBG Group's accounting records used to prepare such financial statements. Where information has been extracted from the audited financial statements of the CYBG Group, the information is described as audited unless otherwise stated. Where information has been extracted from the unaudited interim financial statements of the CYBG Group, the information is described as unaudited unless otherwise stated.

FINANCIAL INFORMATION RELATING TO THE VIRGIN MONEY GROUP

All financial information relating to the Virgin Money Group contained in this Prospectus, unless otherwise stated, has been extracted from the audited financial statements as of and for the financial years ended 31 December 2017, 31 December 2016 and 31 December 2015 and unaudited financial statements as of and for the six month periods ended 30 June 2018 and 30 June 2017 as set out in Part VII (*Historical Financial Information Relating to the Virgin Money Group*) of this Prospectus. Where information has been extracted from the audited historical financial information of the Virgin Money Group, the information is described as audited unless otherwise stated. Where information has been extracted from the unaudited interim financial information of the Virgin Money Group, the information is described as unaudited unless otherwise stated.

PRO FORMA FINANCIAL INFORMATION

Certain pro forma financial information in relation to the Combined Group is set out in Part VIII (*Unaudited Pro Forma Financial Information*) of this Prospectus.

ALTERNATIVE PERFORMANCE MEASURES

The CYBG Group utilises a range of alternative performance measures to assess the CYBG Group's performance. These are defined in the section of the CYBG Annual Report 2017 entitled "Measuring financial performance—glossary", which is incorporated by reference into this Prospectus.

The Virgin Money Group also utilises a range of alternative performance measures to assess the Virgin Money Group's performance. These are defined in the section of the Virgin Money Annual Report 2017 entitled "Alternative Performance Measures", which is incorporated by reference into this Prospectus.

MARKET, ECONOMIC AND INDUSTRY DATA

Market, economic and industry data used throughout this Prospectus is derived from various industry and other independent sources. Where third-party information has been used in this Prospectus, the source of such information has been identified. Where market, economic and industry data is derived from industry and other independent sources, the publications in which they are contained generally state that the information they contain has been obtained from sources believed to be reliable, but that the accuracy and completeness of such information is not guaranteed.

CURRENCY PRESENTATION

Unless otherwise indicated, all references in this Prospectus to "**pounds**", "**pounds sterling**", "**£**", "**pence**" or "**p**" are to the lawful currency of the United Kingdom.

ROUNDING

Certain figures contained in this Prospectus or incorporated into this Prospectus by reference, including financial and numerical information, have been subject to rounding adjustments. Accordingly, in certain instances, the sum of the numbers in a column or a row in tables contained in this Prospectus or incorporated into this Prospectus by reference may not conform exactly to the total figure given for that column or row.

REFERENCES TO DEFINED TERMS

Certain terms used in this Prospectus, including certain capitalised terms and certain technical and other terms, are defined, and certain selected industry and technical terms used in this Prospectus are defined and explained in Part XIV (*Definitions*) of this Prospectus.

NO INCORPORATION OF WEBSITE INFORMATION

The contents of CYBG's and Virgin Money's websites do not form part of this Prospectus.

INFORMATION INCORPORATED BY REFERENCE

The table below sets out the documents of which certain parts are incorporated by reference into this Prospectus and which are available for inspection as set out in paragraph 27 of Part XIII (*Additional Information*) of this Prospectus. This Prospectus should be read and construed in conjunction with the following documents which have been previously published and filed with the FCA.

Documents containing information incorporated by reference	Part and paragraph in this Prospectus in which the document is referred to	Information incorporated by reference into this Prospectus
CYBG Interim Report 2018	Part IV (*Operating and Financial Review Relating to the CYBG Group*)	All text and tables under the heading "*Operating Environment*" on page 5
		All text and tables under the heading "*Interim condensed consolidated income statement*" on page 31
		All text and tables under the heading "2.4 Delivering cost savings ahead of plan" on page 11
		All text and tables under the heading "*Taxation*" on pages 42–43
		All text and tables under the heading "*Summary balance sheet*" on page 6
		All text and tables under the heading "*Summary income statement—underlying and statutory basis*" on page 6
		All text and tables under the heading "*Unsecured Personal Lending*" on page 9
		All text and tables under the heading "*Net interest incomes*" on page 10
		All text and tables under the heading "*1. Continued sustainable growth in asset and deposit balances*" on pages 8–9
		Section 2.1—Segment information on page 39–40
		All text and tables under the heading "*Key performance indicators*" on page 3
		All text and tables under the heading "*Credit risk*" on pages 15–21
		All text and tables under the heading "*Balance sheet & prudential regulation risks*" on pages 22–28
		Section 3.6—Provisions for liabilities and charges on pages 47–50
		Section 5—Contingent liabilities and commitments on page 56
		Section 1—Basis of preparation and accounting policies on pages 36–38
		Section 1.3—Critical accounting estimates and judgements on page 36
		All text under the headings "*Measuring Financial Performance Glossary*" and "*Glossary*" on pages 58–59

Documents containing information incorporated by reference	Part and paragraph in this Prospectus in which the document is referred to	Information incorporated by reference into this Prospectus
	Part VI (*Historical Financial Information Relating to the CYBG Group*)	Interim review report on page 30
		Interim condensed consolidated income statement on page 31
		Interim condensed consolidated statement of comprehensive income on page 32
		Interim condensed consolidated balance sheet on page 33
		Interim condensed consolidated statement of changes in equity on page 34
		Interim condensed consolidated statement of cash flows on page 35
		Notes to the interim condensed consolidated financial statements on pages 36–57
CYBG Annual Report 2017	Important Information, paragraph entitled "Alternative Performance Measures"	All text and tables under the heading "Measuring financial performance—glossary" on pages 250–252
	Risk Factors, paragraph 1.29	Note 1.8 to the consolidated financial statements on page 192
	Part II (*Information on the CYBG Group*) paragraph 2	Risk report on pages 128–135
		Credit risk on pages 138–153
		Balance sheet and prudential regulation risk on pages 154–171
		Regulatory, compliance and conduct risk on page 172
		Operational risk (including people risks) on page 173
		Financial crime risk on page 174
		Strategic, business and financial performance risk on page 175
	Part IV (*Operating and Financial Review Relating to the CYBG Group*)	All text and tables under the heading "*Environment and Market Outlook*" on page 17
		All text and tables under the heading "*Consolidated income statement*" on page 186
		All text and tables under the heading "*Net interest income*" and "*Non-interest income*" on page 44
		All text and tables under the heading "*2. Delivering on our efficiency programme*" on pages 45–46
		All text and tables under the heading "2.5 *Taxation*" on pages 201–202
		All text and tables under the heading "*Summary balance sheet*" on page 38

Documents containing information incorporated by reference	Part and paragraph in this Prospectus in which the document is referred to	Information incorporated by reference into this Prospectus
		All text and tables under the heading "*Summary income statement—underlying and statutory basis*" on page 38
		All text and tables under the heading "*Sustainable customer growth*" on pages 41–43
		Section 2—Segment information on pages 196–197
		All text and tables under the heading "*Strategy in action*" and "*Measuring our performance*" on pages 12–15
		All text and tables under the heading "*Credit risk*" on pages 138–153
		All text and tables under the heading "*Balance sheet & prudential regulation risks*" on pages 154–171
		All text and tables under the heading "*Regulatory, compliance & conduct risk*" on page 172
		All text and tables under the heading "*Operational risk (including & people risks)*" on page 173
		All text and tables under the heading "*Strategic, business and financial performance risk*" on page 175
		All text and tables under the heading "*Financial crime risk*" on page 174
		Section 3.14—Provisions for liabilities and charges on pages 219–223
		Section 5—Contingent liabilities and commitments on pages 237–238
		Section 1—Basis of preparation on pages 191–195
		Accounting policies described in note to which it relates on pages 198–244
		Section 1.8—Critical accounting estimates and judgements on page 192
		All text under the headings "*Measuring Financial Performance—Glossary*", "*Glossary*" and "*Abbreviations*" on pages 250–259
	Part VI (*Historical Financial Information Relating to the CYBG Group*)	Independent auditor's report on pages 178–185
		Consolidated income statement on page 186
		Consolidated statement of comprehensive income on page 187
		Consolidated balance sheet on page 188

Documents containing information incorporated by reference	Part and paragraph in this Prospectus in which the document is referred to	Information incorporated by reference into this Prospectus
		Consolidated statement of changes in equity on page 189
		Consolidated statement of cash flow on page 190
		Notes to the consolidated financial statements on pages 191–240
	Part XIII (*Additional Information*) paragraph 8	The remuneration policy of CYBG on page 99–107
		The Executive Directors' total remuneration for the year ended 30 September 2017 under the "*Executive Directors—single total figure of remuneration (audited)*" heading in the Directors' Remuneration Report on page 109
		The Non-Executive Directors' total remuneration for the year ended 30 September 2017 under the "*Non-Executive Directors (Audited)*" heading in the Directors' Remuneration Report on page 114
		The terms of the Directors' service contracts under the "*Service contracts and policy on payments for loss of office*" heading in the Directors' Remuneration Report on page 105
	Part XIII (*Additional Information*) paragraph 11	Notes 5.3 and 6.6 on pages 240 and 248, respectively
	Part XIII (*Additional Information*) paragraph 23	Details of the CYBG Group's pensions scheme obligations under the heading "*Pension risk*" on page 171
CYBG Annual Report 2016	Part IV (*Operating and Financial Review Relating to the CYBG Group*)	All text and tables under the heading "*Consolidated income statement*" on page 44
		All text and tables under the heading "*Income analysis*" on page 45
		All text and tables under the heading "*Operating and administrative expenses*" on page 46
		All text and tables under the heading "*Net interest margin analysis*" on pages 48–49
		All text and tables under the heading "*Customer loans*" on page 50
		All text and tables under the heading "*Mortgages*" on page 51
		All text and tables under the heading "*SME lending*" on page 52
		All text and tables under the heading "*Note 4—Segment information*" on pages 228–230

Documents containing information incorporated by reference	Part and paragraph in this Prospectus in which the document is referred to	Information incorporated by reference into this Prospectus
		All text and tables under the heading "*Key performance indicators*" on page 55
		All text and tables under the heading "*Impairment analysis—lending and provisions*" on page 56–57
		All text and tables under the heading "*Credit risk*" on pages 148–168
		All text and tables under the heading "*Balance sheet & prudential regulation risks*" on pages 169–191
		All text and tables under the heading "*Regulatory, compliance & conduct risk*" on pages 192–193
		All text and tables under the heading "*Operational risk (including strategic, business, financial, performance & people risks)*" on pages 194–195
		All text and tables under the heading "*Financial crime risk*" on pages 196–197
		All text and tables under the heading "*Note 27—Provisions for liabilities and charges*" on pages 256–259
		All text and tables under the heading "*Note 33—Contingent liabilities and commitments*" on pages 269–270
		All text and tables under the heading "*Note 1—Basis of preparation*" on page 212
		All text and tables under the heading "*Note 2—Accounting policies*" on page 213–226
		All text and tables under the heading "*Note 3—Critical accounting estimates and judgements*" on page 226–228
		All text under the headings "*Glossary*" and "*Abbreviations*" on pages 291–296
	Part VI (*Historical Financial Information Relating to the CYBG Group*)	Independent auditor's report on pages 200–205
		Consolidated income statement on page 207
		Consolidated statement of comprehensive income on page 208
		Consolidated balance sheet on page 209
		Consolidated statement of changes in equity on page 210
		Consolidated statement of cash flow on page 211
		Notes to the consolidated financial statements on pages 212–290

Documents containing information incorporated by reference	Part and paragraph in this Prospectus in which the document is referred to	Information incorporated by reference into this Prospectus
	Part XIII (*Additional Information*) paragraph 11	Note 12 on disclosure standards on pages 237–240
CYBG IPO Prospectus	Part VI (*Historical Financial Information Relating to the CYBG Group)*	Accountant's report on the historical financial information on pages 272–273
		Consolidated income statements for the years ended 30 September 2015, 30 September 2014, 30 September 2013 and 30 September 2012 on page 274
		Consolidated statements of comprehensive income for the years ended 30 September 2015, 30 September 2014, 30 September 2013 and 30 September 2012 on page 275
		Consolidated balance sheets as at 30 September 2015, 30 September 2014, 30 September 2013 and 30 September 2012 on page 276
		Statements of changes in equity for the years ended 30 September 2015, 30 September 2014, 30 September 2013 and 30 September 2012 on pages 277–278
		Statements of cash flows for the years ended 30 September 2015, 30 September 2014, 30 September 2013 and 30 September 2012 on page 279
		Notes to the Historical Financial Information on pages 280–372
	Part XIII (*Additional Information)* paragraph 12	The Articles of Association of CYBG under the heading "*Articles of Association of CYBG*" on page 422–434
Circular	Part XIII (*Additional Information)* paragraph 3	The resolutions, authorisations and approvals set out in the Notice of General Meeting
Virgin Money Interim Report 2018	Part V (*Operating and Financial Review relating to the Virgin Money Group*) paragraph 1	All text and tables under the heading "*Condensed Consolidated Half-Year Financial Statements (Unaudited)*" on pages 36–67
		All text and tables under the heading "*Risk Management Report*" on pages 17–34
Virgin Money Annual Report 2017	Important information	All text and tables under the heading "*Alternative performance measures*" on page 262
	Part V (*Operating and Financial Review Relating to the Virgin Money Group*)	All text and tables under the heading "*Consolidated income statement*" on page 200
		All text and tables under the heading "*Income benefitted from growth in asset balances*" on page 45
		All text and tables under the heading "*Note 6: Operating expenses*" on page 220

Documents containing information incorporated by reference	Part and paragraph in this Prospectus in which the document is referred to	Information incorporated by reference into this Prospectus
		All text and tables under the heading "*Note 9: Taxation*" on page 224
		All text and tables under the heading "*Consolidated balance sheet*" on page 43
		All text and tables under the heading "*Mortgages and savings*" on pages 53–55
		All text and tables under the heading "*Credit cards*" on pages 56–57
		All text and tables under the heading "*Financial services*" on pages 58
		All text and tables under "*2017 key performance indicators*" on page 19
		All text and tables under "*Impairments reflected a resilient economy and rigorous credit risk management*" on page 47
		All text and tables under "*Impaired assets*" on pages 143–145
		All text and tables under "*Impairment provisions*" on pages 146–147
		All text and tables under the heading "*Credit risk*" on pages 134–156
		All text and tables under the heading "*Market risk*" on pages 157–161
		All text and tables under the heading "*Operational risk*" on page 162
		All text and tables under the heading "*Conduct risk and compliance*" on page 163
		All text and tables under the heading "*Concentration risk*" on pages 164–169
		All text and tables under the heading "*Funding and liquidity risk*" on pages 170–181
		All text and tables under the heading "*Note 31: Contingent liabilities and commitments*" on page 240–241
		All text and tables under the heading "Note 1—Basis of preparation and accounting policies" on pages 207–217
		All text under the headings "*Glossary*" and "*Abbreviations*" on pages 263–266
Virgin Money Annual Report 2016	Part V (*Operating and Financial Review Relating to the Virgin Money Group*)	All text and tables under the heading "*Consolidated income statement*" on page 202
		All text and tables under the heading "*Income benefitted from growth in asset balances*" on page 58

Documents containing information incorporated by reference	Part and paragraph in this Prospectus in which the document is referred to	Information incorporated by reference into this Prospectus
		All text and tables under the heading "*Note 6: Operating expenses*" on pages 225–226
		All text and tables under the heading "*Note 9: Taxation*" on pages 230–231
		All text and tables under the heading "*Consolidated balance sheet*" on page 56
		All text and tables under the heading "*Mortgages and savings*" on pages 63–65
		All text and tables under the heading "*Credit cards*" on pages 66–68
		All text and tables under the heading "*Financial services*" on pages 69–70
		All text and tables under "*Financial highlights*" on page 6–7
		All text and tables under "*Impairments reflected rigorous credit risk management*" on page 59
		All text and tables under "*Impaired assets*" on pages 151–154
		All text and tables under the heading "*Credit risk*" on pages 140–163
		All text and tables under the heading "*Market risk*" on page 164–168
		All text and tables under the heading "*Operational risk*" on page 169
		All text and tables under the heading "*Conduct risk and compliance*" on page 170
		All text and tables under the heading "*Concentration risk*" on page 171–176
		All text and tables under the heading "*Funding and liquidity risk*" on pages 177–186
		All text and tables under the heading "*Note 32: Contingent liabilities and commitments*" on page 246–247
		All text and tables under the heading "*Note 1—Basis of preparation and accounting policies*" on page 209–220
		All text and tables under the headings "*Alternative Performance Measures",* "*Glossary*" and "*Abbreviations*" on pages 267–271

To the extent that any document or information incorporated by reference or attached to this Prospectus itself incorporates any information by reference, either expressly or impliedly, such information will not form part of this Prospectus for the purposes of the Prospectus Rules, except where such information or documents are stated within this Prospectus as specifically being incorporated by reference or where this Prospectus is specifically defined as including such information.

Except as set out above, no other portion of these documents is incorporated by reference into this Prospectus and those portions which are not specifically incorporated by reference in this Prospectus are either not relevant for the prospective investors and/or Shareholders or the relevant information is included elsewhere in this Prospectus.

Any statement contained in a document which is deemed to be incorporated by reference into this Prospectus shall be deemed to be modified or superseded for the purpose of this Prospectus to the extent that a statement contained in this Prospectus (or in a later document which is incorporated by reference into this Prospectus) modifies or supersedes such earlier statement (whether expressly, by implication or otherwise). Any statement so modified or superseded shall not be deemed, except as so modified or superseded, to constitute a part of this Prospectus.

EXPECTED TIMETABLE OF PRINCIPAL EVENTS

The times and dates set out in the expected timetable of principal events below and mentioned throughout this Prospectus are based on the CYBG Directors' and the Proposed Directors' current expectations and will depend, amongst other things, on the dates upon which conditions to the Offer are satisfied. The times and dates set out below may be adjusted by CYBG in which event details of the new times and dates will be notified to the FCA, the London Stock Exchange and, where appropriate, CYBG Shareholders through a Regulatory Information Service. Notwithstanding the foregoing, CYBG Shareholders may not receive any further written communication. All references to times in this Prospectus are to London times unless otherwise stated. References to a time of day are to London time.

Announcement of the Offer	18 June 2018
Publication of this Prospectus and the Circular	31 July 2018
Publication of Scheme Document	31 July 2018
Latest time and date for receipt of nominee shareholder forms of instruction for the Court Meeting	11.00 a.m. on 5 September 2018
Latest time and date for receipt of nominee shareholder forms of instruction for the Virgin Money General Meeting	11.15 a.m. on 5 September 2018
Latest time and date for receipt of Forms of Proxy for the CYBG General Meeting	10.00 a.m. on 6 September 2018
Latest time and date for receipt of CDI Voting Instruction Forms for the CYBG General Meeting	7.00 p.m. (AEST) on 6 September 2018
Latest time and date for receipt of forms of instruction for the Court Meeting	11.00 a.m. on 6 September 2018
Latest time and date for receipt of forms of instruction for the Virgin Money General Meeting	11.15 a.m. on 6 September 2018
Voting record time for the CYBG General Meeting	7.00 p.m. on 6 September 2018
CDI voting instruction record time for the CYBG General Meeting	11.00 p.m. (AEST) on 6 September 2018
Voting record time for the Virgin Money General Meeting	6.30 p.m. on 6 September 2018
CYBG General Meeting	10.00 a.m. on 10 September 2018
Court Meeting	11.00 a.m. on 10 September 2018
Virgin Money General Meeting	11.15 a.m. on 10 September 2018(1)
Court Hearing	A date expected to be in calendar Q4 2018 subject to satisfaction (or, where applicable, waiver of the relevant Conditions) ("**D**")(2)
Last day of dealings in, for registration of transfers of, and disablement in CREST of, Virgin Money Shares	D*(2)
Scheme Record Time	6.00 p.m. on D*(2)
Effective Date	D+1*(2)(3)
New CYBG Shares issued to Virgin Money Shareholders	By 8.00 a.m. on D+1*(2)
Admission and commencement of dealings in the New CYBG Shares on the London Stock Exchange	By 8.00 a.m. on D+1*(2)
Cancellation of listing of Virgin Money Shares on the premium segment of the Official List and the Main Market of the London Stock Exchange	By 8.00 a.m. on D+1*(2)

CREST accounts of Virgin Money Shareholders credited with New CYBG Shares	On or soon after 8.00 a.m. on D+1*(2) but no later than 14 days after the Effective Date
CREST accounts credited with any cash due to Restricted Shareholders under the Scheme and in relation to the sale of fractional entitlements	Within 14 days of the Effective Date(2)
Despatch of share certificates for New CYBG Shares and cheques for any cash due to Restricted Shareholders under the Scheme and in relation to the sale of fractional entitlements for those Virgin Money Shareholders who do not hold their Virgin Money Shares in CREST	Within 14 days of the Effective Date(2)
Long Stop Date	31 January 2019(4)

Notes:

(1) To commence at the time fixed or, if later, immediately after the conclusion or adjournment of the Court Meeting.

(2) The date of the Court Hearing to sanction the Scheme and each of the subsequent dates set out in the timetable will depend on, among other things, the date on which (i) the relevant Conditions to the Scheme are satisfied or, if capable of waiver, waived; (ii) the Court sanctions the Scheme; and (iii) a copy of the Court Order sanctioning the Scheme is delivered to the Registrar of Companies.

(3) Scheme to become Effective by 8.00 a.m. and before the subsequent events set out in the timetable.

(4) This is the latest date by which the Scheme may become Effective. However, the Long Stop Date may be extended to such later date as may be agreed in writing by CYBG and Virgin Money (with the Panel's consent and as the Court may approve (if required)).

(*) All references to "D+1" are to the day falling one Business Day after the actual date which is "D".

INDICATIVE STATISTICS

Number of New CYBG Shares to be issued for each Virgin Money Share . . .	1.2125
Number of CYBG Shares in issue as at 27 July 2018, being the Latest Practicable Date	886,010,853
Number of New CYBG Shares to be issued pursuant to the Offer	546,954,891
New CYBG Shares as a percentage of the issued share capital of CYBG immediately following Completion	approximately 38 per cent.
Number of CYBG Shares in issue immediately following Completion	1,432,965,744

Note:

These figures are calculated assuming that the numbers of CYBG Shares and Virgin Money Shares in issue and to be issued as at close of business on the Latest Practicable Date do not change and that no issues of CYBG Shares, other than those described above occur between the Latest Practicable Date and Completion.

DIRECTORS, PROPOSED DIRECTORS, COMPANY SECRETARY, REGISTERED OFFICE AND ADVISERS

CYBG Directors	James Pettigrew, Chairman David Bennett, Deputy Chairman and Senior Independent Non-Executive Director David Duffy, Executive Director and Chief Executive Officer Ian Smith, Executive Director and Group Chief Financial Officer Debbie Crosbie, Executive Director and Group Chief Operating Officer Clive Adamson, Independent Non-Executive Director Paul Coby, Independent Non-Executive Director Adrian Grace, Independent Non-Executive Director Fiona MacLeod, Independent Non-Executive Director Dr Teresa Robson-Capps, Independent Non-Executive Director Tim Wade, Independent Non-Executive Director The business address of all of the CYBG Directors is the head office of Clydesdale Bank PLC at 30 St Vincent Place, Glasgow G1 2HL
Proposed Directors	Darren Pope, Independent Non-Executive Director Geeta Gopalan, Independent Non-Executive Director Amy Stirling, Non-Executive Director, nominated by VEL pursuant to the Brand Licence Agreement
Company Secretary and Registered Office	Lorna McMillan 20 Merrion Way Leeds LS2 8NZ
Financial Adviser, Corporate Broker and Sponsor	Morgan Stanley & Co. International plc 20 Bank Street, Canary Wharf, London E14 4AD
Financial Adviser	Deutsche Bank AG, London Branch Winchester House 1 Great Winchester Street London EC2N 2DB
Corporate Broker	Macquarie Capital (Europe) Limited Ropemaker Place 28 Ropemaker Street London EC2Y 9HD
Legal Adviser to the Company	Clifford Chance LLP 10 Upper Bank Street London E14 5JJ
Legal Adviser to the Sponsor .	Herbert Smith Freehills LLP Exchange House Primrose Street London EC2A 2EG
Auditor and reporting accountant	Ernst & Young LLP 1 More London Place London SE1 2AF
Reporting accountant	Deloitte LLP 1 New Street Square London EC4A 3HQ
UK Registrar	Computershare Investor Services PLC The Pavilions, Bridgwater Road, Bristol BS13 8AE
Australian Registrar	Computershare Investor Services Pty Limited Yarra Falls, 452 Johnston Street, Abbotsford Victoria 3067 Australia

PART I
INFORMATION ABOUT THE OFFER

1. INTRODUCTION AND SUMMARY OF THE OFFER

On 18 June 2018, the boards of CYBG and Virgin Money announced that they had reached agreement on the terms of a recommended all-share offer to be made by CYBG for Virgin Money by way of a court-sanctioned scheme of arrangement under Part 26 of the 2006 Act (although CYBG reserves the right to implement the Offer by way of a Takeover Offer, subject to the terms of the Co-operation Agreement) (the "**Offer**").

The Offer, which is being recommended to Virgin Money Shareholders by the Independent Virgin Money Directors, comprises an all-share offer by CYBG for the entire issued and to be issued share capital of Virgin Money.

Under the terms of the Offer, which is subject to the further terms and conditions set out in the Scheme Document, the Virgin Money Shareholders at the Scheme Record Time will be entitled to receive:

1.2125 New CYBG Shares in exchange for each Virgin Money Share

Based on the Closing Price of 338 pence per CYBG Share on the Latest Practicable Date, the Offer values each Virgin Money Share at 410 pence and Virgin Money's issued ordinary share capital on a fully diluted basis at approximately £1.8 billion, representing a premium of:

- 31 per cent. to the Closing Price of 312 pence per Virgin Money Share on 4 May 2018 (being the last Business Day prior to the commencement of the Offer Period); and
- 48 per cent. to the volume weighted average price of 276 pence per Virgin Money Share for the three-month period ended 4 May 2018.

Following Completion, Virgin Money Shareholders will own approximately 38 per cent. of the Combined Group (on a fully diluted basis). As a result, the voting rights of the Existing CYBG Shareholders will be diluted such that the Existing CYBG Shareholders would, immediately after the Effective Date, hold voting rights of approximately 62 per cent of the total voting rights they held immediately prior to Completion.

On Completion, the current Virgin Money Directors will resign as directors of Virgin Money and will be replaced by David Duffy, Debbie Crosbie and Ian Smith, who will join the Virgin Money board on Completion, subject to the usual regulatory approvals. Darren Pope and Geeta Gopalan, who are currently independent non-executive directors of Virgin Money will join the CYBG Board as independent non-executive directors on Completion, subject to the usual regulatory approvals. In addition, on Completion, Amy Stirling, who is currently a non-executive director of Virgin Money, will become a non-executive director of CYBG pursuant to the right of VEL to nominate a director under the terms of the Brand Licence Agreement, subject to the usual regulatory approvals.

Jayne-Anne Gadhia, currently the CEO of Virgin Money will step down from the Virgin Money board and she has agreed, in principle, to support the Combined Group as a senior adviser to David Duffy, the CEO of the Combined Group in a consultancy role for a period of up to 18 months, with effect from Completion on terms to be agreed.

Further details are set out in paragraph 6 (*CYBG's Strategic Plans and Intentions*) below.

2. CYBG'S BACKGROUND TO AND REASONS FOR THE OFFER

The CYBG Directors believe that the banking industry in the UK is reaching an inflection point: more and more customers are choosing to interact digitally; new entrants are looking to disrupt the industry and partner with existing players; technological change is happening at a faster pace than ever before; and the implementation of the Payment Services Directive 2 and Open Banking regulation aims to open up banking services and encourage competition. These trends are expected to transform existing bank business models in the UK, with an expected increase in partnerships and disintermediation of traditional value chains. The CYBG Directors believe that the successful banking propositions of the future will be digitally-led customer experiences supported by exceptional omni-channel service, with the winners delivering technology-enabled, customer-centric propositions that resonate with and enhance customers' lifestyles.

Recognising these underlying industry trends, the Combination will bring together the complementary strengths of two successful challenger banks to create the UK's first true national competitor to the large incumbent banks. The Combination will offer retail and SME customers an enhanced alternative to the status quo. The Combined Group will have the capabilities, scale and national presence required to lead the way in the Open

Banking environment, with a full-service product offering across retail and SME, modern and innovative technology and the iconic Virgin Money national brand underpinned by a strong customer service culture.

The CYBG Board believes the Combination has a strong strategic and financial rationale as described below, creating a compelling opportunity for both sets of shareholders:

Scale and national presence:

- The combination of two of the largest challenger banks to create a national competitor of scale to the incumbent UK banks, with around six million customers, £69.5[1] billion customer loans, and £59.3[1] billion customer deposits.
- The Combined Group will benefit from national brand recognition and a complementary national branch network.

Full-service offering:

Retail offering:

- The Combined Group will be better positioned to serve the broader needs of the combined customer base by offering a more comprehensive range of products for retail clients, anchored on a core relationship PCA proposition, thereby deepening multi-product customer relationships as well as partnership opportunities with the wider Virgin Group.
- The Combined Group will have a complementary mix of product expertise, combining CYBG's strengths in PCAs and digital propositions, shared strengths in mortgages and Virgin Money's expertise in credit cards and digital savings. The CYBG Directors believe that the resulting omni-channel offering for both sets of customers will put the Combined Group at the forefront of customer service and convenience, with the potential to generate deeper customer relationships and higher product holdings.

SME offering:

- CYBG has a strong and long-established, full-service SME business with over £7 billion of customer loans and 200,000 customers. The Combination would accelerate the delivery of Virgin Money's current plans to build an SME business.
- In addition, as a Pool A eligible applicant for the alternative remedies package proposed by the EC and UK authorities to replace the commitment for The Royal Bank of Scotland to divest Williams & Glyn, the Combined Group will have an opportunity to accelerate the creation of a leading, digitally enabled SME proposition through a planned application to the Capability and Innovation Fund. This opportunity builds on CYBG's existing strengths and could help accelerate its ambition to deliver a differentiated SME proposition in UK banking. In addition, given CYBG's existing and substantive BCA offering, the Combined Group envisages playing a significant role in the proposed incentivised switching scheme as part of the alternative remedies package, further enhancing the Combined Group's potential to acquire new SME customers.

Iconic national brand and customer-focused cultures:

- Virgin is one of the most powerful and iconic brands in the UK, with 99 per cent. brand awareness.
- Under the Brand Licence Agreement, the Combined Group will have exclusive and perpetual access to use of the Virgin Money brand for financial services in respect of retail, SME and corporate customers in the UK. Virgin Money has a leading net promoter score of +37 (as at 30 June 2018).
- It is envisaged that the retail brand for the Combined Group will transition to Virgin Money using a phased approach over a period of 36 months following Completion. The CYBG Directors believe that the Virgin Money brand has potential in the SME market, particularly in light of its entrepreneurial spirit. Testing of the brand with existing CYBG SME customers and the wider SME market will be undertaken to evaluate the Virgin Money brand affinity with customers and the appropriate timescale for any rebranding exercise for CYBG's SME business.

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1 Based on CYBG's unaudited interim financial statements for the six months ending 31 March 2018 and Virgin Money's audited annual financial statements for the year ending 31 December 2017. The calculations of these pro forma amounts are set out in Part VIII (*Unaudited Pro Forma Financial Information*).

- Use of the Virgin Money brand combined with CYBG's customer-centric product range and service model is expected to lead to higher awareness, consumer interest and advocacy across the UK over time, generating higher customer acquisition and greater customer retention for the Combined Group. The wider Virgin portfolio also provides attractive opportunities for partnerships and collaboration.
- The cultures of CYBG and Virgin Money already share many common attributes: a disruptor mindset; customer-centricity; a close alignment to business strategy; and a focus on diversity and inclusion. The Combined Group offers a real opportunity to capitalise on the strengths of both cultures. Both CYBG and Virgin Money are committed to a positive working culture in which employees can thrive and share a commitment to supporting talent, flexible working and a diverse and inclusive working environment. This includes continued support for the Women in Finance Charter, and a continued commitment to take action to reduce the gender pay gap of the Combined Group.
- The Combined Group will establish a unifying purpose to seek to galvanise employees under the Virgin Money brand, to maintain a culture of customer centricity as well as guiding an ethical and sustainable approach to business. This will be supported by a strong set of common values which will be embedded into all people practices. It will continue to build on CYBG's innovative approach to performance, with a focus on team rather than individual contributions.

Innovative and modern technology:

- CYBG has an established, proven, scalable and resilient, Open Banking-enabled technology platform which has facilitated the development of innovative services for customers such as mobile cheque clearing and account aggregation using secure, open APIs. The addition of Virgin Money's iconic national brand to this existing proposition is expected to increase customer awareness and interest in the offering.
- CYBG is in the process of migrating its retail and SME products onto its Open Banking-enabled technology platform, with retail customers already successfully migrated and SME customers in the process of migrating during 2018. This has provided the opportunity to test and demonstrate the scalability of the platform.
- The Combined Group will benefit in the future from CYBG's technology platform supporting all products, services and customer interactions. This will deliver business advantages in terms of flexibility, security and data insights. In addition, it will allow Virgin Money to avoid the significant investment and time required to build its own digital bank.

Low-complexity integration plan and management strength:

- The proposed phased migration and re-branding approach will be separated into several distinct phases aligned to transaction events that minimise the complexity to deliver and any impact on customers. This will be achieved in particular by leveraging product maturities and limiting the use of large-scale automated transfers, thereby avoiding any large migration events within the process.
- All Virgin Money products and customers will be migrated in phases over time to CYBG's robust IT platform, with the exception of credit cards where CYBG card customers will be migrated to the TSYS platform used by Virgin Money. TSYS is a modern platform with open architecture, which will be integrated with CYBG's proprietary platform.
- The nature of both businesses' portfolios reduces execution risk and provides greater optionality for integration and migration for the Combined Group. A number of options are being considered for migrating the small number of Virgin Money PCAs (approximately 100,000) including the industry standard Current Account Switching Service ("**CASS**"), which would eliminate the need for a single-event migration of these higher-interaction accounts. CYBG has significant experience of PCA on-boarding, including using CASS to on-board nearly 20,000 accounts in two weeks as part of its current account switching campaign in October 2017. It is expected that a significant majority of Virgin Money mortgages and cash ISAs will be migrated to CYBG platforms on renewal. Virgin Money personal and business savings accounts are expected to be migrated using an automated transfer. It is currently estimated that approximately 30 per cent. of all accounts of the Combined Group will be part of a transfer or migration process within the proposed integration plan.
- CYBG is developing a detailed plan to ensure that integration can be achieved with minimal impact on the customers and other stakeholders of the Combined Group. It is expected that the IT migration will be phased over 36 months in order to minimise execution risk with operational integration phased over a similar timeframe.

- Both CYBG and Virgin Money are organisations with a strong track record in delivering large-scale transformation. The integration delivery team will draw on this management experience, and will be supported, guided and challenged by the CYBG Directors, the Proposed Directors and the CYBG Senior Managers (whose skills and experience are set out in Part XI (*CYBG Directors, Proposed Directors, CYBG Senior Managers and Corporate Governance*) of this Prospectus). The team will be closely supervised by David Duffy, the CEO of the Combined Group.

The CYBG Directors believe these capabilities provide the Combined Group with the attributes it needs to be a leading force in the Open Banking environment, disrupting the status quo and championing customer service in the future financial services landscape.

Furthermore, the CYBG Directors believe that successful future banking models will leverage partnerships to innovate and to bring together additional products and services that increase customer convenience. CYBG's technology platform has the capability to interact with fintech and other partners and the Combined Group will also have enhanced opportunities to link customer propositions with services, including the opportunity to partner with the wider Virgin portfolio of branded businesses.

Significant synergy and value creation potential:

- The CYBG Directors expect the Combined Group to generate £120 million of annual pre-tax cost synergies, run rate by the end of the financial year ending 30 September 2021. CYBG believes these synergies will deliver substantial value for all shareholders. Further detail on the quantified synergies and the costs to achieve them is given in paragraph 5 below.
- CYBG also expects additional value creation through avoidance of planned future Virgin Money digital bank running costs, revenue synergies and funding synergies over time which have not been quantified for reporting under the Takeover Code.

Diversified, low-risk balance sheet:

- The Combined Group will benefit from a diversified and stable funding model. This will comprise a mix of PCAs, BCAs, savings accounts and wholesale funding. The Combined Group's total customer deposit base of £59.3[1] billion equates to approximately 74 per cent. of total funding, with approximately 30 per cent. of total funding related to core relationships (defined as PCA and BCA balances and savings balances linked to those same PCA and BCA customers). The Combined Group will seek to benefit from the pro forma historical renewal rate of approximately 80 per cent. for CYBG's and Virgin Money's fixed term savings products.
- TFS funding in aggregate comprises £8.7 billion (comprising £2.3 billion for CYBG as at 31 March 2018 and £6.4 billion for Virgin Money as at 30 June 2018), which represents 10.9 per cent. of total funding, and will mature in 2021-2022. The CYBG Directors believe that the Combined Group's diversified funding model will enable it to refinance its outstanding TFS balances in advance of their contractual maturities. Furthermore, the CYBG Directors believe that as part of the Combined Group's overall funding strategy the Combined Group would be able to utilise multiple funding sources including PCA growth, BCA growth (including leveraging the RBS Alternative Remedies Scheme), savings growth, and ongoing wholesale issuance including MREL.
- On a pro forma basis, the Combined Group has £83.8[1] billion of total assets and a £69.5[1] billion total customer loan portfolio. The loan portfolio includes £57.8[1] billion of mortgages, representing 83 per cent. of total customer lending. These mortgages have an average indexed loan-to-value of 57.2 per cent., a net cost of risk of one basis point and a non-performing loan ratio of 0.6 per cent.
- The remaining customer loan portfolio comprises: £7.4[1] billion of SME and corporate lending; a £3.5[1] billion credit card portfolio; and other unsecured lending of £0.8[1] billion.
- Virgin Money's prime credit card portfolio will transfer to the Combined Group, providing growth optionality in unsecured lending. Virgin Money's credit card portfolio is more concentrated in lower risk segments (classified as segments of the loan book with lower than 2.5 per cent. expected loss rates), compared to the broader industry: 92 per cent. of Virgin Money's credit card portfolio versus 81 per cent. for the industry. The focus on prime lending has contributed to a lower charge-off rate compared to the

1 Based on CYBG's unaudited interim financial statements for the six months ending 31 March 2018 and Virgin Money's audited annual financial statements for the year ending 31 December 2017. The calculations of these pro forma amounts are set out in Part VIII (*Unaudited Pro Forma Financial Information*).

industry and a declining impairment ratio in the credit card portfolio experienced by Virgin Money for the three years to December 2017: 200bps (2015FY), 170bps (2016FY) and 151bps (2017FY).

- As part of the fair valuation exercise to be conducted at Completion, CYBG will finalise its review of Virgin Money's accounting policies and practices. As part of this process, CYBG will focus on reviewing the inputs to the EIR methodology for the Combined Group.

Strong capital position:

- The CYBG Directors believe the Combined Group will have a strong capital position following Completion. At Completion, the CET1 ratio is expected to be in excess of 12 per cent. and the Combined Group will maintain a significant buffer in excess of its regulatory minimum capital requirements. In calculating this figure, the CYBG Directors have projected the expected capital positions of each of CYBG and Virgin Money at Completion taking into account factors including underlying capital generation, impairment charges, asset growth, investment, and restructuring spend. The expected capital position of the Combined Group does not assume that CYBG achieves IRB accreditation before Completion. In addition, the CYBG Directors have estimated the potential impact on Virgin Money's assets and liabilities which will be determined as part of the fair value exercise to be undertaken following Completion. The expected CET1 ratio does not take into account any discussions between CYBG and the PRA.
- Based on the latest disclosed Pillar 2A requirements for both CYBG, as at 31 March 2018, and Virgin Money, as at 30 June 2018, the Combined Group's fully loaded CRD IV CET1 ratio minimum requirement at Completion is estimated to be 10.7 per cent (including Pillar 1, Pillar 2A, CCB and CCYB buffers).
- In addition, the Combined Group has the potential to benefit from RWA reductions over time. CYBG has increasing confidence that it will receive IRB accreditation for its mortgage portfolio in October 2018 (subject to completion by CYBG and review by the PRA of certain remediation actions). On 5 July 2018, Virgin Money announced that it had received a decision from the PRA on improvements to its mortgage risk weight models. The impact at 30 June 2018 of the agreed model improvements was an increase of over 250 basis points in its CET1 ratio to 16.3 per cent. (as set out in the Virgin Money Interim Report 2018.

Reinforces delivery of existing financial targets:

CYBG expects to deliver:

- *Mid-single digit CAGR loan growth to FY19*: Sustainable growth ambition continues;
- *Loan to deposit ratio of less than 120 per cent.*: Diversified funding model continues;
- *Cost to income ratio ("**CIR**") of 55-58 per cent. by FY19*: CIR at the lower end of the target range with significant cost synergies achievable over time;
- *Double-digit return on tangible equity by FY19*: Returns target maintained; and
- *50 per cent. dividend pay-out ratio over time*: Accelerated progressive dividend ambition.

Earnings accretive to all shareholders:

- The Combination is expected to be materially accretive for both sets of shareholders on an earnings per share basis once full cost synergies have been delivered.

Strong capital generation accelerates progressive dividend ambitions:

- The CYBG Directors expect that the delivery of significant cost synergies and enhanced earnings potential created by the Combination will support improved capital generation in the future. This would provide capacity for necessary investment in the business to drive and support sustainable asset growth as well as funding the initial investment required to achieve the cost synergies identified through the Combination.
- Given the expected strong capital generation, the Combined Group should be well placed to accelerate both CYBG and Virgin Money's progressive dividend ambitions.

3. ARRANGEMENTS WITH VIRGIN HOLDINGS AND VIRGIN ENTERPRISES

The CYBG Directors believe that the use of Virgin Money's iconic national brand combined with CYBG's customer centric propositions will drive further growth opportunities for the Combined Group.

3.1 Brand Licence Agreement

On 18 June 2018, CYBG, Virgin Money and Virgin Enterprises entered into the Brand Licence Agreement in respect of the novation, amendment and restatement of the Existing Brand Licence Agreement which had been entered into between Virgin Money and Virgin Enterprises. With effect from Completion, CYBG's use of the Virgin Money brand will be licensed under the Brand Licence Agreement, and governed by its terms. Further information on the Brand Licence Agreement is set out in paragraph 13.3 of Part XIII (*Additional Information*).

3.2 Virgin Holdings irrevocable undertaking

CYBG has received an irrevocable undertaking to vote in favour of the Scheme at the Court Meeting and the Virgin Money Resolutions (other than the Brand Licence Resolutions in respect of which Virgin Holdings is conflicted) to be proposed at the Virgin Money General Meeting from Virgin Holdings in respect of 155,120,454 Virgin Money Shares (representing approximately 34.8 per cent. of the issued ordinary share capital of Virgin Money as at the Latest Practicable Date).

The undertaking given by Virgin Holdings will cease to be binding in the following circumstances:

(i) the Scheme lapses or is withdrawn in accordance with its terms and CYBG publicly confirms that it does not intend to proceed with the Offer or to implement the Offer by way of a Takeover Offer;

(ii) CYBG has exercised its right to implement the Offer by way of a Takeover Offer and the Takeover Offer lapses or is withdrawn;

(iii) the Scheme has not become Effective by 6.00 p.m. on the Long Stop Date (or such later time or date as agreed between CYBG and Virgin Money, with the approval of the Court and/or the Panel if required); or

(iv) at any time prior to the Scheme becoming Effective, a third party announces a firm intention to make an offer to acquire the entire issued and to be issued ordinary share capital of Virgin Money, which in Virgin Holdings' reasonable opinion represents an improvement to the terms of the Offer.

4. IRREVOCABLE UNDERTAKINGS

CYBG has received irrevocable undertakings from the Independent Virgin Money Directors who have beneficial holdings of Virgin Money Shares to vote in favour of the Scheme at the Court Meeting, as well as to vote in favour of the resolutions relating to the Offer to be proposed at the Virgin Money General Meeting (and if the Offer is subsequently structured as a Takeover Offer, to accept any offer made by CYBG). This is in respect of their entire beneficial holdings, amounting to an aggregate holding of 2,612,309 ordinary shares representing approximately 0.586 per cent. of Virgin Money's issued ordinary share capital as at the Latest Practicable Date.

CYBG and Virgin Money have also received irrevocable undertakings from the CYBG Directors (including for these purposes, David Browne, who has stepped down as a CYBG Director) who have beneficial holdings of CYBG Shares to vote in favour of the resolutions to approve the Offer to be proposed at the CYBG General Meeting. This is in respect of their entire beneficial holdings, amounting to an aggregate holding of 604,837 ordinary shares representing approximately 0.068 per cent. of CYBG's issued ordinary share capital as at the Latest Practicable Date.

5. POTENTIAL SYNERGIES AND INTEGRATION PLANNING

The Announcement included statements of estimated cost savings and synergies expected to arise from the Offer.

The CYBG Directors, having reviewed and analysed the potential synergies of the Combined Group, as well as taking into account the factors they can influence, believe that the Combined Group can deliver shareholder value through expected realisation of approximately £120 million of annual pre-tax cost synergies. Incremental to these quantified cost synergies, the Combined Group will benefit from avoiding planned future Virgin Money digital bank running costs, given the existing CYBG capabilities.

It is currently envisaged that the approximately £120 million of annual pre-tax cost synergies will be realised principally from:

(i) **Organisational design**: Reduction of FTEs across the Combined Group, removing duplication of senior management roles, delivering approximately £35 million of run rate cost savings.

(ii) **Central cost management**: Approximately £35 million of run rate cost savings generated by rationalisation of the Combined Group's central functions locations; with scale efficiencies in IT, central procurement costs, third party outsourcing and other operating expenses. Central cost management savings are net of incremental trademark licence fees related to the use of the "Virgin Money" brand.

(iii) **Operational efficiency**: Reduction of FTEs across the Combined Group through removing duplication of central functions roles, integrating customer service operating models and driving efficiencies through increased digitisation and automation, delivering approximately £35 million of run rate cost savings.

(iv) **Network efficiencies**: Optimisation of the Combined Group's branch network, delivering approximately £15 million of run rate cost savings.

The run rate of these annual pre-tax cost synergies will be fully achieved by the end of the financial year ending 30 September 2021, with approximately 28 per cent. achieved as at 30 September 2019 and approximately 67 per cent. as at 30 September 2020. It is therefore expected that the first year of full run rate cost synergies will be the financial year ending 30 September 2022. The cost synergies recognised during the financial year ending 30 September 2019 are expected to be approximately £20 million and approximately £50 million recognised during the financial year ending 30 September 2020.

The identified recurring cost synergies will accrue as a direct result of the Combination and would not be achieved on a standalone basis. The estimated cost synergies referred to above reflect both the beneficial elements and the relevant costs.

It is expected that the realisation of these cost synergies would result in one-off pre-tax costs to achieve of approximately £240 million. These are expected to be phased broadly evenly across a three year period: employee restructuring costs and IT migration strategy phased over all three years following Completion, contract break fees to be recognised in the third year following Completion, and the optimisation of branches and office locations to be achieved in years two and three following Completion. Aside from these one-off exceptional costs and the incremental trademark licence fees incorporated into the assessed cost synergies, no material dis-synergies are expected in connection with the Combination.

These statements relating to identified synergies and estimated savings relate to future actions or circumstances which by their nature involve risks, uncertainties and contingencies. As a consequence, the identified synergies and estimated savings referred to may not be achieved, may be achieved later or sooner than estimated, or those achieved could be materially different from those estimated.

Please refer to Part XII (*Quantified Financial Benefits Statement*) of this Prospectus for further details on the above Quantified Financial Benefits Statement (including the supporting bases for belief and principal assumptions). References in this Prospectus to the Quantified Financial Benefits Statement should be read in conjunction with Part XII. The Quantified Financial Benefits Statement set out above was reported on under the Takeover Code by Deloitte, and by CYBG's financial advisers, Morgan Stanley and Deutsche Bank.

Separately, the Combined Group is expected to incur approximately £60 million of one-off pre-tax costs associated with the rebranding exercise, expected to be largely incurred during the first two years following Completion. The majority of the costs associated with the rebranding exercise relate to products, IT and property. These rebranding costs replace the costs that would otherwise have been required to scale the B brand more widely.

The CYBG Directors believe that the Combined Group will benefit from the rebranding exercise, realising incremental revenue synergies from the use of the "Virgin Money" brand across an enhanced product range, thereby driving increased customer loyalty, higher sales conversion and an enhanced customer relationship. A rebranding steering committee (which will include representatives of Virgin Enterprises) and a rebranding working group will be set up in due course to ensure the rebranding process is undertaken in an effective manner, including by leveraging the experience that Virgin Enterprises has gained from prior rebranding exercises.

In addition, the CYBG Directors believe the Combined Group will benefit from funding synergies that are expected to be available over time.

These potential revenue and funding synergies, as well as the avoided planned future Virgin Money digital bank running costs, have not been quantified for the purposes of reporting under the Takeover Code.

It is intended that an integration team will be established, which will bring together the relevant CYBG and Virgin Money capabilities, to ensure that the implementation of the synergy and integration programme is effected in an efficient and effective manner. As at the date of this Prospectus, a detailed integration plan is being compiled. Finalisation of the integration plan will be subject to engagement with appropriate stakeholders, including employee representative bodies and unions. The integration process will be carefully managed to leverage the best talent from both the CYBG and Virgin Money businesses and ensure that the necessary implementation measures are taken with the least disruption to the Combined Group's operations and customer base.

6. CYBG'S STRATEGIC PLANS AND INTENTIONS

Throughout integration, purpose and culture will be central to continuing to build a customer centric business with high levels of engagement and motivation whilst minimising risk of disruption and maximising performance.

Board and management of the Combined Group

The existing CYBG Directors will remain in office following Completion. In particular, Jim Pettigrew, Chairman of CYBG, David Duffy, CEO of CYBG and Ian Smith, CFO of CYBG, will retain their current positions in the Combined Group.

Jayne-Anne Gadhia, the CEO of Virgin Money (the "**Virgin Money CEO**") has been in her current role with Virgin Money for over 10 years. She brings a wealth of experience in successfully leading customer-facing banking businesses and delivering the "Virgin Money" brand to customers. She will step down from the Virgin Money Board and on Completion has agreed, in principle, to support the Combined Group as a senior adviser to the CEO of the Combined Group (in a consultancy role) for a period of up to 18 months following Completion, on terms to be agreed.

Peter Bole will also step down from his role as CFO of Virgin Money on Completion.

On Completion, each of the other current Virgin Money Directors will also resign as directors of Virgin Money and will be replaced by David Duffy, Debbie Crosbie and Ian Smith, who will join the Virgin Money Board on Completion, subject to the usual regulatory approvals. Darren Pope and Geeta Gopalan, who are currently independent non-executive directors of Virgin Money will join the CYBG Board as independent non-executive directors on Completion, subject to the usual regulatory approvals. In addition, on Completion, Amy Stirling, who is currently a non-executive director of Virgin Money, will become a non-executive director of CYBG pursuant to Virgin Enterprises' right to nominate a director under the terms of the Brand Licence Agreement, subject to the usual regulatory approvals.

As the integration plan proceeds, so the size and composition of the Combined Group's leadership team will be kept under review.

Management and employees

CYBG attaches great importance to the skills and experience of the existing management and employees of the Virgin Money Group. CYBG will aim to leverage the best talent across the Combined Group and management and employees of the Virgin Money Group will have the possibility of benefiting from potential new opportunities within the Combined Group following the Combination.

The CYBG Board recognises that, in order to achieve the expected benefits of the Combination, operational and administrative restructuring will be required following completion of the Combination. As a result of the significant operational overlap between CYBG and Virgin Money, the Combined Group will be able to reduce the duplication of roles, leading to a decrease in the total number of FTEs. It is currently expected that the total number of FTEs of the Combined Group, being approximately 9,500 FTEs, will reduce by approximately 16 per cent., some of which will take place via natural attrition. The CYBG Board does not expect any material change to the balance of skills and functions in the Combined Group.

Following Completion, the existing contractual and statutory employment rights of the Virgin Money employees will be observed and pension obligations complied with, in accordance with applicable law. CYBG does not envisage making any material changes to the conditions of employment of Virgin Money employees or the existing agreed pension contributions for existing members of the Virgin Money pension plans or admission of new members into the existing Virgin Money defined contribution pension plans in connection with Completion. CYBG has also agreed to maintain Virgin Money's redundancy policies, for a period of three years from Completion.

At this stage, CYBG and Virgin Money have had limited preliminary discussions on future incentivisation arrangements for the directors and employees of Virgin Money.

Settlement Agreement

Jayne-Anne Gadhia, the Virgin Money CEO, has agreed to step down from her current role upon Completion and has entered into a settlement agreement dated 18 June 2018 with Virgin Money Bank (the "**Settlement Agreement**"), which will take effect from Completion.

Under the terms of the Settlement Agreement, the Virgin Money CEO is entitled to certain payments and awards. These include a termination payment of £1,140,000 comprised of payments in lieu of notice for salary, role-based allowance and pension contributions. The Virgin Money CEO may also receive a redundancy payment element of £619,231. The current directors' remuneration policy of Virgin Money does not provide for executive directors to receive redundancy payments on the same basis as all the other employees of the Virgin Money Group in accordance with the Virgin Money Group's current redundancy policy. To remove this difference in treatment, Virgin Money will propose to Virgin Money Shareholders at the Virgin Money General Meeting an amendment to the Virgin Money directors' remuneration policy to permit the payment of redundancy payments to Virgin Money executive directors on the same basis as other employees. If the resolution is passed by Virgin Money Shareholders, a redundancy payment will be made to the Virgin Money CEO pursuant to the terms of the Settlement Agreement. The passing of this resolution is not a condition to the Scheme becoming Effective and Completion occurring.

In the event that this change is not approved by Virgin Money Shareholders then the redundancy payment will not be made.

The Virgin Money CEO will also receive a bonus payment of £1,026,000 in respect of the financial year ending 31 December 2018 (the "**Bonus Award**") along with an allocation of 840,821 Virgin Money Shares to satisfy her outstanding awards under the Virgin Money LTIP. The Bonus Award and the allocation of the Virgin Money Shares in respect of awards under the Virgin Money LTIP are subject to the current regulatory deferral requirement that these awards should vest and be settled over a period of seven years ending in March 2026. The Bonus Award will be split as follows:

(a) 40 per cent. will be paid to the Virgin Money CEO in cash (less deductions for PAYE and national insurance contributions) on Completion;

(b) 40 per cent. will be paid to the Virgin Money CEO in CYBG Shares as soon as practicable following Completion (with sufficient shares sold to satisfy any PAYE and national insurance contribution liability with the net number of CYBG Shares being transferred to the Virgin Money CEO and held subject to the required regulatory holding period); and

(c) 20 per cent. will be deferred into an award over CYBG Shares (for a period of 7 years ending in March 2026).

The Virgin Money CEO will retain 121,404 Virgin Money Shares previously allocated in respect of the Virgin Money LTIP for 2015 and awards granted under the Virgin Money Deferred Bonus Share Plan over 317,661 Virgin Money Shares. All of these awards will be subject to the current regulatory deferral/holding period requirements.

Places of business

CYBG intends that the Combined Group will maintain a substantial base in Gosforth for at least three years following Completion. CYBG does not intend to materially alter the overall size or nature of operations at its Glasgow headquarters.

As a result of the significant overlap in operational functions between CYBG and Virgin Money, CYBG expects to derive significant run-rate cost synergies from the rationalisation of the Combined Group's property portfolio to remove duplication over time. It is expected that the majority of these savings will be derived from the optimisation of CYBG and Virgin Money's respective branch networks. In addition, CYBG expects the rationalisation of a limited number of operational function offices, in two to three years' time. Until the integration planning work has been completed, the precise impact of the Combination on the places of business of the Combined Group will not be known, but where practicable, the aim will be to relocate staff in nearby locations of the Combined Group. CYBG does not intend to redeploy any material fixed assets of Virgin Money.

Research and development

Owing to the nature of its business, Virgin Money does not conduct significant research and development activities, but to the extent any such activities are currently undertaken, they are not expected to be impacted in any material way by the Combination.

Diversity

CYBG intends that the Combined Group will remain a committed supporter of the Women in Finance Charter and will continue to take action to reduce its gender pay gap in line with the Annual Report and Accounts of CYBG. The Combined Group will remain transparent on its reporting of progress both on the Women in Finance Charter and its gender pay gap.

Virgin Money Foundation

CYBG recognises the considerable impact the Virgin Money Foundation has had in promoting the sustainable regeneration of socially and/or economically deprived communities across the UK, with particular focus on the North East of England, and intends not only to support the final £1 million instalment of the £4 million pledge to the Virgin Money Foundation which is due in the tax year ending 31 March 2019, but also to continue to provide up to £400,000 per annum of financial support to the Virgin Money Foundation to cover its operating costs, as well as an annual donation of at least £1 million per annum (to be invested in charitable causes), for at least three years after Completion.

The statements in this paragraph under the headings "Management and employees", "Places of business", "Research and development", "Diversity" and "Virgin Money Foundation" will be treated as post-offer intention statements by CYBG for the purpose of Rule 19.6 of the Takeover Code.

7. DIVIDENDS

If Virgin Money announces, declares or pays any dividend or any other distribution to Virgin Money Shareholders after the date of the Announcement, CYBG reserves the right to make an equivalent reduction in the terms of the Offer. This right will not be invoked in respect of the dividend of 2.3 pence per Virgin Money Share which was announced by Virgin Money on 26 July 2018 and is payable in respect of Virgin Money's six month interim period ending 30 June 2018.

As noted above, given the expected strong capital generation, the CYBG Directors believe the Combined Group should be well placed to accelerate both CYBG and Virgin Money's progressive dividend ambitions.

8. CURRENT TRADING

8.1 CYBG

The CYBG Group continued to perform in line with the CYBG Directors' expectations in the three months to 30 June 2018.

The CYBG Group maintained sustainable balance sheet growth despite the competitive environment, with year-to-date mortgage growth of 3.8 per cent. (nine months annualised) to £24.2 billion. In line with previous guidance, there were reduced mortgage drawdowns in the three months to 30 June 2018 due to lower applications in the second quarter, stemming from servicing and fulfilment delays that arose during the implementation of a new onshore mortgage processing operation.

The CYBG Group maintained momentum in SME origination during the period, with £420 million of gross loans and facilities written in the three months to 30 June 2018. New business drawdowns in the period were £453 million, with net core SME lending growth maintained at 4.7 per cent (nine months annualised).

The CYBG Group delivered deposit balance growth of 4.5 per cent (nine months annualised) in the nine months to 30 June 2018, managed in line with asset growth.Asset quality remained strong with an annualised net cost of risk of 0.12 per cent. in the nine months to 30 June 2018.

Net interest margin for the nine month period to 30 June 2018 (annualised) was maintained at 2.18 per cent, with retail asset pricing pressure offset by improved SME margins and lower liquidity costs.

The CYBG Group's CET1 ratio strengthened to 11.4 per cent. in the three months to 30 June 2018, with approximately 15 basis points of CET1 capital generation in the period.

8.2 **Virgin Money**

In the first six months of 2018 asset growth was managed by the Virgin Money Group to protect returns in a competitive environment. The Virgin Money Group experienced strong credit performance and continued to maintain a high quality balance sheet.

The robust performance of the savings franchise underpinned the Virgin Money Group's growth and helped deliver a banking net interest margin of 164 basis points and net interest income growth of 5.1 per cent. Underlying total income increased by 4.8 per cent. as compared to the six month period ended 30 June 2017.

Further improvements in operating leverage and effective cost management resulted in a 3.1 per cent reduction in costs. This reduction in costs resulted in the cost:income ratio reducing by 4.0 percentage points as compared to the six month period ended 30 June 2017, to 49.9 per cent. The cost of risk of 0.16 per cent. continued to evidence the Virgin Money Group's commitment to prime lending segments.

Taken together, the Virgin Money Group delivered an underlying profit before tax of £141.6 million, 10.1 per cent. higher than the six month period ended 30 June 2017. As a result, return on tangible equity improved to 14.2 per cent, from 13.3 per cent in the first six months of 2017. In March 2018 an application was submitted for a reduction in mortgage risk-weights to the PRA reflecting the excellent credit quality of the Virgin Money Group's mortgage portfolio. The PRA have approved these model changes and the reduction in risk-weights is reflected within the material increase to the Virgin Money Group's CET1 ratio to 16.3 per cent. Further detail is set out in the consolidated unaudited financial statements of the Virgin Money Group for the six months ended 30 June 2018 in Part VII (*Historical Financial Information relating to the Virgin Money Group*) of this Prospectus.

9. OFFER-RELATED ARRANGEMENTS

Virgin Money Confidentiality Agreement between CYBG and Virgin Money

CYBG and Virgin Money entered into the Virgin Money Confidentiality Agreement on 21 May 2018 pursuant to which each of CYBG and Virgin Money has undertaken to keep certain information relating to the Offer and to the other party confidential and not to disclose such information to third parties except to certain permitted disclosees for the purposes of evaluating the Offer or as permitted in writing provided by the other party in advance, and, unless or if required by applicable laws or regulations. The confidentiality obligations of each party under the Virgin Money Confidentiality Agreement shall terminate on 7 May 2020, with certain exceptions.

The Virgin Money Confidentiality Agreement also contains undertakings from CYBG that for a period of 12 months from the date of the Virgin Money Confidentiality Agreement, subject to certain exceptions, neither CYBG nor any other member of the CYBG Group shall, without the prior written consent of Virgin Money acquire or offer to acquire any interest in shares or other securities of Virgin Money (which undertaking ceased as at the date of the Announcement).

Each of CYBG and Virgin Money has undertaken that, for a period of 12 months from the date of the Virgin Money Confidentiality Agreement, neither party shall solicit a senior or key employee of the other party or any member of the other party's group, subject to customary carve-outs.

Virgin Holdings Confidentiality Agreement between CYBG and Virgin Holdings

CYBG and Virgin Holdings entered into the Virgin Holdings Confidentiality Agreement on 22 May 2018 pursuant to which each of CYBG and Virgin Holdings has undertaken to keep certain information relating to entry into the Brand Licence Agreement and to the other party confidential and not to disclose such information to third parties except to certain permitted disclosees for the purposes of considering entry into the Brand Licence Agreement or if required by applicable laws or regulations. The confidentiality obligations of each party under the Virgin Holdings Confidentiality Agreement shall terminate on 22 May 2020, with certain exceptions.

The Virgin Holdings Confidentiality Agreement also contains undertakings from each party that, for a period of 12 months from the date of the Virgin Holdings Confidentiality Agreement, neither party shall solicit any director, officer or employee of the other party or any member of the other party's group, subject to customary carve-outs.

Co-operation Agreement between CYBG and Virgin Money

CYBG and Virgin Money have entered into the Co-operation Agreement, pursuant to which CYBG and Virgin Money have agreed to use all reasonable efforts to satisfy, as soon as reasonably practicable, the Conditions relating to regulatory and other third party clearances set out in paragraphs 6 to 9 of Appendix 1 of the Announcement.

CYBG and Virgin Money have agreed to certain undertakings to provide each other with reasonable information, assistance and access in relation to the filings, submissions and notifications to be made in relation to such regulatory and other third party clearances. CYBG and Virgin Money have also agreed to provide each other with reasonable information, assistance and access for the preparation of the key shareholder documentation.

The Co-operation Agreement records CYBG's and Virgin Money's intention to implement the Offer by way of the Scheme. However, CYBG may implement the Offer by way of a Takeover Offer if: (i) Virgin Money consents; (ii) a third party announces a firm intention to make an offer for Virgin Money; or (iii) the Independent Virgin Money Directors withdraw, adversely qualify or adversely modify their unanimous recommendation of (or intention to recommend) the Offer.

CYBG is subject to certain customary restrictions on the conduct of its business during the period pending Completion, and which prohibit, among other things: (i) the payment by CYBG of dividends (save that it may pay a final dividend for the financial year ending 30 September 2018 consistent with its published dividend policy) and (ii) the allotment of further shares (or rights or options in respect of shares) (other than pursuant to employee share incentive plans, or in order to satisfy options or awards vesting under those plans).

The Co-operation Agreement also contains provisions that will apply in respect of the Virgin Money Share Plans and certain other employee incentive arrangements.

The Co-operation Agreement shall terminate (amongst other circumstances):

(i) if CYBG and Virgin Money so agree in writing;

(ii) upon service of written notice by either party to the other party;

  (a) if the Offer is withdrawn, terminated or lapses in accordance with its terms prior to the Long Stop Date and, where required, with the consent of the Panel;

  (b) if the Scheme is not approved by the Virgin Money Shareholders at the Court Meeting and/or the Virgin Money General Meeting or the Court refuses to sanction the Scheme; or

  (c) unless otherwise agreed by the parties in writing, if the Effective Date has not occurred by the Long Stop Date.

10. RATINGS AND OUTLOOK

As at the Latest Practicable Date, CYBG had a S&P long-term Issuer Credit Rating of BBB-, outlook Stable, and a Fitch long-term Issuer Default Rating of BBB+, outlook Stable. Its subsidiary, Clydesdale Bank PLC, had a Moody's Adjusted Baseline Credit Assessment of Baa2, on Review for Upgrade, a Moody's long-term Deposit Rating of Baa1, on Review for Downgrade, a S&P long-term Issuer Credit Rating of BBB+, outlook Stable, and a Fitch long-term Issuer Default Rating of BBB+, outlook Stable.

As at the Latest Practicable Date, Virgin Money Holdings had a Moody's long-term local- and foreign-currency Issuer Rating of Baa3, on Review for Upgrade, and a Fitch long-term Issuer Default Rating of BBB+, outlook Stable. Its subsidiary, Virgin Money plc, had a Moody's Baseline Credit Assessment and Adjusted Baseline Credit Assessment of baa2, on Review for Upgrade, a Moody's long-term local-currency Bank Deposit Rating of Baa2, on Review for Upgrade, with the outlook changed to Rating under Review from Positive, a Moody's long-term local- and foreign currency Issuer Rating of Baa2, on Review for Upgrade, with the outlook changed to Rating under Review from Stable, and a Fitch long-term Issuer Default Rating of BBB+, outlook Stable.

11. VIRGIN MONEY SHARE PLANS

The offer will extend to any Virgin Money Shares unconditionally allotted, issued or transferred prior to the Scheme Record Time to satisfy the vesting of awards granted under the Virgin Money Share Plans.

Appropriate proposals are being made to participants in the Virgin Money Share Plans. Details of these proposals are set out in the Scheme Document and in separate letters to be sent to the participants in the Virgin Money Share Plans.

12. **SCHEME PROCESS**

The Offer is being implemented by way of a Court sanctioned scheme of arrangement between Virgin Money and Virgin Money Shareholders, made under Part 26 of the 2006 Act (although CYBG reserves the right to implement the Offer by way of a Takeover Offer, subject to the Panel's consent and to the terms of the Co-operation Agreement). The Scheme is an arrangement between Virgin Money Scheme Shareholders and is subject to the approval of the Court. The procedure involves, among other things, an application by Virgin Money to the Court to sanction the Scheme, which will involve the Virgin Money Scheme Shares being transferred to CYBG, in consideration for which the Virgin Money Scheme Shareholders will receive the New CYBG Shares. The purpose of the Scheme is to provide for CYBG to become the owner of the entire issued and to be issued ordinary share capital of Virgin Money.

To become Effective, the Scheme requires, among other things, the approval of a majority in number representing not less than 75 per cent. in value of the relevant Virgin Money Shareholders present and voting in person or by proxy at the Court Meeting, which is convened by order of the Court, and the passing of the necessary resolutions to implement the Offer at the Virgin Money General Meeting. The Scheme must also be sanctioned by the Court.

The Conditions in paragraphs 1 and 2 of Part 3 of the Scheme Document provide that the Scheme will lapse if:

(i) the Court Meeting and the Virgin Money General Meeting are not held by 2 October 2018 (or such later date as may be agreed between CYBG and Virgin Money);

(ii) the Court Hearing to approve the Scheme is not held on or before the 22nd day after the expected date of the Court Hearing set out in the Scheme Document (or such later date as may be agreed between CYBG and Virgin Money); or

(iii) the Scheme has not become Effective by 11.59 p.m. on the Long Stop Date (or such later date as may be agreed between CYBG and Virgin Money and the Panel and the Court may allow).

In addition to these approvals, the Scheme is subject to (among other things): (i) all resolutions necessary to approve, implement and effect the Offer and the acquisition of Virgin Money Shares pursuant to the Offer being duly passed by the requisite majority or majorities at the CYBG General Meeting or at any adjournment of that meeting; (ii) the passing at the Virgin Money General Meeting or at any adjournment of that meeting of an ordinary resolution of the Independent Virgin Money Shareholders voting, either in person or by proxy, on a poll to approve the Brand Licence Agreement; (iii) the Existing Brand Licence Agreement not having been terminated and notice not having been served to terminate the Existing Brand Licence Agreement; (iv) (a) the FCA having acknowledged to CYBG that the application for the Admission of the New CYBG Shares to the Official List with a premium listing has been approved and Admission will become effective as soon as a dealing notice has been issued by the FCA and any listing conditions have been satisfied; and (b) the London Stock Exchange having acknowledged to CYBG that the New CYBG Shares will be admitted to trading on the Main Market of the London Stock Exchange; (v) the CMA (a) deciding not to make a Phase 2 CMA Reference or (b) not having requested submission of a Merger Notice or commenced a Phase 1 CMA review by indicating that the Initial Period has begun; and (vi) in respect of CYBG, Virgin Holdings and each other relevant person over which the Offer contemplates an acquisition of or increase in control, the FCA and/or the PRA (as applicable) (a) giving notice that they have determined to approve such acquisition of or increase in control; (b) giving notice that they have determined to approve such acquisition of or increase in control, on terms or conditions satisfactory to CYBG (acting reasonably); or (c) being treated as having approved such acquisition of, or increase in, control. The Scheme is also subject to the full terms and Conditions set out in Part 3 of the Scheme Document. In relation to the CMA clearance described in Condition 6 of the Scheme Document, following consultation with the CMA, CYBG has determined that no voluntary CMA filing needs to be made at this time.

If any Condition in paragraphs 2(a) and (b) and 3 to 16 of Part 3 of the Scheme Document is not capable of being satisfied by the date specified therein, CYBG shall make an announcement through a Regulatory Information Service as soon as practicable and, in any event, by no later than 7.00 a.m. on the Business Day following the date so specified, stating whether CYBG has invoked that Condition, (where applicable) waived that Condition or, with the agreement of Virgin Money, specified a new date by which that Condition must be satisfied.

Upon the Scheme becoming Effective: (i) it will be binding on all Virgin Money Scheme Shareholders, irrespective of whether or not they attended or voted at the Court Meeting or the Virgin Money General Meeting (and if they attended and voted, whether or not they voted in favour); and (ii) share certificates in respect of Virgin Money Shares will cease to be valid and entitlements to Virgin Money Shares held within the

CREST system will be cancelled. The New CYBG Shares will be issued by CYBG to Virgin Money Scheme Shareholders no later than 14 days after the Effective Date.

The Scheme Document includes the full details of the Scheme, together with notices of the Court Meeting and the Virgin Money General Meeting. The Scheme Document also contains the expected timetable for the Offer, and specifies the necessary actions to be taken by the Virgin Money Shareholders.

Once the necessary approvals from Virgin Money Shareholders and CYBG Shareholders have been obtained and the other Conditions have been satisfied or (where applicable) waived and the Scheme has been approved by the Court, the Scheme will become Effective upon delivery of the Court Order to the Registrar of Companies. Subject to the satisfaction of the Conditions, the Scheme is expected to become Effective during calendar Q4 of 2018.

The Scheme will be governed by English law and will be subject to the jurisdiction of the Courts of England and Wales. The Scheme will also be subject to the applicable requirements of the Takeover Code, the Panel, the London Stock Exchange and the FCA.

The Virgin Money Shares will be acquired pursuant to the Offer fully paid and free from all liens, charges, equities, encumbrances, rights of pre-emption and any other interests of any nature whatsoever and together with all rights now or hereafter attaching thereto, including without limitation voting rights and the right to receive and retain in full all dividends and other distributions (if any) announced, declared, made or paid on or after the date of the Announcement, except for the dividend of 2.3 pence per Virgin Money Share which was announced by Virgin Money on 26 July 2018 and is payable in respect of Virgin Money's six month interim period ending 30 June 2018.

Fractions of New CYBG Shares will not be allotted or issued to Virgin Money Shareholders and entitlements will be rounded down to the nearest whole number of New CYBG Shares and all fractions of New CYBG Shares will be aggregated and sold in the market as soon as practicable after the Offer becomes Effective. The net proceeds of such sale (after deduction of all expenses and commissions, including any VAT thereon, incurred in connection with the sale) will be distributed in due proportions to Virgin Money Shareholders who would otherwise have been entitled to such fractions, save that if the entitlement of any Virgin Money Shareholder in respect of the proceeds of sale of fractional entitlements amounts to less than £5, such proceeds will be retained for the benefit of the Combined Group.

In relation to the Condition in paragraph 7(b) of Appendix 1, if any approval is given by the appropriate regulator (as defined under section 178(2A) of FSMA) subject to any condition(s), subject to the requirements of the Panel, CYBG will have regard to the reasonable views of Virgin Holdings when considering whether or not to accept such condition(s) (subject to any restrictions which may be imposed by the relevant regulator).

13. CYBG GENERAL MEETING

The implementation of the Offer is conditional upon, amongst other things, CYBG Shareholders' approval of the CYBG Offer Resolution being obtained at the CYBG General Meeting. A notice convening a general meeting to be held at the offices of Clifford Chance LLP, 10 Upper Bank Street, London, E14 5JJ at 10.00 a.m. on 10 September 2018 at which the CYBG Offer Resolution will be proposed. The purpose of the CYBG General Meeting is to consider and, if thought fit, pass the CYBG Offer Resolution and the AT1 Resolutions (as described below).

The CYBG Offer Resolution will be proposed as an ordinary resolution requiring a simple majority of votes cast in favour.

The CYBG Offer Resolution proposes that (A) the Offer be approved and the CYBG Directors be authorised to take all steps and enter all agreements and arrangements necessary or desirable to implement the Offer and (B) subject to certain conditions of the Scheme being satisfied, the CYBG Directors be generally and unconditionally authorised in accordance with section 551 of the 2006 Act to allot New CYBG Shares to be issued in connection with the Offer, up to an aggregate nominal amount of £54,800,000.

If granted, the authority conferred by the CYBG Offer Resolution will expire at the end of CYBG's annual general meeting in 2020 and will be used to allot New CYBG Shares pursuant to the Offer.

The full text of the CYBG Offer Resolution is set out in the Circular (which has been posted to CYBG Shareholders). If the CYBG Offer Resolution is not passed, the Scheme will not proceed.

The CYBG Board is also seeking authority from the CYBG Shareholders by way of Resolutions 2 and 3 (the "**AT1 Resolutions**") at the CYBG General Meeting to allot CYBG Shares in connection with a conversion of the Virgin Money AT1 Securities into CYBG Shares in the event that the CET1 ratio of the Issuer Group (as defined in the terms and conditions of the Virgin Money AT1 Securities (the "**Virgin Money AT1 Securities Conditions**")) falls below a threshold specified in the Virgin Money AT1 Securities Conditions (a "**Trigger Event**"), and, as is becoming customary for UK banks, to have the flexibility to issue additional AT1 Securities in order to comply with, or maintain compliance with, the regulatory capital requirements or targets applicable to the CYBG Group from time to time.

Resolution 2 proposes that the CYBG Directors be authorised to allot CYBG Shares or grant rights to subscribe for, or to convert any security into, CYBG Shares, in accordance with section 551 of the 2006 Act in connection with a conversion of the Virgin Money AT1 Securities into CYBG Shares should a Trigger Event occur or in order to comply with, or maintain compliance with, the regulatory capital requirements or targets applicable to the CYBG Group from time to time, up to an aggregate nominal amount of £32,000,000. Resolution 2 will be proposed as an ordinary resolution requiring a simple majority of votes cast in favour.

Resolution 3 proposes that the CYBG Directors be empowered to allot equity securities (as defined in section 560 of the 2006 Act) up to a nominal amount of £32,000,000 in relation to a conversion of Virgin Money AT1 Securities into CYBG Shares should a Trigger Event occur or in order to comply with, or maintain compliance with, the regulatory capital requirements or targets applicable to the CYBG Group from time to time as if section 561 of the 2006 Act (existing shareholders' right of pre-emption), to the extent applicable, did not apply to any such allotment. Resolution 3 will be proposed as a special resolution requiring at least three-quarters of votes cast in favour.

If passed, the AT1 Resolutions will expire (unless previously renewed, varied or revoked by CYBG in general meeting) at the end of CYBG's annual general meeting in 2019.

The full text of the AT1 Resolutions is set out in the Circular (which has been posted to CYBG Shareholders).

The AT1 Resolutions are conditional on the Offer becoming Effective but are not conditions to the Offer or Scheme.

14. DELISTING AND CANCELLATION OF TRADING

It is intended that the London Stock Exchange and the FCA will be requested respectively to cancel trading in Virgin Money Shares on the Main Market and the listing of the Virgin Money Shares from the Official List on the Effective Date.

If the Offer is effected by way of a Takeover Offer, it is anticipated that the cancellation of Virgin Money's listing on the Official List and Admission to trading on the London Stock Exchange's Main Market will take effect no earlier than 20 Business Days following the date on which the Takeover Offer becomes or is declared unconditional in all respects provided CYBG has obtained 75 per cent. or more of the voting rights of Virgin Money.

Delisting would significantly reduce the liquidity and marketability of any Virgin Money Shares not assented to the Offer at that time. If the Offer is effected by way of a Takeover Offer and such Takeover Offer becomes or is declared unconditional in all respects and sufficient acceptances are received, CYBG intends to exercise its rights to acquire compulsorily the remaining Virgin Money Shares in respect of which the Takeover Offer has not been accepted.

15. ADMISSION TO THE OFFICIAL LIST AND TO TRADING ON THE LONDON STOCK EXCHANGE AND DEALINGS IN THE NEW CYBG SHARES

The consideration payable to Virgin Money Scheme Shareholders under the terms of the Scheme will be despatched by CYBG to Virgin Money Scheme Shareholders within 14 days of the Effective Date (subject to any arrangements that are required to be put in place to effect the payment of any income tax or social security contributions by holders of awards under the Virgin Money Share Plans who receive Virgin Money Shares on the vesting of awards conditional on the Court sanctioning the Scheme).

Applications will be made to the FCA and the London Stock Exchange for the New CYBG Shares to be admitted to the Official List and to trading on the London Stock Exchange's Main Market respectively. It is expected that Admission will become effective and that dealings for normal settlement in the New CYBG Shares will commence on the London Stock Exchange at 8.00 a.m. on the Effective Date.

The New CYBG Shares will be issued in registered form and will be capable of being held in certificated or uncertficated form.

Steps will be taken to allow for quotation of CDIs representing the New CYBG Shares on the ASX following Completion.

16. TAXATION

Please see the general description set out in Part X (*Taxation*) of this Prospectus for certain information on United Kingdom tax consequences relevant to Shareholders who are resident (or, in the case of individuals, domiciled and resident) in the United Kingdom for tax purposes.

The summary is intended as a guide only and Shareholders who are in doubt about their tax position are strongly advised to contact an appropriate professional, independent adviser immediately.

PART II
INFORMATION ON THE CYBG GROUP

The following information should be read in conjunction with the information appearing elsewhere in, or incorporated by reference in, this Prospectus, including the financial and other information in, or incorporated by reference in, Part IV (Operating and Financial Review Relating to the CYBG Group) and Part VI (Historical Financial Information Relating to the CYBG Group).

1. BUSINESS OVERVIEW

1.1 Overview

With over 175 years of history, the CYBG Group is a leading mid-sized UK retail and SME bank with a long-established customer franchise across its core regions (Scotland, North East England, North West England, Yorkshire and the Humber) and selected national markets. Headquartered in Glasgow, Scotland, the CYBG Group offers, through its community brands "Clydesdale Bank" and "Yorkshire Bank", a full range of banking products and services, including mortgages, current accounts, deposits, term lending, personal loans, working capital solutions, overdrafts, credit cards and payment and transaction services.

In 2016 the CYBG Group launched a new app-based digital banking service under the "B" brand, offering PCAs, savings and transaction banking services in the UK. The range of products and services available in this digital proposition continue to expand and evolve.

The CYBG Group's long-established retail and SME franchises, serving 2.8 million customers, have significant scale and strength in PCAs, BCAs, SME lending and mortgages in its core regions. As at 31 March 2018, the CYBG Group had £28.4 billion of customer deposits and a £32.7 billion customer loan portfolio, of which £24.1 billion were mortgage loans, £7.4 billion was SME lending and the remainder of the portfolio comprised unsecured personal lending (including credit cards and overdrafts).

The CYBG Group has a standalone operating platform, with limited ongoing support required by NAB under transitional service arrangements until the CYBG Group's planned separation is fully implemented (expected by the end of 2018). The CYBG Group's operating platform supports its full service customer proposition and enables the CYBG Group to provide services to customers through multiple distribution channels. As at 31 March 2018, these distribution channels included 169 retail customer banking centres (70 Clydesdale Bank branded, 97 Yorkshire Bank branded, two "B" branded) and 48 business and private customer banking centres (including 40 centres integrated with retail customer banking centres), strong and well-established relationships with leading third-party mortgage intermediaries, access to certain banking services through the UK Post Office's approximately 11,500 branches, telephony and voice services, and an ATM network. The CYBG Group's distribution platform continues to develop to allow Clydesdale Bank, Yorkshire Bank and "B" customers to complete their retail and SME banking needs across multiple distribution channels with an emphasis on digital and non-branch channel usage which reflects changing customer interaction preferences and behaviour. This distribution capability is underpinned by a rapidly evolving digital platform ("**iB**") which powers CYBG's retail franchises: the digital-only brand "B" and omni-channel distribution of the Clydesdale Bank and Yorkshire Bank brands. During 2018, CYBG's SME franchise will be transferred onto the iB platform, ending a migration of all customer activity onto a platform that offers enhanced capability including the aggregation of customer accounts and seamless aggregation of third party products and services.

For the year ended 30 September 2017, the CYBG Group's net interest income was £844 million as compared to £806 million for the year ended 30 September 2016. For the six month period ended 31 March 2018, the CYBG Group's net interest income was £426 million, as compared to £411 million for the six month period ended 31 March 2017.

CYBG had approximately 6,500 FTEs as at 30 September 2017. CYBG is building a purpose-led, high performing, team-based culture. A clear set of organisational behaviours shape the culture of the business. Performance approaches drive alignment with the CYBG Group strategy, teamwork and individual focus on improvement. The CYBG Group has significantly increased its focus on wellbeing, inclusion and diversity. These are hardwired into values and behaviours, and built into people practices. The culture transformation is focused on creating a set of leaders, colleagues and ways of working that will allow the business to evolve and change in line with the market and the CYBG Group strategy.

As part of its wholesale funding activity, CYBG has accessed and will continue, from time to time, to look to access the securitisation markets through its Lanark or Lannraig Mortgage Backed Securities programmes and its Regulated Covered Bond programme as well as the wholesale markets through it Medium Term

Note Programme. On 5 July 2018, a further series of notes were issued pursuant to the Lanark Mortgage Backed Securities programme.

1.2 **History**

CYBG has a long track record of serving the needs of its customers in its core regions.

Set out below are key milestones in the CYBG Group's development.

1838 **Clydesdale Bank founded in Glasgow, Scotland**

1859 **Yorkshire Bank founded in Halifax, West Yorkshire, England**

1877 **Clydesdale Bank establishes London presence**

1911 **Yorkshire Bank incorporates as The Yorkshire Penny Bank Limited**

1920 **Midland Bank buys Clydesdale Bank**

1987 **NAB acquires Clydesdale Bank**

1990 **NAB acquires Yorkshire Bank**

2001 **Clydesdale Bank and Yorkshire Bank's banking licences are merged pursuant to the National Australia Group Europe Act 2001, a UK Private Act of Parliament**

Pursuant to this Act, in 2004, Clydesdale Bank PLC assumed all assets, rights, liabilities and obligations of Yorkshire Bank, with integration efforts resulting in a single brand-agnostic operating platform with two distinct marketing brands maintained in recognition of their strong regional presence.

2013 **"We care about here" brand repositioning and launch of mobile banking**

CYBG Group is rooted in the communities in which its customers and colleagues live and work. The brand refresh reinforced CYBG's commitment to delivering superior customer service.

2014 **New concept branches, new service proposition and increased digital functionalities introduced**

2015 **First polymer banknotes in Great Britain issued by Clydesdale Bank**

2016 **Successful conclusion of the CYBG Group's demerger from NAB and IPO, a significant milestone in a move towards becoming an independent banking group, and launch of its third brand, "B"**

As a result of the demerger and IPO, the CYBG Group operates its business as a standalone banking group. As of February 2016, the CYBG Group shares are traded on the London Stock Exchange and the Australian Securities Exchange.

In 2016 the CYBG Group launched a new app-based digital banking service under the "B" brand, offering PCAs, savings and transaction banking services in the UK. The CYBG Group launched its app-based digital banking service under the "B" brand, offering PCAs, savings and transaction banking services in the UK underpinned by a rapidly evolving digital platform, "iB".

2017 **The CYBG Group launches Studio B and establishes a global medium term note (GMTN) programme and issues notes thereunder as part of its wholesale funding activities**

CYBG Group opened its first consumer innovation lab, Studio B in April 2017, enabling it to collaborate directly with customers and other interested parties on the design of future banking products and services, then showcase and test the best ideas, all within a fully functioning customer banking centre.

In May 2017 CYBG Group established a £10 billion global medium term note programme and then issued under that programme in June 2017.

2018 **The CYBG Group launches mobile digital cheque processing**

In February 2018, the CYBG Group became the first UK bank to launch mobile digital cheque processing.

1.3 **Capital**

As at 31 March 2018, the CYBG Group's capital position was:

- CET1 ratio was 11.3 per cent;
- Total Capital Ratio was 16.7 per cent; and
- UK Leverage Ratio was 7.0 per cent.

1.4 **Banking Activities**

Retail Banking

The CYBG Group has a comprehensive regional and national retail banking product proposition, serving over 2.8 million customers. The CYBG Group's personal deposit portfolio was £19.4 billion as at 31 March 2018, comprising PCAs (41 per cent. of the total portfolio), variable rate savings accounts (32 per cent. of the total portfolio) and fixed rate term deposits (27 per cent. of the total portfolio). As at 31 March 2018, 84 per cent. of variable rate savings account and fixed rate term deposits customers were located in the CYBG Group's core regions, compared to 88 per cent. of PCA customers.

The CYBG Group's retail loan portfolio was £25.3 billion as at 31 March 2018, comprising mortgages (95 per cent. of the total portfolio), personal loans (3 per cent. of the total portfolio) and credit cards and overdrafts (2 per cent. of the total portfolio).

(a) *Current Accounts*

The CYBG Group had approximately 1.8 million PCA customers as at 31 March 2018. 38 per cent. of the CYBG Group's PCA customers also held savings accounts with the CYBG Group.

The CYBG Group has a loyal PCA customer base that represents a stable source of funding. As at 31 March 2018, 79 per cent. of the CYBG Group's PCA customers had a tenure with the CYBG Group of more than ten years. As at 31 March 2018, 88 per cent. of the CYBG Group's PCA customers were located in its core regions, with 36 per cent. in Scotland, 33 per cent. in Yorkshire & Humber, 8 per cent. in North East England, 11 per cent. in North West England and around 13 per cent. in the rest of the UK.

(b) *Savings Accounts*

As at 31 March 2018, the CYBG Group had approximately 1.2 million personal savings account customers and personal fixed rate term deposit customers and £6,289 million of personal variable rate savings account deposits. The CYBG Directors and Proposed Directors believe savings accounts are an important component of funding. As at 31 March 2018, 81 per cent. of personal savings account customers held an account with the CYBG Group for more than ten years.

The CYBG Group offers a variety of savings accounts that pay a variable rate of interest. The CYBG Group also offers a variable rate cash ISA with competitive, tiered rates and which offers depositors tax free returns and instant access to their funds at any time. The Cash ISA account, Flexi Cash ISA, had balances of £1,321 million as at 31 March 2018.

(c) *Private Banking*

The CYBG Group offers private banking customers a wide variety of products such as current accounts (with or without travel insurance cover), savings products (including cash ISAs and term deposits), discounted mortgages, branded credit cards, asset finance as well as a wealth management referral to an Origen Financial Services adviser and access to foreign exchange solutions.

(d) *Term deposits*

As at 31 March 2018, the CYBG Group had £5,158 million of personal fixed rate term deposits. Taken together with the CYBG Group's savings account customers, 84 per cent. of variable rate savings and fixed rate term deposit customers were located in the core regions as at 31 March 2018.

Term deposits (sometimes referred to as "fixed rate savings accounts" or "time deposits") offer a fixed interest rate for a fixed term. The CYBG Group also offers fixed rate cash ISAs.

(e) *Mortgage lending*

As at 31 March 2018, the CYBG Group had 0.2 million retail mortgage customers, with 92 per cent. of mortgage balances within Scotland, North of England, South of England and London. The CYBG Group successfully increased its mortgage portfolio from £20.5 billion as at 30 September 2015 to £24.1 billion as at 31 March 2018 (of which 68 per cent. were owner occupied mortgages and 32 per cent. were buy-to-let mortgages). Mortgage lending in the UK remains a strategic priority for the CYBG Group, with a significant portion of the CYBG Group's net interest income derived from interest received on its mortgage portfolio.

(f) *Unsecured Personal Lending*

The CYBG Group's unsecured personal lending offerings consist of personal loans, credit cards, and overdraft facilities associated with current accounts, which are originated by the CYBG Group through its branch, and other direct channels (e.g. telephony). The CYBG Group also remains focused on digital distribution channels (online and mobile) including aggregators.

The CYBG Group provides retail and private banking customers with unsecured personal loans through its branch network as well as its digital and telephone channels. The CYBG Group's unsecured personal loan portfolio of £755 million as at 31 March 2018 accounted for 3.0 per cent. of total retail lending as at that date. As at 31 March 2018, the loans were held by 0.1 million customers. There has been further recent investment in the digital personal loan proposition, aimed at facilitating additional growth in our personal loan business by digitising the offering to give customers a faster, simpler process with quick access to funds and so moving the Bank towards a 'best in class' proposition and customer experience. This functionality is being delivered in phases over 2018.

The CYBG Group's credit and charge card portfolio had a total outstanding balance of £382 million as at 31 March 2018. As at 31 March 2018, the CYBG Group had over 400,000 credit card customers having opened approximately 56,000 new credit card accounts in the twelve months prior.

(g) *Payment and Merchant Services*

The CYBG Group is a direct participant in all UK payment schemes, Euro Clearings and fulfils global transactions through SWIFT and its network of correspondent banks. This allows the CYBG Group to provide full payment services to both retail and business customers.

Clydesdale Bank/Yorkshire Bank merchant services are enabled by Worldpay UK Limited and enables businesses to accept credit and debit card payments. These merchant services are available to business and private banking customers.

(h) *Insurance*

The CYBG Group offers home and contents insurance, life and critical illness insurance, life insurance for individuals over 50 years of age, commercial insurance, car insurance, and travel insurance, among other insurance products. These products are underwritten by third parties and distributed by the CYBG Group to customers. The CYBG Group receives commissions and other payments in connection with these arrangements.

SME Banking

The CYBG Group's SME lending portfolio was £7.4 billion as at 31 March 2018. This represents an increase of approximately £0.1 billion in the period (2.6 per cent. annualised) from £7.3 billion as at 30 September 2017, ahead of system growth of 2.2 per cent. The CYBG Group is delivering on its pledge to support small and medium sized businesses across the UK as part of the CYBG Group's 3 year commitment to fuel growth by lending £6bn in the three years to 2019. The CYBG Group has continued to implement a number of new propositions and developed new capabilities to better support the funding needs of our SME customers.

The SME portfolio remains well positioned. Underlying asset quality is resilient and stable, reflective of the diversity within the portfolio as a result of controlled risk appetite and an economic environment which continues to support business performance. The impaired asset portfolio has reduced to £114 million as at 31 March 2018 from £126 million as at 30 September 2017 which is at its lowest level for more than 10 years.

The CYBG Group offers its SME customers a full range of business banking products and services to meet their banking needs across its Business Direct, small business, commercial and specialist and acquisition finance segments.

The alternative package proposed by the UK authorities to replace the commitment for RBS to divest Williams & Glyn, required as part of the RBS Alternative Remedies Scheme, has received significant focus across the business banking sector since its announcement in September 2017. It is currently planned that in 2018, eligible "challenger banks" can apply to participate in an Incentivised Switching Scheme through which certain RBS SME customers (former W&G customers) will be financially incentivised to switch their BCAs from RBS to participating "challenger" banks. In addition, "challenger banks" and other small financial services and FinTech firms offering SME banking and financial services (or with ambitions to offer such services) will be able to apply to a Capability and Innovation Fund which will provide a range of awards (split across different categories with pre-determined eligibility criteria) that could be used to invest in delivering sustainable long-term improvements to firms' propositions and services for SME clients. Applicant firms will be required to set out how potential investments would improve their own SME banking proposition and enhance competition across the wider UK SME banking market. The RBS Alternative Remedies Scheme has been designed to facilitate the divestment of three per cent. of the BCA market share in the UK SME banking market from RBS to "challenger" segment.

The CYBG Group intends to play a material part in both the Incentivised Switching Scheme and to bid for a 'Pool A' award under the Capability and Innovation Fund (which has three amounts available: £60 million; £100 million; and £120 million). The CYBG Group believes it is well placed to be a beneficiary of the Incentivised Switching Scheme.

(a) *Relationship Management Based Operating Model*

The CYBG Group's business and private banking services are built upon a relationship management model, providing customers with access to a relationship manager, with wide banking knowledge and access to a network of sector specialists, committed to helping the customer meet their banking needs and financial requirements. Business customers benefit from additional product and sector expertise, with dedicated sector teams available to deliver solutions to customers.

(b) *Customers*

The CYBG Group offers a full range of SME banking products and services to approximately 231,000 SME customers as at 31 March 2018, comprised of the following:

- micro businesses (which the CYBG Group defines as businesses with no lending outstanding and turnover of less than £250,000, constituting approximately 43 per cent. of business customers);
- Business Direct (which the CYBG Group defines as businesses with outstanding lending of less than £0.25 million and turnover of less than £2.0 million, constituting 46 per cent. of business customers and 9 per cent. of the CYBG Group's total revenue for the business and banking segment); and
- medium businesses (which the CYBG Group defines as businesses with lending of higher than £0.25 million and greater than £2.0 million in turnover, constituting 11 per cent. of business customers (including 1,800 specialist and acquisition finance customers and 3,600 national business solutions customers) and 90 per cent. of the CYBG Group's total revenue for the segment).

Across all business segments, the CYBG Group provides working capital solutions to business customers through asset finance, invoice finance, international trade, merchant acquiring and treasury solutions.

(c) *Business Lending*

The CYBG Group offers SME customers a full range of business lending products and services designed to meet their needs. For the 12 month period to 31 March 2018, the CYBG Group made approximately 46,000 credit decisions for business customers. In making business decisions, the CYBG Group focuses on, among other things, the sustainability of customer earnings and cash flow as the primary credit consideration with asset security as a secondary credit consideration.

(d) *Business Current Accounts & Deposits*

The CYBG Group offers new business customers 25 months free day-to-day banking with its Business Current Account. Designed for the basic management of everyday business banking needs, the account offers the full services of a current account, with the option of an agreed overdraft. The CYBG Group's relationship-based approach means customers have personal attention from a business banking contact along with internet banking services and a mobile app.

As at 31 March 2018, CYBG Group had an estimated 3.4 per cent. share of active BCAs in the UK, with a total BCA balance of £6.1 billion. The CYBG Group has continued to grow the number of BCAs it operates, opening 7,136, 6,925, 6,761, 5,908, in the first, second, third and fourth quarters of financial year 2017, respectively, and 5,738 and 7,806 in the first and second quarters of financial year 2018, respectively.

1.5 **Distribution Channels**

The CYBG Group provides its products and services through an omni-channel distribution platform. The CYBG Group's comprehensive distribution capability offers a product set aligned to its customers.

(a) ***Branch Network***

As at 31 March 2018, the CYBG Group had 169 retail customer banking centres in the UK (88 per cent. of which were located in the core regions).

The CYBG Group's branch network is key to the CYBG Group's ability to meet the needs of its customers in local communities and will continue to provide an important source of customer acquisition and deposit and asset growth.

(b) ***Business and Private Banking Centres and Customer Service Centres***

As at 31 March 2018, the CYBG Group's physical network included 48 business and private banking centres, 40 of which are integrated with retail customer banking centres and eight of which are standalone centres. The CYBG Group's strategy of co-locating business and private banking centres with retail branches enables it to meet a wider range of customer product and service needs while achieving efficiencies across the network. The CYBG Group also supports customer delivery via its four regional customer service centres.

(c) ***Mortgage Intermediaries***

The CYBG Group has a 14 year track record with intermediary mortgage brokers and mortgage networks, with 51 per cent. of its broker panel members having a relationship with the CYBG Group for four years or longer. The CYBG Group's "invitation only" broker panel had a membership of 578 directly authorised brokers and network brokers as at 31 March 2018, with the top 10 brokers providing 41 per cent. of the CYBG Group's gross intermediary new mortgage applications in the six months to 31 March 2018.

A significant proportion of the mortgages sold in the UK retail mortgage market are sold through intermediaries. The use of the intermediary mortgage market allows the CYBG Group to compete effectively outside of its core regions, reducing concentration risk within those regions without having to increase the size of its branch network or add a significant number of employees.

(d) ***Digital (internet & mobile)***

The CYBG Group offers online and mobile banking to its customers which are the two fastest growing distribution channels for CYBG Group as measured by log-ons and transactions. With the industry expecting a significant increase in internet banking and mobile use by 2020, the CYBG Group has seen a notable increase in mobile application and digital usage.

The CYBG Group's digital platform is rapidly evolving with the launch of 'B' in May 2016, supporting the evolution of the CYBG Group's capabilities closer to parity with peers. 'B' is an intuitive digital banking service incorporating a current account, an instant savings account and an app for tablet and mobile, enabling customers to 'tag' debit card spending and set up savings and budget targets with no monthly account fees. Users of 'B' have access to the CYBG Group's branch support and a dedicated UK-based telephone banking team, enhancing the mobile and online banking capability provided to customers. 'B' is powered by the CYBG Group's iB digital platform, an open API architecture platform that leverages the power of Big Data. Since its launch in 2016, 'B' has reached over 100,000 customers.

The launch of 'B' represents a major initiative for the CYBG Group following its IPO in 2016, signalling the importance of innovation in the Company's growth strategy, and forms part of a wider omni-channel strategy across the business using digitisation to deliver better, sustainable services for customers.

Following the launch of 'B', the CYBG Group launched its Studio B innovation lab in Kensington High Street, London in April 2017. The central London premises provide a unique experience, offering customers the opportunity to work with industry partners in its innovative lab to solve the financial challenges of the future. In September 2017, the CYBG Group expanded its UK presence by opening a next generation 'B' store in

Birmingham. As well as being a fully operational branch for its 'B' and Yorkshire Bank customers, the 'B' store is a showcase for customers to experience the CYBG Group's digital innovations.

(e) ***Voice***

The CYBG Group provides retail telephony services via two principal contact centres in Clydebank and Kilmarnock in Scotland (the latter being outsourced to provide increased flexibility for call volumes) as well as two smaller centres in England to handle certain customer requirements. These centres support customers on both an inbound and outbound basis in a full range of account servicing and product sales activities, including non-voice activities such as web and social media. The CYBG Group also provides SME customers with telephone support via the Business Direct channel, which services approximately 200,000 customers.

(f) ***ATMs***

As at 31 March 2018, the CYBG Group held 813 branch, remote or deposit ATMs (381 of which were Clydesdale Bank branded and 432 of which were Yorkshire Bank branded) in the CYBG Group network across the UK.

1.6 **Branding**

With effect from Completion, CYBG's use of the "Virgin Money" brand will be licensed under the Brand Licence Agreement, and governed by its terms. Further details relating to the Brand Licence Agreement are set out in paragraph 13.3 of Part XIII (*Additional Information*).

1.7 **Liquidity and Funding**

The CYBG Group has a diversified funding mix, a strong base of predominantly lower-cost retail customer deposits, proven access to wholesale secured funding and limited reliance on short-term wholesale funding. The CYBG Group has improved its funding position and reduced its funding costs between 30 September 2015 and 31 March 2018 by growing its lower-cost current account funding, which increased from £13.0 billion as at 30 September 2015 to £14.0 billion as at 31 March 2018, increasing its medium- and long-term wholesale funding and reducing the volume of its more expensive fixed-rate term deposits. As at 31 March 2018, customer deposits of £28.4 billion accounted for 80 per cent. of the CYBG Group's funding base (defined as customer deposits, debt securities in issue and amounts due to other banks, which totalled £35.6 billion at 31 March 2018).

(a) ***Liquidity***

The CYBG Group undertakes a conservative approach to liquidity management by imposing internal limits, including limits based on stress and scenario testing, in addition to regulatory requirements. The CYBG Group manages liquidity risk by maintaining sufficient net liquid assets as a percentage of liabilities to cover cash flow imbalances and fluctuations in funding in order to retain full public confidence in the solvency of the CYBG Group and to enable the CYBG Group to meet its financial obligations.

As at 31 March 2017, the CYBG Group's LCR was 112 per cent. and its net stable funding ratio ("**NSFR**") was 120 per cent. As at 31 March 2018, the CYBG Group's LCR was 131 per cent. and its NSFR was 119 per cent.

The CYBG Group maintains a liquid asset portfolio that includes primarily cash in deposits with central banks and UK Government gilts. The CYBG Group manages this portfolio to meet PRA liquidity requirements while diversifying the mix to reduce basis risk and optimise the yield on liquid assets.

As at 31 March 2018, the CYBG Group held unencumbered liquid assets of £4,722 million.

(b) ***Funding***

The CYBG Group has a diversified funding base, with the majority of the CYBG Group's funding for its loan portfolio generated through customer deposits in the form of current accounts and savings accounts.

The CYBG Group monitors its LDR ratio and this was 116 per cent. and 115 per cent. as at 31 March 2017 and 31 March 2018, respectively.

The CYBG Group also actively seeks to diversify its funding mix through RMBS and covered bond programmes, differentiating its funding in terms of the type of instrument and product, maturity, currency, counterparty, term structure and markets through such programmes. As at 31 March 2018, the CYBG Group had securities in issue with a value of £2,898 million from RMBS, £740 million from covered bonds and £297 million from medium term notes. The RMBS notes currently in issue have maturity dates ranging from 2054 to 2069, although their average life cannot be stated because the actual rate of repayment of the mortgage loans and redemption of the mortgages and a number of other relevant factors are unknown. However, it is expected that, subject to having sufficient funds and to other commercial considerations, the issuers of the relevant notes will exercise their options to redeem the notes in full on their respective step-up dates. The covered bonds in issue have a final maturity date falling in June 2026. The medium term notes in issue have a final maturity date falling in June 2025.

2. RISK MANAGEMENT

The CYBG Group operates a number of policies designed to manage the risks to which the CYBG Group is exposed. The table below sets out the sections of the CYBG Annual Report 2017 that contain information in respect of the CYBG Group's risk management policies which are incorporated by reference into, and form part of, this Prospectus.

Reference document	Topic	Information incorporated by reference into this Prospectus	Page number in reference document
CYBG Annual Report 2017	Risk management .	Risk report	128–135
		Credit risk	138–153
		Balance sheet and prudential regulation risk	154–171
		Regulatory, compliance and conduct risk	172
		Operational risk (including people risks)	173
		Financial crime risk	174
		Strategic, business and financial performance risk	175

3. STRATEGY

3.1 Strategy of the Combined Group

Overview

The CYBG Directors have three clear strategic aims for CYBG:

1. **Sustainable customer growth**—drive sustainable customer growth by investing to broaden the franchise across our target segments and regions while enhancing the customer experience
2. **Efficiency**—improve efficiency by making our network, operations and organisation more efficient and agile
3. **Capital optimisation**—by securing IRB accreditation and deploying our capital to support our business ambitions while balancing risk and reward

The Offer is aligned to this strategy and reinforces delivery of CYBG's existing financial targets. As a result, the CYBG Directors and the Proposed Directors, intend to continue to execute the above strategy for the benefit of the Combined Group.

Sustainable customer growth

CYBG's customers are at the heart of its strategy and to better support them CYBG has been rapidly developing seamless customer services through delivery of its digitally-enabled, omni-channel distribution strategy. In response to consumers increasingly choosing to interact with their banks digitally, CYBG has created a series of banking propositions which are digitally-led customer experiences supported by exceptional omni-channel service. CYBG's customers can therefore interact with it through whichever channel they choose—online, mobile, tablet, phone, branch—whenever they want and in a seamless way.

CYBG's digital banking platform, "iB", was built to support this strategy. As well as supporting real-time, omni-channel experiences the platform also enables CYBG to partner with third parties to deliver additional financial and non-financial services to customers, empowering the creation of a technology-enabled, customer-centric proposition that resonates with consumers and enhances their lifestyles and businesses. CYBG has made features available to customers through third parties connecting to its iB platform using secure, open API technology, and these are live today. Over time, CYBG expects to create an ecosystem of associated services which will support customer acquisition and hence sustainable customer growth. Deploying CYBG's existing and planned digital capabilities across the Virgin Money franchise offers opportunities for increased customer activity, product penetration and customer satisfaction.

Use of the "Virgin Money" brand, when combined with CYBG's customer-centric service model is expected to lead to higher awareness, consumer interest and advocacy across the UK over time, generating increased customer acquisition and greater customer retention for the Combined Group. The wider group of Virgin companies also provides attractive opportunities for partnerships and collaboration.

Efficiency

CYBG intends to improve the Combined Group's cost structure by delivering:

1. An enhanced organisational design
2. More for less through a focus on central cost management
3. Operational efficiency through improved customer service
4. Network efficiency through a customer banking transformation

At its capital markets day in September 2016, CYBG set out its goal of achieving £100 million of net annual operating cost savings by FY19 versus its FY16 underlying operating costs of £729 million. CYBG has made considerable progress against these goals and as at 31 March 2018 had delivered gross annual cost savings of £120 million.

CYBG's goal of improving its operational efficiency will remain critical beyond its stated targets for FY19 and the CYBG Directors believe that reducing absolute operating costs is one of management's core competences. Importantly, delivery of further operational efficiency will provide additional capacity to reinvest in its digital and growth agenda.

Capital optimisation

CYBG intends to secure IRB accreditation for its mortgage portfolio in October 2018 and remainder of the bank in FY19. Moving to IRB will improve CYBG's competitive positioning, bring a stronger alignment of risk appetite and strategy, and reduce the intensity of our risk weighted assets and potential future bail-in debt requirement (MREL).

CYBG's IRB accreditation application is now in the final stages of the regulatory process and the CYBG Directors are increasingly confident of achieving accreditation for the mortgage book in October 2018. Once accreditation is achieved, CYBG will work with the PRA to determine its go-forward regulatory capital requirement.

As previously guided, the adoption of IRB models is expected to result in a material reduction in CYBG's credit RWA's and a consequential increase in the CYBG Group's CET1 ratio. CYBG will work through the opportunities this may afford the Combined Group during FY19 and consult with stakeholders when appropriate.

4. DIVIDENDS AND DIVIDEND POLICY

The CYBG Directors and the Proposed Directors believe that, given the expected strong capital generation supported by the Combination, the Combined Group should be well placed to accelerate both CYBG and Virgin Money progressive dividend ambitions.

PART III
INFORMATION ON THE VIRGIN MONEY GROUP

The following information should be read in conjunction with the information appearing elsewhere in, or incorporated by reference into, this Prospectus, including the financial and other information in, or incorporated by reference into Part VII (Historical Financial Information Relating to the Virgin Money Group).

1. BUSINESS OVERVIEW

1.1 Overview

The Virgin Money Group's core business is providing personal financial services to UK consumers. It operates exclusively within the UK with the exception of wholesale funding and liquidity management activities which are undertaken both in the UK and, on a limited basis, in overseas markets.

The Virgin Money Group operates through three commercial business lines:

- mortgages and savings;
- credit cards; and
- financial services including investments and pensions, insurance and currency products and services.

The mortgages, savings and credit cards business are operated by Virgin Money plc. The financial services business is operated by other members of the Virgin Money Group.

The Virgin Money Group provides customers with direct access to its products and services through multi-channel distribution, which includes digital channels, postal, telephone and store and lounge propositions. Direct distribution is then supplemented by intermediary distribution with mortgages being primarily sold through the Virgin Money Group's intermediary partners. Certain banking services are also available through any UK Post Office.

The Virgin Money Group remains focused on providing its customers with good value, straightforward products supported by outstanding service. This was reflected in its overall Net Promoter Score ("**NPS**") (a measure of satisfaction that ranges between –100 and +100 and represents the likelihood of respondents recommending Virgin Money, its products or services to others), of +37 for 30 June 2018.

The Virgin Money Group's operations are centred in Gosforth, Norwich and Chester, with additional offices in London and Edinburgh. The monthly average number of persons (including directors) employed by the Virgin Money Group was 3,224 in 2017.

Based on the consolidated audited financial statements of Virgin Money as at 31 December 2017, the Virgin Money Group had total assets of £41,107.8 million, total loans and advances to customers of £36,740.2 million, total customer deposits of £30,808.4 million and total equity of £1,824.9 million. Underlying profit before tax was £273.3 million and statutory profit before tax was £262.6 million for the 52 weeks ended 31 December 2017. Underlying Total Income was £666.0 million and underlying costs was £348.5 million for 52 weeks ended 31 December 2017. Net Interest Margin was 1.57 per cent. and the Banking Net Interest Margin was 1.72 per cent. for the 52 weeks ended 31 December 2017.

Based on the consolidated unaudited financial statements of Virgin Money as at 30 June 2018, the Virgin Money Group had total assets of £43,696.1 million, total loans and advances to customers of £37,176.0 million, total customer deposits of £31,445.6 million and total equity of £1,861.2 million. Underlying profit before tax was £141.6 million and statutory profit before tax was £127.2 million for the six months ended 30 June 2018. Underlying Total Income was £343.0 million and underlying costs was £171.0 million for six months ended 30 June 2018. Net Interest Margin was 1.41 per cent. and the Banking Net Interest Margin was 1.64 per cent. for the six months ended 30 June 2018.

1.2 History

Set out below are key milestones in the Virgin Money Group's development.

1965 Northern Rock Building Society formed following the merger of the Northern Counties Permanent Building Society and the Rock Building Society

1995 Virgin Money, a group of UK financial services businesses now under the common ownership of Virgin Money Holdings (UK) plc, was established by Virgin Money Direct Personal Financial Service Limited ("**VDPFS**"). VDPFS initially offering tax efficient savings in the form of Personal

Equity Plans ("**PEPs**") and later personal pensions, life insurance and unit trust products and subsequently credit cards and general insurance.

1997 Virgin Direct entered into a joint venture with RBS to establish and operate the Virgin Money One Account ("**VOA**"), an innovative current account mortgage, through Virgin Direct Personal Finance Limited. This business was sold to RBS in 2001.

Northern Rock Building Society was converted to a public limited company, when it was also listed on the London Stock Exchange.

2002 VDPFS went on to launch a credit card product in partnership with MBNA and sold its own branded life insurance business. VDPFS was subsequently rebranded as Virgin Money.

2008 Northern Rock plc entered temporary public ownership

2010 Virgin Money acquired Church House Trust plc, a small privately owned, regional bank which provided Virgin Money with its first UK banking licence.

Northern Rock's business was separated into two entities: a new entity, Northern Rock plc, which held all of the customer retail savings and current accounts and a core portfolio of high quality performing mortgage assets, and the original entity renamed Northern Rock (Asset Management) plc and, subsequently, NRAM plc ("**NRAM**"), which retained all remaining and securitised assets and which was owned by HM Treasury through UK Asset Resolution. In addition, all branches, mortgage origination capabilities and information technology were transferred to the new Northern Rock plc. Following the separation, Northern Rock plc carried on business as a mortgage and savings bank, primarily funded by retail deposits.

2012 In January 2012, Virgin Money acquired the entire issued share capital of Northern Rock plc from HM Treasury. As a result, Northern Rock plc became part of the Virgin Money Group.

Also in January 2012, Northern Rock plc also acquired Virgin Money Cards Limited (formerly Virgin Money Limited) from Virgin Money, the principal business of which was the marketing of personal credit cards and pre-paid cards which were distributed pursuant to partnership agreements with MBNA. During 2012, Virgin Money entered into an agreement with MBNA to acquire £1.0 billion of the £3.0 billion Virgin Money-branded credit card balances.

In July 2012, Virgin Money plc entered into a transaction to acquire a mortgage portfolio from NRAM for a cash consideration of £466.4 million.

Northern Rock plc was renamed Virgin Money plc in October 2012.

2013 In January 2013, Virgin Money completed the sale of Virgin Money Cards Limited to MBNA Limited ("**MBNA**") and the acquisition from MBNA of £1.0 billion of assets from the Virgin Money credit card portfolio. Under a transitional arrangement, up until 30 November 2014, MBNA continued to originate new credit card accounts on Virgin Money's behalf and Virgin Money completed an agreement to purchase these assets. Virgin Money plc now originates its own credit cards.

2014 In November 2014, Virgin Money was listed on the London Stock Exchange via an initial public offering.

1.3 **Capital**

The Virgin Money Group's objective with respect to its capital position is to deliver sustainable returns for shareholders while maintaining an overall quality and quantity of capital in line with its low risk profile. The Virgin Money Group's capital position under CRD IV as at 30 June 2018:

- Total capital ratio was 21.1 per cent. (18.1 per cent. as at 31 December 2017);
- Common Equity Tier 1 ratio was 16.3 per cent. (13.8 per cent. at 31 December 2017); and
- Leverage ratio was 3.8 per cent. (3.9 per cent. at 31 December 2017).

In July 2014, Virgin Money issued £160 million Fixed Rate Resettable Additional Tier 1 Securities and used the proceeds to repay the Non-Core Tier 1 notes held by the UK Government following the acquisition of Northern Rock plc.

In November 2016, Virgin Money issued £230 million Fixed Rate Resettable Additional Tier 1 Securities, the proceeds of which were downstreamed to Virgin Money plc through the investment by Virgin Money in £230 million AT1 Securities issued by Virgin Money plc.

1.4 **Banking Activities**

Residential mortgage lending

The Virgin Money Group's core lending activity is the provision of residential mortgages to individuals secured on residential properties located in the UK and represented 91.3 per cent. of gross loans and advances to customers as at 30 June 2018. This lending is principally to prime borrowers who are owner and occupier of the mortgaged property (80.6 per cent.), with a proportion (19.4 per cent.) being to borrowers who are landlords.

The primary distribution channel for mortgages is through intermediary partners supplemented by direct distribution (13.3 per cent. of new business in the six months ended 30 June 2018).

The Virgin Money Group mortgage balances increased 1.2 per cent. to £34.1 billion at 30 June 2018 from £33.7 billion at 31 December 2017.

Customer retention remained consistent in the six months to 30 June 2018 with 72 per cent. of mortgage customers with maturing fixed or tracker products choosing to remain with Virgin Money at the end of their existing deal (72 per cent. in the year ended 31 December 2017).

Virgin Money continued to extend its mortgage proposition to help more people onto the housing ladder and in 2018 launched a portfolio landlord proposition, new seven and ten year fixed rate products and extended Shared Ownership lending.

The weighted average indexed LTV ratio of the Virgin Money Group's residential mortgage portfolio was 57.1 per cent. as at 30 June 2018 (55.8 per cent. as at 31 December 2017). Only 2.3 per cent. of the Virgin Money Group's total residential mortgage book at 30 June 2018 had an indexed LTV in excess of 90 per cent., based on value. The weighted average indexed LTV of the Virgin Money Group's new mortgage lending was 68.8 per cent. in the six months ended 30 June 2018 (68.1 per cent. in 2017).

The Cost of Risk for mortgages was reduced to less than 0.01 per cent. in the half year to 30 June 2018 and the impairment charge was £0.9 million for the six months ended 30 June 2018. Secured credit impaired loans as a proportion of total secured loans have increased marginally to 0.6 per cent. (1 January 2018: 0.5 per cent.), with balances increasing by £23.9 million to £187.5 million as at 30 June 2018. Secured impairment allowances increased by £0.7 million from £12.1 million to £12.8 million during the first six months of 2018.

The Virgin Money Group has experienced a historically low loss experience in its total residential mortgage portfolio with loans over three months in arrears remaining at 0.12 per cent. of the book as at 30 June 2018 (compared to 0.12 per cent. of the book as at 31 December 2017).

Retail savings

The Virgin Money Group offers a range of instant access and fixed term savings products, both available as ISAs and in 2018 the Virgin Money Group launched SME deposit products and a savings account in partnership with Virgin Atlantic.

The Virgin Money Group is predominantly funded through customer deposits, largely originated directly through the digital channel and store network. Retail deposit balances grew 2.1 per cent. in the six months ended 30 June 2018 to £31.4 billion as at 30 June 2018 (compared to £30.8 billion at 31 December 2017). Savings performance was underpinned by strong customer retention. The Virgin Money Group retained 86 per cent. of customers with maturing fixed rate deposit balances in the six months ended 30 June 2018 (89 per cent. in the year ended 31 December 2017) and repriced approximately £1.5 billion of existing deposits.

Credit cards

The Virgin Money Group provides credit card products, predominantly online, to 1.3 million customers. The portfolio is a mix of retail and balance transfer credit cards, and in 2018 the Virgin Money Group launched a new Virgin Atlantic credit card proposition.

The prime credit card portfolio represented 8.7 per cent. of gross loans and advances to customers, with credit card balances totalling £3.1 billion as at 30 June 2018 (compared to £3.0 billion at 31 December 2017). In the first half of 2018 193,000 new accounts were opened (H1 2017: 150,000), of which 64 per cent. were retail-led (H1 2017: 42 per cent.), with spend per active account 10 per cent. higher than the same period in 2017.

The Cost of Risk for credit cards was 1.87 per cent. in the half year to 30 June 2018 and the impairment charge (measured under IFRS 9) was £29.5 million for the six months ended 30 June 2018. Unsecured credit-impaired loans as a proportion of total unsecured loans has remained stable at 1.0 per cent. (1 January 2018: 1.0 per cent.), with balances increasing by £4.5 million to £33.9 million as at 30 June 2018.

There was no underlying deterioration in credit and performance for the six months ended 30 June 2018 reflecting the strong credit quality of the book. Unsecured two month plus arrears remained low at 0.93 per cent. as at 30 June 2018 (31 December 2017: 0.88 per cent.).

Financial services

The Virgin Money Group Financial Services business line offers customers investments and pensions, insurance and currency products and services and the Virgin Money Group works with a number of specialist organisations to deliver these products. Financial Services contributed £21.4 million to total income in the six months ended 30 June 2018 (£37.2 million in the year ended 31 December 2017) and 6.2 per cent. of total underlying income in the six month ended 30 June 2018.

Funds under management were £3.7 billion as at 30 June 2018, 6.2 per cent. higher than 30 June 2017. Investments and pensions income increased by 13.9 per cent. in the same period in 2017 to £18.0 million.

In March 2018 Virgin Money announced a new partnership with Aberdeen Standard Investments for investments and pensions. The transaction is expected to sign and complete by the end of 2018.

Travel insurance sales were up 27 per cent. on the first half of 2017 and 6,500 life insurance sales were achieved in the first six months of 2018. Insurance and other income increased by 70 per cent. in the six months ended 30 June 2018, reflecting increases in sales.

1.5 **Liquidity and Funding**

The Virgin Money Group's treasury function manages liquidity, funding and balance sheet risks. The Virgin Money Group does not manage the treasury function as a profit centre and the treasury function is not engaged in trading activities.

Liquidity

The Virgin Money Group maintains a portfolio of liquid assets, predominantly in high-quality unencumbered securities issued by the UK Government or Supranationals and deposits with the Bank of England.

As at 30 June 2018, Virgin Money Group had total liquid assets of £6.2 billion. This included total level 1 assets of £5.2 billion, of which £4.1 billion were held in cash and balances at central banks, £202.2 million were held in UK Government securities, £395.6 million were held in supranational securities and £470.3 million in level 1 eligible covered bonds. Total level 2a and 2b assets and other liquidity resources for Virgin Money Group were £191.5 million. These included Residential Mortgage Backed Securities ("**RMBS**"). Self-issued RMBS amounted to a further £839.7 million.

During the first half of 2018, Virgin Money maintained a liquidity position in excess of risk appetite and the regulatory minimum. The liquidity coverage ratio was 175.6 per cent. as at 30 June 2018.

Funding

The Virgin Money Group adopts a prudent wholesale funding strategy which is planned and controlled by a series of balance sheet metrics to limit concentration and refinancing exposures. Access to wholesale funding supplements the core retail deposit base in order to extend tenor, ensure appropriate diversification of the funding base and optimise funding costs.

Funding diversification is achieved by the use of long-term wholesale funding. As at 30 June 2018, wholesale funding totalled £10.0 billion, including £2.9 billion of debt securities in issue, £687.0 million under repurchase agreements and £6.4 billion of Government funding through TFS.

Virgin Money plc established a Regulated Global Covered Bond programme in April 2018.

PART IV
OPERATING AND FINANCIAL REVIEW RELATING TO THE CYBG GROUP

The following discussion of the CYBG Group's financial condition and results of operations should be read in conjunction with the historical financial information on the CYBG Group and the notes related thereto set out in Part VI (Historical Financial Information Relating to the CYBG Group). Except as otherwise stated, the financial information included in this Part has been extracted without material adjustment from the financial information referred to in Part VI (Historical Financial Information Relating to the CYBG Group) which has been incorporated into this Prospectus by reference. The historical financial information referred to in this discussion has been prepared in accordance with IFRS as adopted by the EU as explained in Part VI (Historical Financial Information Relating to the CYBG Group).

The following discussion of the CYBG Group's results of operations and financial condition contains forward-looking statements. The CYBG Group's actual results could differ materially from those discussed in the forward-looking statements. Factors that could cause or contribute to such differences include those discussed below and elsewhere in this Prospectus, particularly in the Parts headed 'Risk Factors' and 'Forward Looking Statements'.

1. RESULTS OF OPERATIONS

The tables below set out the sections of the CYBG Interim Report 2018, the CYBG Annual Report 2017 and the CYBG Annual Report 2016 which contain information in respect of the CYBG Group's operating and financial review and which are incorporated by reference into, and form part of, this Prospectus. The parts of these documents which are not incorporated by reference are either not relevant for investors or are covered elsewhere in this Prospectus. To the extent that any part of any information referred to below itself contains information which is incorporated by reference, such information shall not form part of this Prospectus. In the event of any inconsistencies between any information incorporated by reference, and the information contained in this Prospectus, the information contained in this Prospectus will take precedence and supersede any information incorporated by reference into this Prospectus.

Results of operations for the six month period ended 31 March 2018 against the six month period ended 31 March 2017

Reference document	Topic	Information incorporated by reference into this Prospectus	Page number in reference document
CYBG Interim Report 2018	Market context . . .	All text and tables under the heading "*Operating Environment*"	5
	Operating results . .	All text and tables under the heading "*Interim Consolidated income statement*"	31
		All text and tables under the heading "2.4 *Operating and administrative expenses*"	11
		All text and tables under the heading "*Taxation*"	42–43
		All text and tables under the heading "*Summary balance sheet*"	6
		All text and tables under the heading "*Summary income statement—underlying and statutory basis*"	6
		All text and tables under the heading "*Net interest incomes*"	10
		All text and tables under the heading "*Unsecured Personal Lending*"	9
		All text and tables under the heading "*Mortgages*"	8

Reference document	Topic	Information incorporated by reference into this Prospectus	Page number in reference document
		All text and tables under the heading "*SME lending*"	8
		All text and tables under the heading "*Continued sustainable growth in asset and deposit balances*"	8–9
		Section 2.1—Segment information	39–40
	Key performance indicators	All text and tables under the heading "*Key performance indicators*"	3
	Impairment provision	All text and tables under the heading "*Impairment provision*"	17
	Principal risks and uncertainties . . .	All text and tables under the heading "*Credit risk*"	15–21
		All text and tables under the heading "*Balance sheet & prudential regulation risks*"	22–28
		Section 3.6—Provisions for liabilities and charges	47–50
	Contingent liabilities and commitments . . .	Section 5—Contingent liabilities and commitments	56
	Accounting policies	Section 1—Basis of preparation and accounting policies	36–38
		Section 1.3—Critical accounting estimates and judgements	36
	Glossary	All text under the headings "*Measuring Financial Performance Glossary*" and "*Glossary*"	58–59

Results of operations for the year ended 30 September 2017 against the year ended 30 September 2016

Reference document	Topic	Information incorporated by reference into this Prospectus	Page number in reference document
CYBG Annual Report 2017	Market context . . .	All text and tables under the heading "*Environment and Market Outlook*"	17
	Operating results . .	All text and tables under the heading "*Consolidated income statement*"	186
		All text and tables under the heading "*Net interest income*" and "*Non-interest income*"	44
		All text and tables under the heading "*2. Delivering on our effiency programme*"	45–46
		All text and tables under the heading "2.5 *Taxation*"	201–202
		All text and tables under the heading "*Summarised balance sheet*"	38

Reference document	Topic	Information incorporated by reference into this Prospectus	Page number in reference document
		All text and tables under the heading "*Summary income statement—underlying and statutory basis*"	38
		All text and tables under the heading "*Sustainable customer growth*"	41–43
		Section 2—Segment information	196–197
	Key performance indicators	All text and tables under the heading "*Strategy in action*" and "*Measuring our performance*"	12–15
	Principal risks and uncertainties . . .	All text and tables under the heading "*Credit risk*"	138–153
		All text and tables under the heading "*Balance sheet & prudential regulation risks*"	154–171
		All text and tables under the heading "*Regulatory, compliance & conduct risk*"	172
		All text and tables under the heading "*Operational risk (including & people risks)*"	173
		All text and tables under the heading "*Strategic, business and financial performance risk*"	175
		All text and tables under the heading "*Financial crime risk*"	174
		Section 3.14—Provisions for liabilities and charges	219–223
	Contingent liabilities and commitments . . .	Section 5—Contingent liabilities and commitments	237–238
	Accounting policies	Section 1—Basis of preparation	191–195
		Accounting policies described in note to which it relates	198–244
		Section 1.8—Critical accounting estimates and judgements	192
	Glossary	All text under the headings "*Measuring Financial Performance—Glossary*", "Glossary" and "*Abbreviations*"	250–259

Results of operations for the year ended 30 September 2016 against the year ended 30 September 2015

Reference document	Topic	Information incorporated by reference into this Prospectus	Page number in reference document
CYBG Annual Report 2016	Operating results . .	All text and tables under the heading "*Consolidated income statement*"	44
		All text and tables under the heading "*Income analysis*"	45–46
		All text and tables under the heading "*Operating and administrative expenses*"	46
		All text and tables under the heading "*Net interest margin analysis*"	48–49
		All text and tables under the heading "*Customer loans*"	50
		All text and tables under the heading "*Mortgages*"	51
		All text and tables under the heading "*SME lending*"	52
		All text and tables under the heading "*Note 4—Segment information*"	228–230
	Key performance indicators	All text and tables under the heading "*Key performance indicators*"	55
	Impairment analysis	All text and tables under the heading "*Impairment analysis—lending and provisions*"	56–57
	Principal risks and uncertainties . . .	All text and tables under the heading "*Credit risk*"	148–168
		All text and tables under the heading "*Balance sheet & prudential regulation risks*"	169–191
		All text and tables under the heading "*Regulatory, compliance & conduct risk*"	192–193
		All text and tables under the heading "*Operational risk (including strategic, business, financial, performance & people risks)*"	194–195
		All text and tables under the heading "*Financial crime risk*"	196–197
		All text and tables under the heading "*Note 27—Provisions for liabilities and charges*"	256–259
	Contingent liabilities and commitments . . .	All text and tables under the heading "*Note 33—Contingent liabilities and commitments*"	269–270
	Accounting policies	All text and tables under the heading "*Note 1—Basis of preparation*"	212

Reference document	Topic	Information incorporated by reference into this Prospectus	Page number in reference document
		All text and tables under the heading "*Note 2—Accounting policies*"	213–226
		All text and tables under the heading "*Note 3—Critical accounting estimates and judgements*"	226–228
	Glossary	All text under the headings "*Glossary*" and "*Abbreviations*"	291–296

2. LIQUIDITY, CAPITAL RESOURCES AND FUNDING

The tables below set out the sections of the CYBG Interim Report 2018, the CYBG Annual Report 2017 and the CYBG Annual Report 2016 which contain information in respect of the CYBG Group's liquidity, capital resources and funding which are incorporated by reference into, and form part of, this Prospectus. The parts of these documents which are not incorporated by reference are either not relevant for investors or are covered elsewhere in this Prospectus. To the extent that any part of any information referred to below itself contains information which is incorporated by reference, such information shall not form part of this Prospectus. In the event of any inconsistencies between any information incorporated by reference, and the information contained in this Prospectus, the information contained in this Prospectus will take precedence and supersede any information incorporated by reference into this Prospectus.

Liquidity, capital resources and funding for the six month period ended 31 March 2018 against the six month period ended 31 March 2017

Reference document	Topic	Information incorporated by reference into this Prospectus	Page number in reference document
CYBG Interim Report 2018	Funding strategy . .	All text and tables under the heading "*Funding and liquidity*"	9
		All text and tables under the heading "*Funding and liquidity risk*"	27
		All text and tables under the heading "*Section 3: Assets and liabilities—Due to other banks*"	47
		All text and tables under the heading "*Section 3: Assets and liabilities—Due to customers—term deposits*"	44
		All text and tables under the heading "*Section 3: Assets and liabilities—Debt securities in issue*"	51
	Capital position . . .	All text and tables under the heading "*Capital optimisation*"	12
		All text and tables under the heading "*Capital*"	22
		All text and tables under the heading "*Regulatory capital (unaudited)*"	22
		All text and tables under the heading "*Reconciliation of statutory total equity to regulatory capital (unaudited)*"	22
		All text and tables under the heading "*Regulatory capital flow of funds (unaudited)*"	23

Reference document	Topic	Information incorporated by reference into this Prospectus	Page number in reference document
		All text and tables under the heading "*Minimum Pillar 1 capital requirements*"	23
		All text and tables under the heading "*RWA movements*"	23
		All text and tables under the heading "*Pillar 1 RWAs and capital requirements by business line*"	24–26
	Liquidity	All text and tables under "*Liquid assets*"	27
		All text and tables under "*Encumbered assets by asset category*"	28

Liquidity, capital resources and funding for the year ended 30 September 2017 against the year ended 30 September 2016

Reference document	Topic	Information incorporated by reference into this Prospectus	Page number in reference document
CYBG Annual Report 2017	Funding strategy . .	All text and tables under the heading "*Funding and liquidity risk*"	160–170
		All text and tables under the heading "*Section 3: Assets and liabilities—Cash and balances with central banks*"	203
		All text and tables under the heading "*Section 3: Assets and liabilities—Securitisation and covered bond programmes*"	212–214
		All text and tables under the heading "*Section 3: Assets and liabilities—Due to other banks*"	218
		All text and tables under the heading "*Section 3: Assets and liabilities—Due to customers*"	218
		All text and tables under the heading "*Section 3: Assets and liabilities—Debt securities in issue*"	223–224
	Capital position . . .	All text and tables under the heading "*Capital optimisation*"	46–47
		All text and tables under the heading "*Capital position*"	156–157
		All text and tables under the heading "*RWA movements*"	158
		All text and tables under the heading "*Pillar 1 RWAs and Capital requirements by business line (unaudited)*"	158
		All text and tables under the heading "*Leverage Ratio (unaudited)*"	159
	Liquidity	All text and tables under the heading "*Encumbered assets by asset category (audited)*"	164

Reference document	Topic	Information incorporated by reference into this Prospectus	Page number in reference document
		All text and tables under the heading "*Assets and liabilities by maturity*"	165–166
		All text and tables under the heading "*Cash flows payable under financial liabilities by contractual maturity*"	167

Liquidity, capital resources and funding for the year ended 30 September 2016 against the year ended 30 September 2015

Reference document	Topic	Information incorporated by reference into this Prospectus	Page number in reference document
CYBG Annual Report 2016	Funding strategy . .	All text and tables under the heading "*Funding and liquidity risk*"	177–190
		All text and tables under the heading "*Note 11—Cash and balances with central banks*"	236
		All text and tables under the heading "*Note 18—Securitisations and covered bonds*"	248–249
		All text and tables under the heading "*Note 25—Due to other banks*"	255
		All text and tables under the heading "*Note 26—Due to customers*"	255
		All text and tables under the heading "*Note 28—Debt securities in issue*"	260
	Capital position . . .	All text and tables under the heading "*Capital and Funding*"	54
		All text and tables under the heading "*Capital position*"	171–173
		All text and tables under the heading "*RWA movements*"	173
		All text and tables under the heading "*Pillar 1 RWAs and Capital requirements by business line (unaudited)*"	174–175
		All text and tables under the heading "*Leverage Ratio (unaudited)*"	176
	Liquidity	All text and tables under the heading "*Encumbered assets by asset category (audited)*"	182
		All text and tables under the heading "*Assets and liabilities by maturity*"	183–184
		All text and tables under the heading "*Cash flows payable under financial liabilities by contractual maturity*"	185

3. CAPITALISATION AND INDEBTEDNESS

The following table sets out the consolidated capitalisation of the CYBG Group as at 31 March 2018. The information has been extracted without material adjustment from the CYBG Group's unaudited financial statements for the six month period ended 31 March 2018 in the CYBG Interim Report 2018 as incorporated by reference into this Prospectus.

	As at 31 March 2018
	(£ million) unaudited
Shareholders' equity	
Share capital	89
Capital reorganisation reserve	(839)
Merger reserve	633
Other equity instruments	450
Other reserves	(25)
Total Capitalisation	**308**

There has been no significant change in the capitalisation of CYBG since 31 March 2018.

The following table sets out the financial indebtedness of the CYBG Group and has been extracted from the CYBG Group's unaudited accounting records as at 31 May 2018. Indebtedness is unsecured and unguaranteed, unless stated otherwise.

	As at 31 May 2018
	(£ million) unaudited
Indebtedness	
Deposits by banks	2,862
Debt securities in issue(1)	4,331
Total Indebtedness	**7,193**

(1) Debt securities in issue comprises medium term notes and subordinated debt as well as a series of RMBS and covered bonds that are secured on CYBG Group's mortgage assets. The covered bonds are guaranteed by Clydesdale Covered Bonds No. 2 LLP.

	As at 31 May 2018
	(£ million) unaudited
Indirect and contingent indebtedness	
Assets pledged as collateral security	130
Other contingent liabilities	—
Total indirect and contingent indebtedness	**130**

PART V
OPERATING AND FINANCIAL REVIEW RELATING TO THE VIRGIN MONEY GROUP

The following discussion of the Virgin Money Group's financial condition and results of operations should be read in conjunction with the historical financial information on the Virgin Money Group and the notes related thereto set out in Part VI (Historical Financial Information Relating to the Virgin Money Group). Except as otherwise stated, the financial information included in this Part has been extracted without material adjustment from the financial information referred to in Part VI (Historical Financial Information Relating to the Virgin Money Group) which has been incorporated into this Prospectus by reference. The historical financial information referred to in this discussion has been prepared in accordance with IFRS as explained in Part VII (Historical Financial Information Relating to the Virgin Money Group).

The following discussion of the Virgin Money Group's results of operations and financial condition contains forward-looking statements. The Virgin Money Group's actual results could differ materially from those discussed in the forward-looking statements. Factors that could cause or contribute to such differences include those discussed below and elsewhere in this Prospectus, particularly in the Parts headed 'Risk Factors' and 'Forward Looking Statements'.

1. RESULTS OF OPERATIONS

The tables below set out the sections of the Virgin Money Interim Report 2018, the Virgin Money Annual Report 2017 and the Virgin Money Annual Report 2016 which contain information in respect of the Virgin Money Group's operating and financial review and which are incorporated by reference into, and form part of, this Prospectus. The parts of these documents which are not incorporated by reference are either not relevant for investors or are covered elsewhere in this Prospectus. To the extent that any part of any information referred to below itself contains information which is incorporated by reference, such information shall not form part of this Prospectus. In the event of any inconsistencies between any information incorporated by reference, and the information contained in this Prospectus, the information contained in this Prospectus will take precedence and supersede any information incorporated by reference into this Prospectus.

Results of operations for the six month period ended 30 June 2018 against the six month period ended 30 June 2017

Reference document	Topic	Information incorporated by reference into this Prospectus	Page number in reference document
Virgin Money Interim Report 2018	Operating results .	All text and tables under the heading "*Condensed Consolidated Half-Year Financial Statements (Unaudited)*"	36-67
	Principal risks and uncertainties . . .	All text and tables under the heading "*Risk Management Report*"	17-34
	Accounting policies	All text and tables under the heading "*Note 1—Basis of preparation and accounting policies*"	49–50

Results of operations for the year ended 31 December 2017 against the year ended 31 December 2016

Reference document	Topic	Information incorporated by reference into this Prospectus	Page number in reference document
Virgin Money Annual Report 2017	Operating results . .	All text and tables under the heading "*Consolidated income statement*"	200
		All text and tables under the heading "*Income benefitted from growth in asset balances*"	45–46
		All text and tables under the heading "*Note 6: Operating expenses*"	220–221
		All text and tables under the heading "*Note 9: Taxation*"	224–225
		All text and tables under the heading "*Consolidated balance sheet*"	43
		All text and tables under the heading "*Mortgages and savings*"	53–55
		All text and tables under the heading "*Credit cards*"	56
		All text and tables under the heading "*Financial services*"	58
	Key performance indicators	All text and tables under "*2017 key performance indicators*"	19
	Impairment analysis	All text and tables under "*Impairments reflected a resilient economy and rigorous credit risk management*"	47
		All text and tables under "*Impaired assets*"	143–145
		All text and tables under "*Impairment provisions*"	146–147
	Principal risks and uncertainties . . .	All text and tables under the heading "*Credit risk*"	134–156
		All text and tables under the heading "*Market risk*"	157–161
		All text and tables under the heading "*Operational risk*"	162
		All text and tables under the heading "*Conduct risk and compliance*"	163
		All text and tables under the heading "*Concentration risk*"	164–169
		All text and tables under the heading "*Funding and liquidity risk*"	170–181
	Contingent liabilities and commitments . . .	All text and tables under the heading "*Note 31: Contingent liabilities and commitments*"	240–241

Reference document	Topic	Information incorporated by reference into this Prospectus	Page number in reference document
	Accounting policies	All text and tables under the heading "*Note 1—Basis of preparation and accounting policies*"	207–217
	Glossary	All text under the headings "*Alternative Performance Measures*", "*Glossary*" and "*Abbreviations*"	262–266

Results of operations for the year ended 31 December 2016 against the year ended 31 December 2015

Reference document	Topic	Information incorporated by reference into this Prospectus	Page number in reference document
Virgin Money Annual Report 2016	Operating results . .	All text and tables under the heading "*Consolidated income statement*"	202
		All text and tables under the heading "*Income benefitted from growth in asset balances*"	58
		All text and tables under the heading "*Note 6: Operating expenses*"	225–226
		All text and tables under the heading "*Note 9: Taxation*"	230–231
		All text and tables under the heading "*Consolidated balance sheet*"	56–57
		All text and tables under the heading "*Mortgages and savings*"	63–65
		All text and tables under the heading "*Credit cards*"	66–68
		All text and tables under the heading "*Financial services*"	69–70
	Key performance indicators	All text and tables under "*Financial highlights*"	6–7
	Impairment analysis	All text and tables under "*Impairments reflected rigorous credit risk management*"	59–60
		All text and tables under "*Impaired assets*"	151–154
	Principal risks and uncertainties . . .	All text and tables under the heading "*Credit risk*"	140–163
		All text and tables under the heading "*Market risk*"	164–168
		All text and tables under the heading "*Operational risk*"	169
		All text and tables under the heading "*Conduct risk and compliance*"	170
		All text and tables under the heading "*Concentration risk*"	171–176
		All text and tables under the heading "*Funding and liquidity risk*"	177–186
	Contingent liabilities and commitments . . .	All text and tables under the heading	246–247

Reference document	Topic	Information incorporated by reference into this Prospectus	Page number in reference document
		"*Note 32: Contingent liabilities and commitments*"	
	Accounting policies	All text and tables under the heading "*Note 1—Basis of preparation and accounting policies*"	209–220
	Glossary	All text and tables under the headings "*Alternative Performance Measures*", "*Glossary*" and "*Abbreviations*"	267–271

2. LIQUIDITY, CAPITAL RESOURCES AND FUNDING

The tables below set out the sections of the Virgin Money Interim Report 2018, the Virgin Money Annual Report 2017 and the Virgin Money Annual Report 2016 which contain information in respect of the Virgin Money Group's liquidity, capital resources and funding which are incorporated by reference into, and form part of, this Prospectus. The parts of these documents which are not incorporated by reference are either not relevant for investors or are covered elsewhere in this Prospectus. To the extent that any part of any information referred to below itself contains information which is incorporated by reference, such information shall not form part of this Prospectus. In the event of any inconsistencies between any information incorporated by reference, and the information contained in this Prospectus, the information contained in this Prospectus will take precedence and supersede any information incorporated by reference into this Prospectus.

Liquidity, capital resources and funding for the six month period ended 31 June 2018 against the six month period ended 31 June 2017

Reference document	Topic	Information incorporated by reference into this Prospectus	Page number in reference document
Virgin Money Interim Report 2018	Liquidity and capital resources	All text and tables under the heading "*Funding and Liquidity Management*"	19–34

Liquidity, capital resources and funding for the year ended 31 December 2017 against the year ended 31 December 2016

Reference document	Topic	Information incorporated by reference into this Prospectus	Page number in reference document
Virgin Money Annual Report 2017	Funding strategy . .	All text and tables under the heading "*Funding and liquidity risk*"	170
		All text and tables under the heading "*Note 18: Securitisation*"	232
		All text and tables under the heading "*Note 23: Deposits from banks*"	236
		All text and tables under the heading "*Note 24: Customer deposits*"	236
		All text and tables under the heading "*Note 25: Debt securities in issue*"	236
	Capital position . . .	All text and tables under the heading "*Capital*"	182–188
		All text and tables under the heading "*Movement in risk-weighted assets*"	187
		All text and tables under the heading "*Leverage ratio*"	187–188
	Liquidity	All text and tables under the heading "*Encumbered assets*"	174–175

Reference document	Topic	Information incorporated by reference into this Prospectus	Page number in reference document
		All text and tables under the heading "*Liquid asset portfolio*"	176–178
		All text and tables under the heading "*Cash flow profile*"	179–180

Liquidity, capital resources and funding for the year ended 31 December 2016 against the year ended 31 December 2015

Reference document	Topic	Information incorporated by reference into this Prospectus	Page number in reference document
Virgin Money Annual Report 2016	Funding strategy . .	All text and tables under the heading "*Funding and liquidity risk*"	177–186
		All text and tables under the heading "*Note 18: Securitisation*"	238
		All text and tables under the heading "*Note 23: Deposits from banks*"	242
		All text and tables under the heading "*Note 24: Customer deposits*"	242
		All text and tables under the heading "*Note 25: Debt securities in issue*"	242
	Capital position . . .	All text and tables under the heading "*Capital*"	187–192
		All text and tables under the heading "*Movement in risk-weighted assets*"	191
		All text and tables under the heading "*Leverage ratio*"	191–192
	Liquidity	All text and tables under the heading "*Encumbered assets*"	181–184
		All text and tables under the heading "*Cash flow profile*"	185–186

3. CAPITALISATION AND INDEBTEDNESS

The following table sets out the consolidated capitalisation and indebtedness of the Virgin Money Group as at 30 June 2018. The information has been extracted without material adjustment from the Virgin Money Group's financial statements for the six month period ended 30 June 2018 in the Virgin Money Interim Report 2018 as incorporated by reference into this Prospectus.

	As at 30 June 2018
	(£ million)
Share capital and share premium	655
Other equity instruments	384
Other reserves	(12)
Total Capitalisation	**1,027**

There has been no significant change in the capitalisation of Virgin Money since 30 June 2018.

The following table sets out the financial indebtedness of the Virgin Money Group as at 30 June 2018.

	As at 30 June 2018 (£ million)
Indebtedness	
Deposits by banks	7,083
Debt securities in issue	2,939
Total Indebtedness	**10,022**

	As at 30 June 2018 (£ million)
Indirect and contingent indebtedness	
Contingent liabilities	-
Total indirect and contingent indebtedness	**-**

PART VI
HISTORICAL FINANCIAL INFORMATION RELATING TO THE CYBG GROUP

1. BASIS OF FINANCIAL INFORMATION

The audited consolidated financial statements and historical financial information of CYBG included in the CYBG Annual Report 2017, the CYBG Annual Report 2016 and the CYBG IPO Prospectus, together with the audit and accountant's reports thereon, and unaudited consolidated financial statements of CYBG included in the CYBG Interim Report 2018, are incorporated by reference into this Prospectus.

The consolidated financial statements for the financial year ended 30 September 2017, the financial year ended 30 September 2016 and historical financial information for the financial year ended 30 September 2015 were prepared in accordance with IFRS as adopted by the EU and in accordance with the 2006 Act, were audited and the audit and accountant's reports for each such financial year were unqualified.

The basis of preparation of the historical financial information for the financial year ended 30 September 2015 is further explained in Section B of Part 8 (*Historical Financial Information*) of the CYBG IPO Prospectus which is incorporated by reference herein.

The interim condensed consolidated financial statements for the six months ended 31 March 2018 and the six months ended 31 March 2017 have been prepared in accordance with the Disclosure, Guidance and Transparency Rules of the FCA and IAS 34 "Interim Financial Reporting" as adopted by the European Union ("**EU**").

2. DOCUMENTS INCORPORATED BY REFERENCE

Certain sections, as set out below, of the CYBG Interim Report 2018, the CYBG Annual Report 2017, the CYBG Annual Report 2016 and the CYBG IPO Prospectus are incorporated by reference into this Prospectus.

The following cross-reference list is intended to enable investors to identify easily specific items of information which have been incorporated by reference into this Prospectus.

For the six months ended 31 March 2018

Reference document	Information incorporated by reference into this Prospectus	Page number in reference document
CYBG Interim Report 2018	Interim review report	30
	Interim condensed consolidated income statement	31
	Interim condensed consolidated statement of comprehensive income	32
	Interim condensed consolidated balance sheet	33
	Interim condensed consolidated statement of changes in equity	34
	Interim condensed consolidated statement of cash flows	35
	Notes to the interim condensed consolidated financial statements	36–57

For the year ended 30 September 2017

Reference document	Information incorporated by reference into this Prospectus	Page number in reference document
CYBG Annual Report 2017	Independent auditor's report	178–185
	Consolidated income statement	186
	Consolidated statement of comprehensive income	187
	Consolidated balance sheet	188
	Consolidated statement of changes in equity	189
	Consolidated statement of cash flow	190
	Notes to the consolidated financial statements	191–240

For the year ended 30 September 2016

Reference document	Information incorporated by reference into this Prospectus	Page number in reference document
CYBG Annual Report 2016	Independent auditor's report	200–205
	Consolidated income statement	207
	Consolidated statement of comprehensive income	208
	Consolidated balance sheet	209
	Consolidated statement of changes in equity	210
	Consolidated statement of cash flow	211
	Notes to the consolidated financial statements	212–280

For the year ended 30 September 2015

Reference document	Information incorporated by reference into this Prospectus	Page number in reference document
CYBG IPO Prospectus	Accountant's report on the historical financial information	272–273
	Consolidated income statements for the years ended 30 September 2015, 30 September 2014, 30 September 2013 and 30 September 2012	274
	Consolidated statements of comprehensive income for the years ended 30 September 2015, 30 September 2014, 30 September 2013 and 30 September 2012	275
	Consolidated balance sheets as at 30 September 2015, 30 September 2014, 30 September 2013 and 30 September 2012	276
	Statements of changes in equity for the years ended 30 September 2015, 30 September 2014, 30 September 2013 and 30 September 2012	277–278
	Statements of cash flows for the years ended 30 September 2015, 30 September 2014, 30 September 2013 and 30 September 2012	279
	Notes to the Historical Financial Information	280–372

PART VII
HISTORICAL FINANCIAL INFORMATION RELATING TO THE VIRGIN MONEY GROUP

1. BASIS OF FINANCIAL INFORMATION

The following pages set out the audited consolidated financial information of the Virgin Money Group for the years ended 31 December 2017, 31 December 2016 and 31 December 2015 and the unaudited consolidated financial information of the Virgin Money Group for the six month periods ended 30 June 2018 and 30 June 2017.

This information, including the relevant audit opinions, has been extracted without material adjustment from the audited financial statements for the year ended 31 December 2017, as set out in the Virgin Money Annual Report 2017, the audited financial statements for the year ended 31 December 2016, as set out in the Virgin Money Annual Report 2016, the audited financial statements for the year ended 31 December 2015, as set out in the Virgin Money Annual Report 2015 and the unaudited financial statements for the six month periods ended 30 June 2018 and 30 June 2017 as set out in the Virgin Money Interim Report 2018. The audit reports in the Virgin Money Annual Report 2017, the Virgin Money Annual Report 2016 and Virgin Money Annual Report 2015 were unqualified.

Virgin Money's audited financial statements for the six month periods ended 30 June 2018 and 30 June 2017 were prepared in accordance with the accounting policies and presentation applied in preparing the preceding annual financial statements, except as otherwise disclosed therein. The financial statements for the six month periods ended 30 June 2018 and 30 June 2017 are unaudited, but have been reviewed by the auditors and the review reports were unqualified.

As described above, each of these financial statements has been extracted without material adjustment (in each case, as originally published) and reproduced in this Part VII (*Historical Financial Information relating to the Virgin Money Group*). Consequently, page numbers and other references may no longer be valid (in particular, there may be references to other parts of the annual reports not reproduced in this Part VII). The terms used in the Virgin Money historical financial information have the meaning given to them in the relevant annual reports and accounts and not the meaning given to that term in this Prospectus.

SECTION A:
HISTORICAL FINANCIAL INFORMATION RELATING TO THE VIRGIN MONEY GROUP FOR THE YEAR ENDED 31 DECEMBER 2017

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF VIRGIN MONEY HOLDINGS (UK) PLC

REPORT ON THE AUDIT OF THE FINANCIAL STATEMENTS

Opinion

In our opinion, Virgin Money Holdings (UK) plc's Group financial statements and Parent Company financial statements (the 'financial statements'):

- give a true and fair view of the state of the Group's and of the Parent Company's affairs as at 31 December 2017 and of the Group's profit and the Group's and the Parent Company's cash flows for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union and, as regards the Parent Company's financial statements, as applied in accordance with the provisions of the Companies Act 2006; and
- have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

We have audited the financial statements, included within the Annual Report and Accounts (the 'Annual Report'), which comprise: the Group and Parent Company balance sheets as at 31 December 2017; the Group income statement, the Group statement of comprehensive income, the Group and Parent Company statements of cash flows, and the Group and Parent Company statements of changes in equity for the year then ended; and the notes to the financial statements, which include a description of the significant accounting policies.

Our opinion is consistent with our reporting to the Audit Committee.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the financial statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

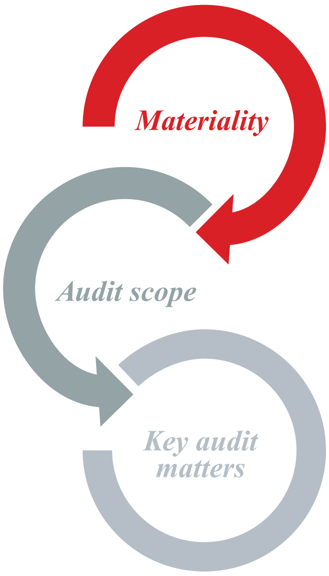
We remained independent of the Group in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, which includes the FRC's Ethical Standard, as applicable to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

To the best of our knowledge and belief, we declare that non-audit services prohibited by the FRC's Ethical Standard were not provided to the Group or the Parent Company.

Other than those disclosed in note 6 to the financial statements, we have provided no non-audit services to the Group or the Parent Company in the period from 1 January 2017 to 31 December 2017.

Our audit approach

Overview



- Overall Group materiality: £13.4 million (2016: £9.8 million), based on 5% of adjusted profit before tax, adjusted for £6.5 million of strategic items (as detailed in note 2), as these are not considered to be recurring. This adjusted measure of profit is deemed as the most appropriate benchmark upon which to base our materiality.
- We performed a full scope audit over the Group's five 100% owned subsidiaries and certain Special Purpose Vehicle (SPV) balances were scoped in on a line by line basis based on their proportion of the consolidated financial statement line item. 98% of interest income, 98% of profit before tax (98% of the adjusted profit before tax figure as used for our overall materiality calculation) and 99% of total assets were subject to audit.

Key audit matters included:

- Revenue recognition—Effective Interest Rate (EIR) accounting.
- Impairment of loans and advances to customers.
- Recognition of intangible assets.
- Disclosure of impact of adoption of IFRS 9.

The scope of our audit

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements. In particular, we looked at where the Directors made subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain.

We gained an understanding of the legal and regulatory framework applicable to the Group and the industry in which it operates, and considered the risk of acts by the Group which were contrary to applicable laws and regulations, including fraud. We designed audit procedures at group and significant component level to respond to the risk, recognising that the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion. We focused on laws and regulations that could give rise to a material misstatement in the Group financial statements, including but not limited to, the Companies Act 2006, the Listing Rules, and UK tax legislation.

Our tests included, but were not limited to, review of the financial statement disclosures to underlying supporting documentation, review of correspondence with and reports to the regulators, review of correspondence with legal advisors, enquiries of management, and review of internal audit reports in so far as they related to the financial statements.

There are inherent limitations in the audit procedures described above and the further removed non-compliance with laws and regulations is from the events and transactions reflected in the financial statements, the less likely we would become aware of it.

We did not identify any key audit matters relating to irregularities, including fraud. As in all of our audits, we also addressed the risk of management override of internal controls, including testing journals and evaluating whether there was evidence of bias by the Directors that represented a risk of material misstatement due to fraud.

Key audit matters

Key audit matters are those matters that, in the auditors' professional judgement, were of most significance in the audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by the auditors, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters, and any comments we make on the results of our procedures thereon, were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. This is not a complete list of all risks identified by our audit.

Each of the key audit matters below related to our audit of Group financial statements.

Key audit matter	How our audit addressed the key audit matter
Revenue recognition—Effective Interest Rate (EIR) accounting See note 1 of the financial statements for the disclosure of the related accounting policies and critical estimates and judgements, and page 88 for the Audit Committee's consideration of key financial issues and judgements. The Group's total loans and advances to customers balance of £36.7 billion and net interest income of £594.6 million include certain EIR adjustments as per the requirements of IAS 39. The vast majority of the income recognised by the Group is system generated and requires minimal judgement, therefore we focused our work in relation to revenue recognition on EIR accounting due to the inherent subjectivity and complexity involved in forecasting future customer behaviour on which the EIR adjustment calculation is based. Changes in assumptions used in the forecasting model could have a material impact on EIR adjustments and hence the revenue recognised in any one accounting period. The most significant assumption for secured lending EIR is the estimation of the expected life of the product over which fees are spread. For unsecured lending, significant judgement is applied in calculating the EIR adjustment including setting assumptions relating to movements in customer balances over the expected life and the related future revenue associated with these balances in the context of the Group's historic experience. Key assumptions include retail spending levels and repayment rates.	Across both the secured and unsecured lending EIR calculation models, we tested controls over data input and checked the accuracy of model calculations. We also assessed controls over the setting and approving of key assumptions. We tested the impact of any changes in assumptions on the financial statements, ensuring these were calculated in accordance with IAS 39. In relation to secured lending EIR, we: • Substantively tested a sample of fees incorporated within the calculation to underlying secured lending agreements and considered the appropriateness of the inclusion of fees in the EIR calculation; and • Assessed the estimate of the expected life applied and forecast cash flows during this life by comparing to recent Group experience and expectations of future patterns. We concluded that, whilst there is significant judgement inherent in the secured EIR adjustment, the assumptions applied were within a reasonable range based on past experience and future assumptions. In relation to unsecured lending EIR, we: • Tested controls over the ongoing monitoring of actual credit card cash flows as compared with the forecast assumptions and compared 2017 experience with expected experience for that period on a sample basis; • Assessed the key forecast assumptions, including expected life, balance, repayment rate, volume of retail spend and interest income earned by comparing to recent experience; • Performed sensitivity analyses of key judgements to understand the materiality of the impact that potential realistic changes in assumptions may have, either individually or in combination, on the EIR asset; and • Assessed the sufficiency of the disclosures in the financial statements relating to significant estimates made in the EIR calculation, including disclosure of sensitivities. We concluded that, whilst there is significant judgement inherent in the unsecured EIR adjustment, the assumptions applied were within a reasonable range based on past experience and future assumptions. We concluded that the disclosures in note 1 of the financial statements provide appropriate details of the degree and nature of estimation uncertainty and the impact on the financial statements of actual future customer experience differing from the assumptions made.

Key audit matter	How our audit addressed the key audit matter
Impairment of loans and advances to customers See note 1 of the financial statements for the disclosure of the related accounting policies and critical estimates and judgements, and page 88 for the Audit Committee's consideration of key financial issues and judgements. The impairment provision of £59.4 million consists of provisions of £12.1 million in relation to secured lending and £47.3 million in relation to unsecured lending. Total loans and advances as at 31 December 2017 relating to secured lending was £33.7 billion and £3.1 billion for unsecured lending. We focused on this area because Management make subjective judgements over both the timing of recognition and the size of provisions for impairment of loans and advances. This judgement includes considering the completeness of the provisions and whether any specific judgemental overlays are appropriate to recognise the impact of emerging trends not captured in the impairment models. The Group has developed historic data based models that derive key assumptions used within the provision calculation such as probability of default (PD) and loss given default (LGD). The output of these models is then applied to the provision calculation with other information including the selection of an appropriate loss emergence period (LEP) and the exposure at default (EAD).	We assessed and tested the design and operating effectiveness of the controls over data flows, model governance and setting and approval of key assumptions used in the provisioning process. As part of our detailed work, we: • Assessed the provision calculation methodology applied in the context of industry practice and the requirements of accounting standards; • Tested key assumptions used within the models to internal and external information where appropriate; • Tested that the model calculations were consistent with our understanding of the Group's methodology and the requirements of accounting standards; and • Examined the basis for the judgemental overlays made to the results produced by models and assessing the rationale for the adjustments, as well as considering the completeness of the overlays. We found the approach taken in relation to the Group's impairment provisions to be consistent with the requirements of IAS 39 and judgements made were reasonable.
Recognition of intangible assets See note 1 of the financial statements for the disclosure of the related accounting policies and also page 88 for the Audit Committee's consideration of key financial issues and judgements. During 2017 certain technology project costs incurred by the Group were capitalised. These projects require cash and non-cash resources during development and management applies judgement in considering whether or not costs should be capitalised in the context of IAS 38. As technology and customer expectations continue to change there is a risk that certain technology assets may not generate the return that the Group had initially anticipated and therefore may be subject to impairment. The Group's total net book value of intangible assets was £128.4 million as at 31 December 2017.	We assessed the Group's capitalisation policy to check that it met the requirements of IAS 38. We tested the design and operating effectiveness of the control environment in relation to the recording and approval of project costs which form the basis of capitalisation accounting entries. We selected a sample of intangible assets and undertook the following procedures: • Substantively tested a selection of costs including those related to new projects to check that these meet the criteria of IAS 38 for capitalisation as intangible assets; • Discussed material capitalised assets with management to identify any that may be at higher risk of potential impairment; and • Where higher risk items were noted, we discussed the asset and related forecast economic benefits with management to inform our independent consideration as to whether any possible impairment triggers existed. One item was noted by management as requiring impairment resulting in a charge of £4.8 million to the income statement. This is disclosed in note 19. We found the accounting treatment applied in recognising capitalised costs was consistent with the requirements of IAS 38 and we did not identify any material matters which we considered necessary to report to the Audit Committee.
Disclosure of impact of adoption of IFRS 9 IFRS 9 became effective on 1 January 2018 and therefore does not affect the Balance Sheet and Income Statement of the Group as at 31 December 2017.	We read the disclosure as set out in note 37 to assess its compliance with the requirements of IAS 8. We also tested the completeness and accuracy of data inputs for the Group's material IFRS 9 models to identify any material inconsistencies with source system data.

Key audit matter	How our audit addressed the key audit matter
However, under the requirements of IAS 8, the Group is required to disclose the estimated impact that new accounting standards will have on initial adoption. The Group has presented a transition disclosure in note 37. Management estimate that the transition to IFRS 9 will reduce shareholders' equity by approximately £35 million after deferred tax as at 1 January 2018. The most significant impact of adopting IFRS 9 to the Group relates to a change in the way that credit losses are recognised, moving from an incurred loss to an expected loss basis for financial instruments held at amortised cost. The estimation of expected credit losses (ECL) for the disclosure required in these 2017 financial statements has required significant judgement to be applied in the development of lifetime PD, LGD and EAD. This has required a more complex provision calculation methodology based on the application of differing levels of forecasting of losses. This is dependent on whether a significant increase in credit risk has occurred, as well as an adjustment applied for the impact of multiple economic scenarios in the future.	Our detailed work in auditing the estimated 2018 opening impairment provisions included: • Reading model documentation papers and assessing the Group's methodology and modelling approach in the context of our understanding of IFRS 9; • Independently estimating model outputs based on the Group's methodology and data for material IFRS 9 models and comparing our outcomes with those of management; and • Comparing macroeconomic forecasts used by the Group for IFRS 9 purposes with third party market information. We found the disclosure in respect of the transition to IFRS 9 and the estimated impact this has on shareholders' equity to be consistent with the requirements of accounting standards.

How we tailored the audit scope

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the financial statements as a whole, taking into account the structure of the Group, the accounting processes and controls, and the industry in which the Group operates.

We updated our understanding of processes within the business in order to understand and evaluate the key financial processes and controls across the Group. Our audit plan was presented to the Audit Committee. Following our procedures, we were able to obtain sufficient appropriate audit evidence to form a basis for our audit opinion.

The consolidated financial statements include the Group's five 100% owned subsidiaries as well as a number of securitisation related SPVs. As the statutory audit of subsidiaries is undertaken concurrently with the Group audit, all five subsidiaries were designated as in-scope components for Group audit purposes. Additionally, certain SPV balances were scoped in for audit on a line by line basis based on their proportion of the consolidated financial statement line item to ensure adequate overall audit coverage for each line item. 98% of interest income, 98% of profit before tax (98% of the adjusted profit before tax figure as used for our overall materiality calculation) and 99% of Total Assets were subject to audit.

In establishing the overall approach to the Group audit, we determined the type of work that needed to be performed over the components. All of the audit work was completed by the Group engagement team.

Materiality

The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures on the individual financial statement line items and disclosures and in evaluating the effect of misstatements, both individually and in aggregate on the financial statements as a whole. Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

	Group financial statements	Parent Company financial statements
Overall materiality	£13.4 million (2016: £9.8 million).	£13.4 million (2016: £2.8 million).
How we determined it	5% of adjusted profit before tax adjusted for £6.5 million of strategic items (as detailed in note 2), as these are not considered to be recurring.	1% of total assets, capped to Group overall materiality of £13.4 million
Rationale for benchmark applied	This adjusted measure of profit is deemed as the most appropriate measure of underlying business performance and hence an appropriate benchmark upon which to base our materiality.	As the Company is not profit orientated on a solo entity basis, we have used 1% of total assets, but cap this to the lower materiality of the Group.

For each component in the scope of our Group audit, we allocated a materiality that is less than our overall Group materiality. The range of materiality allocated across components was between £0.02 million and £13.0 million.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £0.67 million (Group audit) (2016: £0.49 million) and £0.67 million (Parent Company audit) (2016: £0.14 million) as well as misstatements below those amounts that, in our view, warranted reporting for qualitative reasons.

Going concern

In accordance with ISAs (UK) we are required to report if we have anything material to add or draw attention to in respect of the Directors' statement in the financial statements about whether the Directors considered it appropriate to adopt the going concern basis of accounting in preparing the financial statements and the Directors' identification of any material uncertainties to the Group's and the Parent Company's ability to continue as a going concern over a period of at least twelve months from the date of approval of the financial statements. We have nothing material to add or to draw attention to. However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the Group's and Parent Company's ability to continue as a going concern.

We are also required to report if the Directors' statement relating to Going Concern in accordance with Listing Rule 9.8.6R(3) is materially inconsistent with our knowledge obtained in the audit. We have nothing to report.

Reporting on other information

The other information comprises all of the information in the Annual Report other than the financial statements and our auditors' report thereon. The Directors are responsible for the other information. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except to the extent otherwise explicitly stated in this report, any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report based on these responsibilities.

With respect to the Strategic Report, Directors' Report and Corporate Governance Statement, we also considered whether the disclosures required by the Companies Act 2006 have been included.

Based on the responsibilities described above and our work undertaken in the course of the audit, the Companies Act 2006 (CA06), ISAs (UK) and the Listing Rules of the Financial Conduct Authority (FCA) require us also to report certain opinions and matters as described below (required by ISAs (UK) unless otherwise stated).

Strategic Report and Directors' Report

In our opinion, based on the work undertaken in the course of the audit, the information given in the Strategic Report and Directors' Report for the year ended 31 December 2017 is consistent with the financial statements and has been prepared in accordance with applicable legal requirements. (CA06)

In light of the knowledge and understanding of the Group and Parent Company and their environment obtained in the course of the audit, we did not identify any material misstatements in the Strategic Report and Directors' Report. (CA06)

Corporate Governance Statement

In our opinion, based on the work undertaken in the course of the audit, the information on pages 81, 89 and 126 to 188 of the Annual Report about internal controls and risk management systems in relation to financial reporting processes, and in note 27 to the financial statements about share capital structures in compliance with rules 7.2.5 and 7.2.6 of the Disclosure Guidance and Transparency Rules sourcebook of the FCA (DTR) is consistent with the financial statements and has been prepared in accordance with applicable legal requirements. (CA06)

In light of the knowledge and understanding of the Group and Parent Company and their environment obtained in the course of the audit, we did not identify any material misstatements in this information. (CA06)

In our opinion, based on the work undertaken in the course of the audit, the information given on pages 71 to 94 of the Annual Report with respect to the Parent Company's corporate governance code and practices and about its administrative, management and supervisory bodies and their committees complies with rules 7.2.2, 7.2.3 and 7.2.7 of the DTR. (CA06)

We have nothing to report arising from our responsibility to report if a corporate governance statement has not been prepared by the Parent Company. (CA06)

The Directors' assessment of the prospects of the Group and of the principal risks that would threaten the solvency or liquidity of the Group

We have nothing material to add or draw attention to regarding:

- The Directors' confirmation on page 132 of the Annual Report that they have carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency or liquidity;
- The disclosures in the Annual Report that describe those risks and explain how they are being managed or mitigated; and
- The Directors' explanation on page 120 of the Annual Report as to how they have assessed the prospects of the Group, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

We have nothing to report having performed a review of the Directors' statement that they have carried out a robust assessment of the principal risks facing the Group and statement in relation to the longer-term viability of the Group. Our review was substantially less in scope than an audit and only consisted of making inquiries and considering the Directors' process supporting their statements; checking that the statements are in alignment with the relevant provisions of the UK Corporate Governance Code (the Code); and considering whether the statements are consistent with the knowledge and understanding of the Group and Parent Company and their environment obtained in the course of the audit. (Listing Rules)

Other Code Provisions

We have nothing to report in respect of our responsibility to report when:

- The statement given by the Directors, on page 125, that they consider the Annual Report taken as a whole to be fair, balanced and understandable, and provides the information necessary for the members to assess the Group's and Parent Company's position and performance, business model and strategy is materially inconsistent with our knowledge of the Group and Parent Company obtained in the course of performing our audit;

- The section of the Annual Report on pages 88 and 89 describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee; and
- The Directors' statement relating to the Parent Company's compliance with the Code does not properly disclose a departure from a relevant provision of the Code specified, under the Listing Rules, for review by the auditors.

Directors' Remuneration

In our opinion, the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006.

RESPONSIBILITIES FOR THE FINANCIAL STATEMENTS AND THE AUDIT

Responsibilities of the Directors for the financial statements

As explained more fully in the Statement of Directors' responsibilities set out on page 124, the Directors are responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The Directors are also responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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

Auditors' responsibilities for the audit of the financial statements

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

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

Use of this report

This report, including the opinions, has been prepared for and only for the Parent Company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

OTHER REQUIRED REPORTING

Companies Act 2006 exception reporting

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

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

We have no exceptions to report arising from this responsibility.

Appointment

Following the recommendation of the audit committee, we were appointed by the members on 4 May 2016 to audit the financial statements for the year ended 31 December 2016 and subsequent financial periods. The period of total uninterrupted engagement is two years, covering the years ended 31 December 2016 and 31 December 2017.

Catrin Thomas (Senior Statutory Auditor)

for and on behalf of PricewaterhouseCoopers LLP Chartered Accountants and Statutory Auditors Edinburgh
26 February 2018

CONSOLIDATED INCOME STATEMENT

For the year ended 31 December

	Note	2017	2016
		£ million	**£ million**
Interest and similar income		**958.0**	948.1
Interest and similar expense		**(363.4)**	(425.7)
Net interest income	3	**594.6**	522.4
Fee and commission income		**29.6**	28.8
Fee and commission expense		**—**	(1.2)
Net fee and commission income	4	**29.6**	27.6
Other operating income	5	**41.8**	40.3
Fair value losses on financial instruments	13	**(3.3)**	(8.9)
Other income		**68.1**	59.0
Total income		**662.7**	581.4
Operating expenses	6	**(355.9)**	(349.4)
Profit before tax from operating activities		**306.8**	232.0
Impairment	8	**(44.2)**	(37.6)
Profit before tax		**262.6**	194.4
Taxation	9	**(70.5)**	(54.3)
Profit for the year		**192.1**	140.1
Profit attributable to equity owners		**192.1**	140.1
Profit for the year		**192.1**	140.1
Basic earnings per share (pence)	10	**37.8**	29.4
Diluted earnings per share (pence)	10	**37.5**	29.1

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December

	Note	2017 £ million	2016 £ million
Profit for the year		**192.1**	140.1
Other comprehensive income/(expense)			
Items that may subsequently be reclassified to profit or loss:			
Movements in revaluation reserve in respect of available-for-sale financial assets:			
Change in fair value	29	**14.1**	44.4
Income statement transfers in respect of disposals	29	**(13.5)**	(38.3)
Taxation	29	**(0.1)**	(1.7)
		0.5	4.4
Movements in cash flow hedge reserve:			
Effective portion of changes in fair value taken to other comprehensive income	29	**(1.2)**	(36.1)
Net income statement transfers	29	**12.6**	13.6
Taxation	29	**(2.6)**	6.3
		8.8	(16.2)
Other comprehensive income/(expense) for the year, net of tax		**9.3**	(11.8)
Total comprehensive income for the year		**201.4**	128.3
Total comprehensive income attributable to equity owners		**201.4**	128.3

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED BALANCE SHEET

As at 31 December

	Note	2017 £ million	2016 £ million
Assets			
Cash and balances at central banks		**2,579.0**	786.3
Derivative financial instruments	13	**78.8**	104.2
Loans and receivables:			
• Loans and advances to banks	14	**359.4**	635.6
• Loans and advances to customers	15	**36,740.2**	32,367.1
• Debt securities		**0.3**	0.7
		37,099.9	33,003.4
Available-for-sale financial assets	16	**1,051.8**	858.8
Intangible assets	19	**128.4**	80.6
Tangible fixed assets	20	**74.5**	77.4
Deferred tax assets	21	**11.5**	23.0
Other assets	22	**83.9**	121.9
Total assets		**41,107.8**	35,055.6
Equity and liabilities			
Liabilities			
Deposits from banks	23	**5,379.0**	2,132.5
Customer deposits	24	**30,808.4**	28,106.3
Derivative financial instruments	13	**93.5**	229.7
Debt securities in issue	25	**2,736.9**	2,600.0
Other liabilities	26	**241.5**	299.9
Current tax liabilities		**23.6**	16.7
Total liabilities		**39,282.9**	33,385.1
Equity			
Share capital and share premium	27	**654.6**	654.6
Other equity instruments	28	**384.1**	384.1
Other reserves	29	**(18.1)**	(27.4)
Retained earnings	30	**804.3**	659.2
Total equity		**1,824.9**	1,670.5
Total liabilities and equity		**41,107.8**	35,055.6

The accompanying notes are an integral part of these consolidated financial statements.

The financial statements on pages 200 to 250 were approved and authorised for issue by the Board and were signed on its behalf on 26 February 2018.

Glen Moreno
Chair

Jayne-Anne Gadhia CBE
Chief Executive

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2017

Attributable to equity holders

	Share capital and share premium	Other equity instruments	Other reserves	Retained earnings	Total equity
	£ million	£ million	£ million	£ million	£ million
Balance at 1 January 2017	**654.6**	**384.1**	**(27.4)**	**659.2**	**1,670.5**
Comprehensive income					
Profit for the year	—	—	—	**192.1**	**192.1**
Other comprehensive income					
Net movement in revaluation reserve in respect of available-for-sale financial assets	—	—	**0.5**	—	**0.5**
Net movement in cash flow hedge reserve	—	—	**8.8**	—	**8.8**
Total other comprehensive income	—	—	**9.3**	—	**9.3**
Total comprehensive income for the year	—	—	**9.3**	**192.1**	**201.4**
Transactions with equity holders					
Dividends paid to ordinary shareholders	—	—	—	**(23.9)**	**(23.9)**
Distribution to Additional Tier 1 security holders	—	—	—	**(32.7)**	**(32.7)**
Tax attributable to Additional Tier 1 securities	—	—	—	**8.4**	**8.4**
Purchase of own shares	—	—	—	**(8.5)**	**(8.5)**
Share based payments—charge for the year (net of tax)	—	—	—	**9.9**	**9.9**
Other distributions	—	—	—	**(0.2)**	**(0.2)**
Total transactions with equity holders	—	—	—	**(47.0)**	**(47.0)**
Balance at 31 December 2017	**654.6**	**384.1**	**(18.1)**	**804.3**	**1,824.9**

The accompanying notes are an integral part of these consolidated financial statements.

Further details of movements in the Group's share capital and reserves are provided in notes 27 to 30.

Attributable to equity holders (Continued)

	Share capital and share premium	Other equity instruments	Other reserves	Retained earnings	Total equity
	£ million	£ million	£ million	£ million	£ million
Balance at 1 January 2016	654.6	156.5	(15.6)	544.8	1,340.3
Comprehensive income					
Profit for the year	—	—	—	140.1	140.1
Other comprehensive income/(expense)					
Net movement in revaluation reserve in respect of available-for-sale financial assets	—	—	4.4	—	4.4
Net movement in cash flow hedge reserve	—	—	(16.2)	—	(16.2)
Total other comprehensive expense	—	—	(11.8)	—	(11.8)
Total comprehensive income for the year	—	—	(11.8)	140.1	128.3
Transactions with equity holders					
Dividends paid to ordinary shareholders	—	—	—	(20.8)	(20.8)
Distribution to Additional Tier 1 security holders	—	—	—	(12.6)	(12.6)
Tax attributable to Additional Tier 1 securities	—	—	—	2.5	2.5
Purchase of own shares	—	—	—	(7.3)	(7.3)
Issue of Additional Tier 1 securities	—	227.6	—	—	227.6
Share based payments—charge for the year	—	—	—	12.8	12.8
Deferred tax on share based payments	—	—	—	(0.3)	(0.3)
Total transactions with equity holders	—	227.6	—	(25.7)	201.9
Balance at 31 December 2016	**654.6**	**384.1**	**(27.4)**	**659.2**	**1,670.5**

The accompanying notes are an integral part of these consolidated financial statements.

Further details of movements in the Group's share capital and reserves are provided in notes 27 to 30.

CONSOLIDATED CASH FLOW STATEMENT

For the year ended 31 December

	Note	2017	2016
		£ million	£ million
Profit before taxation		**262.6**	194.4
Adjustments for:			
Change in operating assets	34(a)	**(4,357.8)**	(5,387.3)
Change in operating liabilities	34(b)	**5,806.6**	3,957.3
Non-cash and other items	34(c)	**48.2**	60.3
Tax paid		**(45.1)**	(22.1)
Net cash provided by/(used in) operating activities		**1,714.5**	(1,197.4)
Cash flows from investing activities			
Purchase of securities		**(541.5)**	(670.0)
Proceeds from sale and redemption of securities		**497.1**	1,150.0
Purchase and investment in intangible assets		**(74.3)**	(31.6)
Purchase of tangible fixed assets		**(5.8)**	(8.6)
Disposal of tangible fixed assets		**—**	0.7
Net cash (used in)/provided by investing activities		**(124.5)**	440.5
Cash flows from financing activities			
Dividends paid to ordinary shareholders	11	**(23.9)**	(20.8)
Distributions to Additional Tier 1 security holders		**(32.7)**	(12.6)
Other distributions		**(0.2)**	—
Net proceeds from issue of debt securities	25	**746.2**	1,278.9
Repayments of debt securities in issue	25	**(608.3)**	(798.1)
Purchase of own shares		**(8.5)**	(7.3)
Issue of Additional Tier 1 securities (net of costs)		**—**	227.6
Net cash provided by financing activities		**72.6**	667.7
Change in cash and cash equivalents		**1,662.6**	(89.2)
Cash and cash equivalents at beginning of year		**1,372.2**	1,461.4
Cash and cash equivalents at end of year	34(d)	**3,034.8**	1,372.2

The accompanying notes are an integral part of these consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1: BASIS OF PREPARATION AND ACCOUNTING POLICIES

1.1 **Reporting entity**

Virgin Money Holdings (UK) plc (the Company) is a public limited company incorporated and registered in England and Wales. The registered office is Jubilee House, Gosforth, Newcastle-Upon-Tyne, NE3 4PL.

The Company was incorporated on 4 August 1995 as a private limited company with registered number 03087587. On 24 July 2014 the Company was re-registered as a public limited company.

The Company is the parent entity and the ultimate controlling party of the Virgin Money Group (the Group), which consists of the Company and its subsidiaries.

1.2 **Basis of preparation**

The Group consolidated financial statements, which should be read in conjunction with the Directors' Report, have been prepared on a going concern basis in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU, including interpretations issued by the IFRS Interpretations Committee, and with those parts of the Companies Act 2006 applicable to companies reporting under IFRS.

IFRS comprises accounting standards prefixed IFRS issued by the International Accounting Standards Board (IASB) and those prefixed IAS issued by the IASB's predecessor body as well as interpretations issued by the IFRS Interpretations Committee (IFRS IC) and its predecessor body. The EU endorsed version of IAS 39 'Financial Instruments: Recognition and Measurement' relaxes some of the hedge accounting requirements; the Group has not taken advantage of this relaxation, and therefore there is no difference in application to the Group between IFRS as adopted by the EU and IFRS as issued by the IASB.

The Directors have reviewed the strategic plan which shows the financial position, cash flow, liquidity and capital forecasts for the Group. The Directors are confident that the Group will have sufficient resources to meet its liabilities as they fall due and to continue to operate for a period of at least 12 months from the date of approval of the financial statements. Accordingly the Directors believe that it remains appropriate to prepare the financial statements on a going concern basis.

1.3 **Changes in accounting policy**

New standards, amendments to standards and interpretations adopted

In 2017, the Group adopted amendments to existing standards that were endorsed for adoption by the EU and mandatory for annual reporting periods beginning on or after 1 January 2017.

The adoption of the amendments to IAS 12 'Income Taxes' had no impact on these financial statements or the accounting polices applied in their preparation. In adopting the amendments to IAS 7 'Statement of cash flows' reconciliation disclosures have been provided in the notes to these financial statements on liabilities included within 'financing activities' in the consolidated and parent cash flow statements.

New accounting standards issued by the IASB that are relevant to the Group and effective in future periods are presented in note 37.

1.4 **Presentation of information**

Presentation of risk and capital management disclosures

Disclosures under IFRS 7 'Financial Instruments: Disclosure' concerning the nature and extent of risks relating to financial instruments and under IAS 1 'Presentation of financial statements' concerning objectives, policies and processes for managing capital have been included within the audited sections of the Risk Management Report. Where marked as 'audited' these are covered by the Independent Auditors' Report.

1.5 **Basis of consolidation**

The Group consists of the Company and its subsidiaries. The subsidiaries are listed in note 2 of the parent company financial statements. The consolidated financial statements comprise the financial statements of the Group.

Entities are regarded as subsidiaries where the Group has the power over an investee, exposure or rights to variable returns from its involvement with the investee and the ability to affect those returns. Inter-company transactions and balances are eliminated upon consolidation. Subsidiaries are consolidated from the date on which control is transferred to the Group and are de-consolidated from the date that power over an investee, exposure or rights to variable returns and the ability to affect these returns ceases. Accounting policies are applied consistently across the Group.

Special Purpose Vehicles (SPV) are entities created to accomplish a narrow and well defined objective. For the Group this is the securitisation of mortgage assets. An SPV is consolidated if the Group has control over the SPV, through its exposure to variable returns from its involvement in the SPV and the ability to affect those returns through its power over the entity.

The Virgin Money Foundation is classified as an associate.

1.6 Basis of measurement

The financial statements have been prepared under the historical cost convention as modified by the revaluation of derivative financial instruments and available-for-sale financial assets held at fair value. A summary of the material accounting policies of the Group are included within note 1.9. Policies which are relevant to the financial statements as a whole are set out below.

The accounting policies have been applied consistently to all periods presented in these financial statements.

1.7 Client money

The Group's unit trust management and investment intermediary subsidiary administers money on behalf of some clients in accordance with the Client Money Rules of the Financial Conduct Authority. Client money is not recognised in the balance sheet or in the notes to the financial statements as the Group is not the beneficial owner.

1.8 Foreign currency translation

The Group's financial statements are presented in Sterling, which is the functional currency of the Company, all of its subsidiaries and the SPVs included within the consolidated financial statements.

Foreign currency transactions are translated into functional currency using the exchange rates prevailing at the dates of the transactions. Monetary items denominated in foreign currencies are translated at the rate prevailing at the balance sheet date. Foreign exchange gains and losses resulting from the restatement and settlement of such transactions are recognised in the income statement, except when recognised in other comprehensive income if relating to a qualifying cash flow hedge or available-for-sale assets. Non-monetary items (which are assets or liabilities which do not attach to a right to receive or an obligation to pay currency) measured at historical cost and denominated in foreign currencies are translated at the exchange rate at the date of the transaction. Non-monetary items measured at fair value are translated at the exchange rate at the date of valuation. Where these are held at fair value through the income statement, exchange differences are reported as part of the fair value gain or loss.

1.9 Accounting policies

The accounting policies of the Group are set out below.

(a) Operating segments

The Group's chief operating decision maker (which has been determined by the Group to be the Executive Committee) assesses performance and makes decisions regarding the allocation of the Group's resources, in accordance with IFRS 8 'Operating Segments'. All of the Group's product lines are managed under a single centralised commercial function, with the Group's performance assessed, and resource allocation decisions made, on a centralised basis. Therefore the Group has determined that it has only one reportable segment. The underlying basis is the basis on which financial information is presented to the chief operating decision maker which excludes certain items included in profit or loss determined under IFRSs as adopted by the EU.

(b) Interest income and expense

Interest income and expense are recognised in the income statement for all instruments measured at amortised cost using the effective interest rate method.

This method calculates the amortised cost of a financial asset or liability, and allocates the interest income or expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts or payments through the expected life of the financial instrument or, where appropriate, a shorter period to the net carrying amount of the financial asset or liability. The Group estimates cash flows considering all contractual terms of the financial instrument (for example prepayment options) but does not consider future credit losses. The calculation includes all amounts received or paid by the Group that are an integral part of the overall return, direct incremental transaction costs related to the acquisition or issue of a financial instrument, loan commitment fees and all other premiums and discounts.

Once a financial asset or group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised on the written down carrying value using the asset's original effective interest rate, being the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

Interest receivable or payable on derivatives, whether in economic or accounting hedges, is recorded on an accruals basis in interest receivable or payable. Interest on available-for-sale (AFS) debt securities is recorded in interest receivable using the effective interest rate method.

(c) **Fees and commissions**

Where they are not included in the effective interest rate calculation, fees and commissions are recognised on an accruals basis when the service has been received or provided. Income from general insurance and life insurance policies is recognised in full on the effective date of commencement or renewal of the related policies to reflect underlying contracts with product providers.

(d) **Other operating income**

Other operating income comprises the fair value for services, net of value added tax, rebates and discounts. Other operating income is attributable to the sale and management of stocks and shares ISAs, pensions, authorised unit trusts and other financial services products.

Other operating income from sales of units in managed funds is recognised daily based on the average volume of funds under management.

Other income includes commission on donations and other sundry income.

(e) **Operating expenses**

Operating expenses are recognised on an accruals basis as services are provided. Included within the employee benefits expense are employee share based payments. The accounting policy in relation to share based payments is set out in policy (f).

Staff costs

The Group accounts for components of employee costs on the following bases:

- **Short-term employee benefits**

Short-term employee benefits include salaries and social security costs and are recognised over the period in which the employees provide the services to which the payments relate.

Cash bonus awards are recognised to the extent that the Group has a present obligation to its employees that can be measured reliably and are recognised over the period that employees are required to provide services.

- **Other long-term employee benefits**

Other long-term employee benefits include deferred cash bonus awards. Deferred cash bonus awards are recognised at the present value of the obligation at the reporting date. These costs are recognised over the period that employees are required to provide services.

- **Retirement benefit obligations**

A defined contribution plan is a post-employment benefit plan into which the Group pays fixed contributions and has no legal or constructive obligation to pay further amounts. Contributions are recognised as staff expenses in profit or loss in the periods during which related employee services are fulfilled.

The Group operates defined contribution pension schemes for its Directors and employees. The assets of the schemes are held separately from those of the Group in independently administered funds.

Leases

If the lease agreement in which the Group is a lessee transfers the risks and rewards of the asset, the lease is recorded as a finance lease and the related asset is capitalised. At inception, the asset is recorded at the lower of the present value of the minimum lease payments or fair value and is depreciated over the estimated useful life. The lease obligations are recorded as borrowings.

If the lease does not transfer the risks and rewards of the asset, the lease is recorded as an operating lease.

Operating lease payments are charged to profit or loss on a straight line basis over the lease term unless a different systematic basis is more appropriate. Where an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor in compensation is charged to profit or loss in the period in which termination is made.

(f) **Share based payments**

The Group operates a number of equity settled share based payment schemes in respect of services received from certain of its employees.

The value of the employee services received in exchange for awards granted under these schemes is recognised as an employee expense with a corresponding increase in equity over the period that the employees become unconditionally entitled to the awards (the vesting period).

All awards granted under current schemes are conditional shares which have service conditions. The Long Term Incentive Plan awards also have non-market performance conditions. No awards have market performance conditions and no share options have been granted in the current or prior year.

The employee expense is determined by reference to the fair value of the number of shares that are expected to vest. The fair value of the shares granted is based on market prices at the date of award. The determination of fair values excludes the impact of service conditions and any nonmarket performance conditions, which are included in the assumptions used to estimate the number of shares that are expected to vest. At each balance sheet date, this estimate is reassessed and if necessary revised. Any revision of the original estimate is recognised in the income statement, together with a corresponding adjustment to equity.

(g) **Impairment losses**

The Group assesses its financial assets or groups of financial assets for objective evidence of impairment at each balance sheet date. An impairment loss is recognised if a loss event (or events) has occurred after initial recognition, and on or before the balance sheet date, that has an impact on the estimated future cash flows of the financial assets or groups of financial assets that can be reliably measured. Losses incurred as a result of events occurring after the balance sheet date are not recognised in these financial statements.

- **Loans and receivables at amortised cost**

The Group assesses whether objective evidence of impairment exists individually for financial assets that are individually significant. Financial assets that are not individually significant are assessed on a collective basis, except for such assets where there are specific circumstances indicating evidence of impairment (for example loans that have entered possession or where fraud has been committed).

Objective evidence that a financial asset is impaired includes observable data that comes to the attention of the Group about the following loss events:

- there is evidence of the customer or issuer experiencing financial difficulty;
- there is a breach of contract, such as a default or delinquency in repayments;
- the customer is granted a concession that would otherwise not be considered;
- the borrower will enter bankruptcy or other financial reorganisation;
- the disappearance of an active market for that financial asset because of financial difficulties; and

- observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the portfolio, including:
  - there are adverse changes in the payment status of borrowers in the portfolio; and
  - economic conditions that correlate with defaults on the assets in the portfolio.

If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. In assessing collective impairment for retail assets the Group uses statistical modelling of historic trends to assess the probability of a group of financial assets going into default and the subsequent loss incurred. Regular model monitoring is performed to ensure model assumptions remain appropriate.

Assets that are individually assessed and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss on loans and receivables has been incurred, the amount of the loss is measured as the difference between the asset carrying amount and the present value of the estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an impairment allowance and the amount of the loss is recognised in profit or loss.

When a loan or receivable is uncollectible, it is written off against the related allowance for loan impairment. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off are recognised directly in the income statement. If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the customer's credit rating), the previously recognised impairment loss is reversed by adjusting the impairment allowance. The amount of the reversal is recognised in profit or loss.

An allowance is also made in the case of accounts which may not currently be in arrears, where losses may have been incurred but not yet recognised. An increased allowance is held for accounts where an impairment trigger event has occurred which includes accounts benefitting from forbearance and those in arrears. Refer to the Risk Management Report for details of the forbearance policy.

Available-for-sale financial assets

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset is impaired. The loss is measured as the difference between the asset's acquisition cost less principal repayments and amortisation and the current fair value. The impairment loss is recognised in profit or loss. This includes cumulative gains and losses previously recognised in other comprehensive income which are recycled from other comprehensive income to the income statement.

If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through profit or loss. Impairment losses recognised in profit or loss on equity instruments are not reversed through profit and loss.

(h) **Taxation**

Taxation comprises current tax and deferred tax. Current tax and deferred tax are recognised in profit or loss except to the extent that they relate to items recognised directly in equity or other comprehensive income. Current tax is based on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years. The Group has adopted the Code of Practice on Taxation for Banks issued by HM Revenue & Customs.

Deferred tax is recognised in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

Deferred tax assets are recognised for unused tax losses, tax credits and deductible temporary differences, to the extent that it is probable that future taxable profits will be available against which they can be utilised.

Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

(i) **Earnings per share**

Basic earnings per share is calculated by dividing the profit attributable to ordinary shareholders of the parent company by the weighted-average number of ordinary shares outstanding during the period excluding own shares held in employee benefit trusts or held for trading.

The diluted earnings per share is calculated by adjusting profit or loss that is attributable to ordinary shareholders and the weighted-average number of ordinary shares outstanding for the effects of all dilutive potential ordinary shares, which comprise share options and awards granted to employees.

For the calculation of diluted earnings per share the weighted average number of ordinary shares in issue is adjusted to assume conversion of all dilutive potential ordinary shares, if any, that arise in respect of share options and rewards granted to employees. The number of shares that could have been acquired at the average annual share price of the Company's shares based on the monetary value of the subscription rights attached to outstanding share options and awards is determined. This is deducted from the number of shares issuable under such options and awards to leave a residual bonus amount of shares which are added to the weighted average number of ordinary shares in issue, but no adjustment is made to the profit attributable to equity shareholders.

(j) **Financial instruments**

Financial assets

Management determines the classification of its financial instruments at initial recognition.

In line with IAS 39 'Financial Instruments: Recognition and Measurement', financial assets can be classified in the following categories:

- loans and receivables;
- available-for-sale;
- held to maturity; or
- financial assets at fair value through profit or loss.

Purchases and sales of financial assets at fair value through profit or loss, held to maturity and available-for-sale are recognised on the trade date, the date on which the Group commits to purchase or sell the asset.

- **Loans and receivables at amortised cost**

The Group's loans and advances to banks and customers, and asset backed securities for which there is no active market, are classified as loans and receivables. Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, whose recoverability is based solely on the credit risk of the customer and where the Group has no intention of trading the loan or receivable. Loans and receivables are initially recognised at fair value including direct and incremental transaction costs. Subsequent recognition is at amortised cost using the effective interest rate method, less any provision for impairment.

- **Available-for-sale financial assets**

Available-for-sale financial assets are non-derivative assets that are either designated as available-for-sale or are assets that do not meet the definition of loans and receivables and are not derivatives or assets held at fair value through profit or loss. These are principally, but not exclusively, investment securities intended to be held for an indefinite period of time which may be sold in response to a need for liquidity or changes in interest rates, exchange rates or equity prices. They are initially measured at fair value including direct and incremental transaction costs. Fair values are obtained from quoted market prices in active markets and, where these are not available, from valuation techniques including discounted cash flow models (refer policy (m)). With the exception of certain unquoted equity instruments measured at cost less impairment because their fair value cannot be measured reliably, subsequent measurement is at fair value, with changes in fair value being recognised in other comprehensive income except for impairment losses and translation differences, which are recognised in profit or loss. Upon derecognition of the asset, or where there is objective evidence that the investment security is impaired, the cumulative gains and losses recognised in other comprehensive income are removed from other comprehensive income and recycled to profit or loss.

- **Held to maturity financial assets**

Held to maturity financial assets are non-derivative financial assets with fixed or determinable payments that the Group has the ability and intention to hold to maturity. No financial assets were classified as held to maturity during either the current or prior year.

- **Financial assets at fair value through profit or loss**

This category consists of derivative financial assets. Assets in this category are carried at fair value. The fair values of derivative instruments are calculated by discounted cash flow models using yield curves that are based on observable market data or are based on valuations obtained from counterparties. Gains and losses arising from the changes in the fair values are recognised in the income statement or other comprehensive income (refer policy (n)).

Financial liabilities

The Group measures all of its financial liabilities at amortised cost, other than derivatives and those instruments which have been designated as part of a hedging relationship (refer policy (n)). Borrowings, including deposits and debt securities in issue are recognised initially at fair value, being the issue proceeds net of premiums, discounts and transaction costs incurred. All borrowings are subsequently measured at amortised cost using the effective interest rate method. Amortised cost is adjusted for the amortisation of any premiums, discounts and transaction costs. The amortisation is recognised in interest expense and similar charges using the effective interest rate method. The Group does not hold any financial liabilities classified as held for trading.

Offsetting financial instruments

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

Sale and repurchase agreements

Securities sold subject to repurchase agreements (repos) are reclassified in the financial statements as assets pledged when the transferee has the right by contract or custom to sell or repledge the collateral. The counterparty liability is included in deposits from banks or customer deposits, as appropriate. Securities purchased under agreements to resell (reverse repos) are recorded as loans and advances to banks or customers as appropriate. The difference between sale and repurchase price is treated as interest and accrued over the life of the agreements using the effective interest rate method. Securities lent to counterparties are also retained in the financial statements.

Derecognition of financial assets and liabilities

Derecognition is the point at which the Group ceases to recognise an asset or liability on its balance sheet. The Group's policy is to derecognise financial assets only when the contractual right to the cash flows from the financial asset expires or when the Group transfers the financial assets to another party provided the transfer of the asset also transfers the right to receive the cash flows of the financial asset or where the Group has transferred substantially all the risks and rewards of ownership. Where the transfer does not result in the Group transferring the right to receive the cash flows of the financial assets, but it does result in the Group assuming a corresponding obligation to pay the cash flows to another recipient, the financial assets are also accordingly derecognised. The Group derecognises financial liabilities only when the obligation specified in the contract is discharged, converted to shares, cancelled or has expired or is transferred to a third party. There were no transactions in the year where the Group transferred financial assets that should have been derecognised in their entirety.

(k) **Loans and advances to banks**

The Group's loans and advances to banks are classified as loans and receivables.

(l) **Loans and advances to customers**

The Group's loans and advances to customers are classified as loans and receivables.

(m) **Available-for-sale financial assets**

The Group's debt securities and equity instruments are classified as available-for-sale assets. Equity instruments are classified as available-for-sale because they do not meet the definition of loans and receivables, have no defined maturity dates and are not derivatives or assets held at fair value through profit or loss.

(n) **Derivative financial instruments and hedge accounting**

The Group is authorised to undertake the following types of derivative financial instrument transactions for non-trading purposes: cross currency swaps, interest rate swaps, equity swaps, interest rate caps, forward rate agreements, options, foreign exchange contracts and similar instruments.

The Group's derivative activities are entered into for the purpose of matching or eliminating risk from potential movements in interest rates, foreign exchange rates and equity exposures inherent in the Group's assets, liabilities and positions. All derivative transactions are for economic hedging purposes and it is decided at the outset which position the derivative will be hedging. Derivatives are reviewed regularly for their effectiveness as hedges and corrective action taken, if appropriate. Derivatives are measured initially and subsequently at fair value. Fair values are calculated by discounted cash flow models using yield curves that are based on observable market data or are based on valuations obtained from counterparties. Where derivatives are not designated as part of an accounting hedge relationship, changes in fair value are recorded in the income statement. Where derivatives are designated within accounting hedge relationships, the treatment of the changes in fair value depends on the nature of the hedging relationship as explained below.

Hedge accounting is used for derivatives designated in this way provided certain criteria are met. The Group documents at the inception of the accounting hedge relationship the link between the hedging instrument and the hedged item as well as its risk management objective and strategy for undertaking various hedge transactions. The Group also documents its assessment both at inception and on an ongoing basis of whether the derivatives used in hedging transactions are highly effective in offsetting changes in the fair values or cash flows of hedged items. The Group designates certain derivatives as either:

- **Cash flow hedges**

A cash flow hedge is used to hedge exposures to variability in cash flows, such as variable rate financial assets and liabilities. The effective portion of changes in the derivative fair value is recognised in other comprehensive income, and recycled to the income statement in the periods when the hedged item will affect profit and loss. Interest rate derivatives designated as cash flow hedges primarily hedge the exposure to cash flow vulnerability from forecast loans and advances to customers. The fair value gain or loss relating to the ineffective portion is recognised immediately in profit or loss.

- **Fair value hedges**

A fair value hedge is used to hedge exposures to variability in the fair value of financial assets and liabilities, such as fixed rate loans. Changes in 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. If the hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of the hedged item is amortised to the income statement over the period to maturity.

The most frequently used fair value hedges are:

- hedging the interest rate risk of a portfolio of prepayable fixed rate assets with interest rate derivatives. This solution is used to establish a macro fair value hedge for derivatives hedging fixed rate mortgages;
- hedging the interest rate risk of a portfolio of non-prepayable fixed rate liabilities with interest rate derivatives. This solution is used to establish a macro fair value hedge for derivatives hedging fixed rate savings;
- hedging the interest rate risk of non-prepayable fixed rate assets with interest rate derivatives. This solution is used to establish micro fair value hedges for fixed rate investments; and

- hedging the interest rate and foreign currency exchange risk of non-prepayable, foreign currency denominated fixed rate assets or liabilities on a one-for-one basis with fixed/floating or floating/fixed cross currency interest rate swaps. This solution is used to establish micro fair value hedges for foreign currency denominated fixed rate investments.

(o) **Securitisation transactions**

Certain Group companies have issued debt securities in order to finance specific loans and advances to customers. Both the debt securities in issue and the loans and advances to customers remain on the Group balance sheet within the appropriate balance sheet headings unless:

- a fully proportional share of all or of specifically identified cash flows have been transferred to the holders of the debt securities, in which case that proportion of the assets are derecognised;
- substantially all the risks and rewards associated with the assets have been transferred, in which case the assets are fully derecognised; and
- a significant proportion of the risks and rewards have been transferred, in which case the assets are recognised only to the extent of the Group's continuing involvement.

The Group has also entered into self-issuance of securitised debt which may be used as collateral for repurchase or similar transactions. Investments in self-issued debt and the equivalent deemed loan, together with the related income, expense and cash flows, are not recognised in the financial statements.

- **Debt securities in issue**

Issued securities are classified as financial liabilities where the contractual arrangements result in the Group having an obligation to deliver either cash or another financial asset to the security holder, or to exchange financial instruments under conditions that are potentially unfavourable to the Group. Issued securities are classified as equity where they meet the definition of equity and confer a residual interest in the Group's assets on the holder of the securities.

Financial liabilities are carried at amortised cost using the effective interest rate method. Equity instruments are initially recognised at net proceeds, after deducting transaction costs and any related income tax. Appropriations to holders of equity securities are deducted from equity, net of any related income tax, as they become irrevocably due to the holders of the securities.

Securitisation is a means used by the Group to fund an element of its mortgage portfolio. These securitised advances are subject to non-recourse finance arrangements. These advances have been transferred at their principal value to Special Purpose Vehicles (SPV) and have been funded through the issue of amortising mortgage backed securities to investors.

In accordance with note 1.5, the Group has assessed that it controls the SPVs and therefore consolidates the assets and liabilities of the SPVs, on a line by line basis.

(p) **Funding for Lending Scheme**

The Group participates in the Bank of England's Funding for Lending Scheme (FLS). The scheme allows the Group to receive Treasury bills in return for eligible collateral, including approved portfolios of loans and advances to customers.

Receipt of Treasury bills under the FLS does not involve the substantial transfer of the risks and rewards on the collateral, or the right to receive its related cash flows, hence the derecognition criteria outlined in policy (j) are not satisfied. Therefore the collateral assets will continue to be recognised in the financial statements and the Treasury bills are not separately recognised.

In the event that Treasury bills are utilised for repo transactions, the related collateral assets are categorised as pledged assets and the associated liability to the counterparty is recognised in the financial statements.

(q) **Intangible assets and amortisation**

Intangible assets purchased separately from a business combination are capitalised at their cost and amortised from the date from which they become available for use over their useful economic life which is generally 3 to 10 years. Intangible assets acquired as part of an acquisition are capitalised at their fair value where this can be measured reliably in accordance with IFRS 13 'Fair Value Measurement'.

Expenditure incurred in relation to scoping, planning and researching the build of an asset as part of a project is expensed as incurred.

Development expenditure incurred on a project is capitalised only if the following criteria are met:

- an asset is created that can be identified;
- it is probable that the asset created will generate future economic benefits; and
- the development cost of the asset can be measured reliably.

Following the initial recognition of development expenditure, the cost is amortised over the estimated useful lives of the assets created. Amortisation commences on the date that the asset is brought into use.

Internally generated intangible assets relate to computer software and core banking platforms.

- **Computer software**

Costs incurred in acquiring and developing computer software for internal use are capitalised as intangible assets where the software leads to the creation of an identifiable nonmonetary asset and it is probable that the expected future economic benefits that are attributable to the asset will flow to the Group from its use for a period of over one year. The software is classified as an intangible asset where it is not an integral part of the related hardware and amortised over its estimated useful life on a straight line basis which is generally 3 to 10 years.

Costs associated with maintaining software are expensed as they are incurred.

- **Banking platforms**

Banking platforms primarily represent the construction of operating platforms, which are internally generated. Banking platforms are amortised on a straight line basis over 3 to 10 years.

- **Impairment of intangible assets**

Intangible assets are assessed for indications of impairment at each balance sheet date, or more frequently where required by events or changes in circumstances. If indications of impairment are found, these assets are subject to an impairment review. The impairment review compares the carrying value of the assets with their recoverable amounts, which are defined as the higher of the fair value less costs to sell and their value in use. Fair value less costs to sell is the amount at which the asset could be sold in a binding agreement in an arm's length transaction. Value in use is calculated as the discounted cash flows generated as a result of the asset's continued use including those generated by its ultimate disposal, discounted at a market rate of interest on a pre-tax basis.

Where impairments are indicated, the carrying values of intangible assets are written down by the amount of the impairment and the charge is recognised in the income statement in the period in which it occurs. A previously recognised impairment charge on an asset may be reversed in full or in part through the income statement where a change in circumstances leads to a change in the estimates used to determine its recoverable amount. The carrying value will only be increased to the value at which it would have been held had the impairment not been recognised.

(r) **Tangible fixed assets and depreciation**

Tangible fixed assets are stated at cost less accumulated depreciation and provision for impairment, as appropriate. Cost includes the original purchase price of the asset and the costs attributable to bringing the asset to its working condition for its intended use. Additions and subsequent expenditure are included in the asset's carrying value or are recognised as a separate asset only when they improve the expected future economic benefits to be derived from the asset. All other repairs and maintenance are charged to the income statement in the period in which they are incurred.

Depreciation is provided using the straight line method to allocate costs less residual values over estimated useful lives, as follows:

Freehold property	50–100 years
Leasehold property	Unexpired period of the lease
Plant and leasehold improvements	5–30 years
Computer equipment 3–5	years
Office equipment 3–10	years
Motor vehicles	4 years

The residual values and useful lives of assets are reviewed, and adjusted if appropriate, at each balance sheet date. Where the cost of freehold land can be identified separately from buildings, the land is not depreciated.

- **Impairment of tangible fixed assets**

Tangible fixed assets are assessed for indications of impairment at each balance sheet date, or more frequently where required by events or changes in circumstances. If indications of impairment are found, these assets are subject to an impairment review. The impairment review compares the carrying value of the assets with their recoverable amount, which are defined as the higher of the fair value less costs to sell and their value in use. Fair value less costs to sell is the amount at which the asset could be sold in a binding agreement in an arm's length transaction. Value in use is calculated as the discounted cash flows generated as a result of the asset's continued use including those generated by its ultimate disposal, discounted at a market rate of interest on a pre-tax basis.

Where impairments are indicated, the carrying values of fixed assets are written down by the amount of the impairment and the charge is recognised in the income statement in the period in which it occurs. A previously recognised impairment charge on an asset may be reversed in full or in part through the income statement where a change in circumstances leads to a change in the estimates used to determine its recoverable amount. The carrying value will only be increased to the value at which it would have been held had the impairment not been recognised.

(s) **Other assets**

Other assets include prepayments and other amounts the Group is due to receive from third parties in the normal course of business.

(t) **Deposits from banks**

Deposits from banks are initially measured at fair value, which is normally the proceeds received net of any directly attributable transaction costs incurred. Subsequent measurement is at amortised cost, using the effective interest rate method.

(u) **Customer deposits**

Customer deposits are initially measured at fair value, which is normally the proceeds received. Subsequent measurement is at amortised cost, using the effective interest rate method.

(v) **Provisions**

Provisions are recognised for present obligations arising from past events where it is more likely than not that an outflow of resources will be required to settle the obligations and they can be estimated reliably. Provisions for levies are recognised when the conditions that trigger the payment of the levy are met.

(w) **Other liabilities**

Deferred income represents amounts received in advance of the Group providing services, and will be recognised as income in profit or loss when the services have been provided.

Trade creditors and accruals represent amounts the Group is due to pay to third parties in the normal course of business. These include expense accruals, which have been incurred, but not yet billed. Accrued expenses are amounts that the Group is due to pay to third parties in the normal course of business.

(x) **Share capital and share premium**

- **Share capital**

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:

- 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
- 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.

- **Share issue costs**

Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction, net of tax, from the proceeds.

- **Dividends**

Dividends are recognised in equity in the period in which they are approved by the Company's shareholders or paid.

- **Share premium**

Share premium substantially represents the aggregate of all amounts that have ever been paid above par value to the Company when it has issued Ordinary and Deferred Shares. Certain expenses in relation to the issue of share capital can be offset against the share premium account. These expenses must be the incremental expenses arising on issue of the shares.

(y) **Other equity instruments**

Issued financial instruments are recognised as equity where there is no contractual obligation to deliver either cash or another financial asset. The proceeds are included in equity, net of transaction costs. Distributions and other returns to equity holders are treated as a deduction from equity.

(z) **Other reserves**

- Revaluation reserve in respect of available-for-sale financial assets

The revaluation reserve in respect of available-for-sale financial assets represents the unrealised change in the fair value of available-for-sale investments since initial recognition.

- **Cash flow hedge reserve**

For derivatives designated in a cash flow hedge, the effective portion of changes in fair value is recognised in the cash flow hedge reserve and recycled to profit or loss in the periods when the hedged item will affect profit or loss.

(aa) **Contingent liabilities**

Contingent liabilities are possible obligations whose existence depends upon the outcome of uncertain future events or are present obligations where the outflows of resources are uncertain or cannot be reliably measured. Contingent liabilities are not recognised in the financial statements but are disclosed unless they are remote.

(ab) **Fair value of financial assets and liabilities**

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 in the principal, or in its absence, the most advantageous market to which the Group has access at that date. The fair value of a liability reflects its non-performance risk (the risk the Group will not fulfil an obligation), including the Groups own credit risk.

For the majority of instruments, fair value is determined with reference to quoted prices in an active market. A market is regarded as active if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

Where quoted prices are not available, fair value is based upon cash flow models, which use wherever possible independently sourced observable market parameters such as interest rate yield curves, currency rates and option volatilities. The chosen valuation technique incorporates all the factors that market participants would take into account in pricing a transaction and is discounted at a risk free rate.

Refer to note 32 for a description of different levels within the fair value hierarchy. Levels are reviewed at each balance sheet date and this determines whether transfers between levels are required.

The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price—i.e. the fair value of consideration given or received. The Group does not apply a credit valuation adjustment (CVA) or debit valuation adjustment (DVA) to reflect the credit risk of its derivative exposures as the Group's portfolio is fully collateralised.

If an asset or a liability measured at fair value has a bid price and an ask price, the Group measures assets at bid price and liabilities at ask price.

1.10 Critical estimates and judgements

The preparation of financial statements in conformity with IFRS requires Management to make estimates and judgements in the application of accounting policies that affect the reported amounts of assets, liabilities, income and expense. Estimates and judgements are based on historical experience and Management's best knowledge of the amount. Due to the inherent uncertainty in making estimates and judgements, actual results in future periods may be based on amounts which differ from those estimates.

(a) Critical assumptions and sources of estimation uncertainty

The following areas are the critical assumptions concerning the future and the key sources of estimation uncertainty in the reporting period. These areas may have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year:

- **Effective interest rates**

For financial instruments recorded at amortised cost, IAS 39 requires interest to be measured under the effective interest rate (EIR) method. For the Group this includes interest income earned on mortgages and credit cards, as well as interest expense paid on wholesale liabilities. The EIR rate is determined at inception based upon Management's best estimate of the future cash flows of the financial instrument.

In the event that these estimates are revised at a later date, a present value adjustment may be recognised in profit and loss. This adjustment includes an element that adjusts income previously recognised, as well as an element that adjusts for future interest not yet recognised. Such adjustments can introduce significant volatility. As such the EIR method introduces a source of estimation uncertainty. Management consider the most material risk of adjustment to be in relation to the application of EIR to the Group's credit card portfolio.

The Group offers a range of credit card products. Interest income is recorded under the EIR method, which provides a level yield over the life of the card. Management model expected future cash flows over the estimated customer life, restricted to a maximum of seven years, which is supported by observed experience. Income recognition can differ significantly from actual cash receipts over that period. Similarly, the selection of expected life for modelling purposes also has a material bearing on the EIR rate used for each cohort. A shorter modelling period results in a lower rate for income recognition. If the modelled period had been restricted to five years at origination, the profit for the year would have been reduced by approximately £25.2 million in 2017 and £15.8 million in 2016.

As at 31 December 2017 the EIR method gave rise to an adjustment of £159.8 million (2016: £81.8 million) to the balance sheet value of unsecured loans. This adjustment represented 5.3% (2016: 3.3%) of the balance sheet carrying value of unsecured loans. The movement in the year of £78.0 million was recognised as interest income.

In the calculation of EIR, Management uses estimates and assumptions of future customer behaviour. These include the estimation of utilisation of available credit, transaction and repayment activity and the retention of the customer balance after the end of a promotional period. Should Management's current estimation of future cash flows be inaccurate to the extent that the original effective interest rates on unsecured lending cohorts were all reduced by 0.1%, the present value adjustment to interest income, in relation to the revised future cash flows, would be approximately £(10.2) million as at 31 December 2017.

A significant proportion of the Group's credit card portfolio includes customers within promotional periods. The level of repayment immediately post promotional period is a key sensitivity within the EIR assumptions. There is evidence to support the expected behaviour of customers after the end of promotional periods, however there is inherent risk that this data may not be indicative of actual future behaviour. If the proportion of customers who repay their balance post-promotion differs to Management's estimate it can have a material impact on the revised future cash flows.

To illustrate this, Management have undertaken a sensitivity on post-promotion payment rates for all cohorts which are still within their promotional periods at the end of 2017. For these cohorts, should the payment rate be 10% higher than forecast for the six months following end of promotion, Management estimate this would result in a negative present value adjustment to interest income of approximately £(30.8) million as at 31 December 2017. In such an adjustment, £(11.5) million would relate to write-off of income previously recognised, and £(19.3) million would adjust for future interest not yet recognised.

Impairment of loans and receivables

Management must make a best estimate of losses incurred at the balance sheet date when determining the appropriate allowance for impairment of loans and receivables. Judgement is required when individually assessing loans for impairment and significant estimation is required when using statistical models for collective assessment. The key assumptions used within the statistical models are based on behavioural and arrears status. These variables include measurement of probability of default, probability that default results in charge-off or possession, and any subsequent loss incurred in that event. In relation to measuring incurred loss the estimation of the period over which incurred losses emerge is also an area of estimation uncertainty.

Management consider that the measurement of allowance for impairment for a retail bank is a critical estimate. Whilst the estimates used to determine the appropriate balance sheet allowance are not currently considered to be a source of material uncertainty, it is acknowledged that the Group has observed historically low levels of customer arrears and default. Material change in future customer behaviours and unanticipated changes in the economic environment could result in higher losses being incurred in future periods.

The most significant estimation within the measurement of the secured impairment allowance is considered to be the estimation of house prices. To the extent that house prices differed adversely or positively by 10%, the impairment allowance would be an estimated £1.7 million higher (2016: £1.3 million) or £3.2 million lower (2016: £2.6 million) at 31 December 2017.

In relation to the measurement of the unsecured impairment allowance, the estimation of the period over which incurred losses emerge is considered to be the most significant estimation. To the extent that the emergence period of six months differs by +/–3 months, the impairment allowance would be an estimated £7.1 million higher (2016: £5.9 million) or £7.1 million lower (2016: £5.9 million) respectively.

Fair value of financial assets and liabilities

Management must use estimation when calculating the fair value of financial instruments categorised as level 2 and level 3 (as defined by IFRS 13). In these instances the necessary valuation inputs are not observable and/or specific factors may need to be considered. Details of the Group's level 2 and level 3 financial instruments are included in note 32.

The most significant area of estimation uncertainty relates to the Group's level 2 derivative financial instruments, where valuations are not derived from quoted prices. The accuracy of fair value calculations would be affected by unexpected market movements and any inaccuracies within the discounted cash flow models used, particularly use of incorrect interest yield curves. For example, to the extent the interest yield curve differed by +/− 10 bps, the net impact on fair values of derivative financial instruments would be an estimated increase of £41.5 million (2016: £33.1 million) or decrease of £41.7 million (2016: £33.3 million) respectively.

(b) **Critical judgements in applying accounting policies**

The following are the critical judgements that have been made in the process of applying the Group's accounting policies that have the most significant effect on the amount recognised in the financial statements:

Capitalisation of intangibles and assessment for impairment

Significant judgement is required when assessing whether the conditions of IAS 38 have been met to allow the capitalisation of project development costs as an intangible asset. During the reporting period the Group has incurred significant costs in relation to the development of the Group's digital banking programme. Following a detailed review of the programme and the nature of the costs incurred, Management have determined that the amount of £38.3 million meets the recognition criteria for capitalisation as an intangible asset.

Separately, Management judgement is required in assessing whether capitalised intangible assets or assets not yet in use exhibit any indicators of impairment at the reporting date. If there are indicators of impairment, an estimate of the recoverable amount is made which may indicate the need for an impairment charge to be recognised. Management have assessed and reviewed intangible assets for the existence of impairment indicators. This exercise identified previous software development, with a carrying value of £4.8 million, which was discontinued in the year in light of a strategic decision to consolidate activities within the digital banking programme. An impairment charge of £4.8 million was recognised in the financial statements (2016: £nil).

NOTE 2: SEGMENTAL ANALYSIS AND RECONCILIATION TO UNDERLYING BASIS

The Group falls within the scope of IFRS 8 'Operating Segments'. The Group's chief operating decision maker (which has been determined to be the Executive Committee) assesses performance and makes decisions based on the performance of the Group as a whole. The Group has therefore determined that it has one reportable operating segment and is therefore not required to produce additional segmental disclosure.

The Group operates in a single geographic segment, being the UK. The Group is not reliant on a single customer.

Reconciliation of statutory results to underlying basis

The underlying basis is the basis on which financial information is presented to the chief operating decision maker which excludes certain items included in the statutory results, of which further information is provided on page 48. The table below reconciles the statutory results to the underlying basis.

		Adjusted for			
	Statutory results	IPO Share based awards	Strategic items	Fair value losses on financial instruments	Underlying basis
	£ million	£ million	£ million	£ million	£ million
Year ended 31st December 2017					
Net interest income	**594.6**	—	—	—	**594.6**
Other income	**68.1**	—	—	**3.3**	**71.4**
Total income	**662.7**	—	—	**3.3**	**666.0**
Total operating expenses	**(355.9)**	**0.9**	**6.5**	—	**(348.5)**
Profit before tax from operating activities	**306.8**	**0.9**	**6.5**	**3.3**	**317.5**
Impairment	**(44.2)**	—	—	—	**(44.2)**
Profit before tax	**262.6**	**0.9**	**6.5**	**3.3**	**273.3**

		Adjusted for				
	Statutory results	IPO Share based awards	Strategic items	Simplification costs	Fair value losses on financial instruments	Underlying basis
	£ million	£ million	£ million	£ million	£ million	£ million
Year ended 31st December 2016						
Net interest income	522.4	—	(3.4)	—	—	519.0
Other income	59.0	—	—	—	8.9	67.9
Total income	581.4	—	(3.4)	—	8.9	586.9
Total operating expenses	(349.4)	2.0	5.8	5.6	—	(336.0)
Profit before tax from operating activities	232.0	2.0	2.4	5.6	8.9	250.9
Impairment	(37.6)	—	—	—	—	(37.6)
Profit before tax	**194.4**	**2.0**	**2.4**	**5.6**	**8.9**	**213.3**

NOTE 3: NET INTEREST INCOME

	2017	2016
	£ million	£ million
Interest and similar income:		
Loans and advances to customers	**945.2**	933.1
Loans and advances to banks	**0.9**	2.3
Interest receivable on loans and receivables	**946.1**	935.4
Available-for-sale financial assets	**5.6**	8.9
Cash and balances at central banks	**6.3**	3.8
Total interest and similar income	**958.0**	948.1
Interest and similar expense:		
Deposits from banks	**(16.5)**	(7.6)
Customer deposits	**(310.8)**	(370.7)
Debt securities in issue	**(31.0)**	(40.6)
Other	**(5.1)**	(6.8)
Total interest and similar expense	**(363.4)**	(425.7)
Net interest income	**594.6**	522.4

Interest accrued on impaired assets was £7.1 million (2016: £5.8 million).

NOTE 4: NET FEE AND COMMISSION INCOME

	2017	2016
	£ million	£ million
Fee and commission income:		
On loans and advances to customers	**21.3**	19.5
Other fee and commission income	**8.3**	9.3
Total fee and commission income	**29.6**	28.8
Fee and commission expense:		
Other fee and commission expense	—	(1.2)
Net fee and commission income	**29.6**	27.6

NOTE 5: OTHER OPERATING INCOME

	2017	2016
	£ million	£ million
Investment and pension income	**32.0**	31.7
Gains on sale of available-for-sale financial assets	**8.4**	6.8
Other	**1.4**	1.8
Total other operating income	**41.8**	40.3

NOTE 6: OPERATING EXPENSES

	2017 £ million	2016 £ million
Staff costs:		
Wages and salaries	**161.9**	160.7
Social security costs	**15.5**	14.6
Other pension costs	**10.9**	10.7
Employee share schemes	**9.9**	12.8
	198.2	198.8
Premises and equipment:		
Hire of equipment	**4.6**	4.6
Rent and rates	**14.4**	14.3
Other property costs	**11.0**	9.6
	30.0	28.5
Other expenses:		
Marketing costs	**21.8**	21.0
Telecommunications and IT	**18.5**	17.4
Professional fees	**23.1**	20.0
Other	**29.1**	42.7
	92.5	101.1
Depreciation, amortisation and impairment:		
Depreciation of tangible fixed assets	**8.7**	5.6
Amortisation of intangible assets	**21.7**	15.4
Impairment of intangible assets	**4.8**	—
	35.2	21.0
Total operating expenses	**355.9**	349.4

Average headcount

The monthly average number of persons (including Directors) employed by the Group during the year was as follows:

	2017	2016
Full time	**2,413**	2,394
Part time	**811**	746
Total	**3,224**	3,140

Retirement benefit obligations

The Group operates defined contribution pension schemes for its Directors and employees. The assets of the schemes are held separately from those of the Group in independently administered funds.

The Group made contributions of £10.9 million (2016: £10.7 million) during the year. There were no contributions overdue at the year end (2016: £nil).

Fees payable to the auditors

During the year the Group obtained the following services from the Group's auditors as detailed below:

	2017	2016
	£ million	£ million
Fees payable for the audit of the Company's current year Annual Report and Accounts	**0.2**	0.2
Audit of the subsidiaries pursuant to legislation	**1.1**	0.7
Total audit fees	**1.3**	0.9
Audit-related assurance services	**0.2**	0.2
Total audit and audit-related fees	**1.5**	1.1
Other non-audit fees:		
Other services	**0.1**	0.1
Total other non-audit fees	**0.1**	0.1
Total fees payable to the auditors by the Group	**1.6**	1.2

All amounts are shown exclusive of VAT.

The following types of services are included in the categories listed above:

Audit and audit-related fees

This category includes fees in respect of the audit of the Group's Annual Report and Accounts and other services in connection with regulatory filings and services for assurance and related services that are reasonably related to the performance of the audit or review of the financial statements.

NOTE 7: SHARE BASED PAYMENTS

All share based payments charges relate to equity settled schemes. The scheme details are summarised below.

	Award plan	Eligible employees	Nature of award	Vesting conditions[1]	Issue dates[2]
(A)	Long-term incentive plan	Selected senior employees	Conditional share award	Continuing employment or leavers in certain circumstances and achievement of performance conditions	2015, 2016 & 2017
(B)	Deferred bonus share plan	Selected senior employees	Deferred bonus—conditional share	Continuing employment or leavers in certain circumstances	2014, 2015, 2016 & 2017
(C)	Phantom share award	Selected senior employees	Deferred bonus—conditional share award	Continuing employment or leavers in certain circumstances	2012 & 2013
(D)	IPO incentive scheme	Selected senior employees	Conditional share award	Continuing employment or leavers in certain circumstances	2013
(E)	Recruitment award	Two senior employees	Conditional share award	Continuing employment or leavers in certain circumstances	2013
(F)	IPO share award	All employees excluding the Group's Executive Committee	Conditional share award	Continuing employment or leavers in certain circumstances	2014

(1) All awards have vesting conditions and therefore some may not vest.

(2) Issue dates show the year in which issues have been made under the relevant scheme. There could be further issuances in future years under the scheme.

(A) Long-term incentive plan (LTIP)

The LTIP introduced in 2014 is aimed at delivering shareholder value by linking the receipt of shares to performance measures that are based on delivering the Group's strategic objectives over a 3 year period. Awards are made within limits set by the rules of the plan.

The performance period for the 2015 awards ended on 31 December 2017. Based on performance against the targets set, 65.3 per cent of the 2015 awards will vest.

During 2017, selected senior employees of the Group were granted up to a maximum of 1,382,905 Ordinary Shares under the LTIP scheme. Awards granted under the LTIP have performance and service conditions, with vesting dates prescribed for each participant.

The weighted-average fair value of awards granted during 2017 was £3.27 based on market prices at the date of grant.

(B) Deferred bonus share plan

The deferred bonus share plan is an equity settled scheme that is operated in conjunction with the short-term incentive plan for Executive Directors and other senior managers of the Group.

Share awards for the deferred element of 2017 bonuses will be granted under this scheme in 2018.

During 2017, selected senior employees of the Group were granted up to a maximum of 1,833,349 Ordinary Shares under the scheme. This number includes an award granted to senior employees who joined the Company in 2017 in recognition of outstanding awards over shares in their previous employing company that lapsed on accepting employment with the Group. Awards granted under the scheme have service conditions, with vesting dates prescribed for each participant.

The weighted-average fair value of awards granted during 2017 was £3.26 based on market prices at the date of grant.

(C)–(F) Phantom share award, IPO incentive scheme, Recruitment award and IPO share award

These schemes relate to awards issued in previous years. No awards were granted under these schemes in 2017 (2016: none).

Movement in share options and conditional shares

	Ordinary Shares				
	Interest in share options(1)	Long-term incentive plan	Deferred bonus share plan	Phantom share award	IPO share award
Shares in existence at 1 January 2017	**625,328**	**2,651,338**	**2,098,649**	**2,044,480**	**68,920**
Granted in year	—	**1,382,905**	**1,833,349**	—	—
Exercised or vested in year	—	**(47,021)**	**(1,105,235)**	**(1,480,940)**	**(66,304)**
Forfeited in year	—	**(153,464)**	**(124,782)**	**—**	**(2,616)**
Outstanding 31 December 2017	**625,328**	**3,833,758**	**2,701,981**	**563,540**	**—**
Of which exercisable	**625,328**	—	—	—	—

	Ordinary Shares						
	Interest in share options(1)	Long-term incentive plan	Deferred bonus share plan	Phantom share award	IPO incentive scheme	Recruitment award	IPO share award
Shares in existence at 1 January 2016	625,328	1,399,453	1,157,800	3,061,820	332,334	175,810	139,041
Granted in year	—	1,572,717	1,695,266	—	—	—	—
Exercised or vested in year	—	(98,349)	(754,417)	(950,550)	(305,676)	(175,810)	(68,885)
Forfeited in year	—	(222,483)	—	(66,790)	(26,658)	—	(1,236)
Outstanding 31 December 2016	625,328	2,651,338	2,098,649	2,044,480	—	—	68,920
Of which exercisable	625,328	—	—	—	—	—	—

(1) This scheme was set up for Sir David Clementi, who was Chairman for the period from October 2011 to May 2015. All share options granted under the scheme had vested prior to 1 January 2016. No share options have been exercised during 2017 or 2016. The weighted-average exercise price for options outstanding at 1 January 2017 and 31 December 2017 was £2.15. The options outstanding will expire 10 years from the date of listing if not exercised.

NOTE 8: ALLOWANCE FOR IMPAIRMENT LOSSES ON LOANS AND RECEIVABLES

	2017			2016		
	On secured loans	On unsecured loans	Total	On secured loans	On unsecured loans	Total
	£ million	£ million	£ million	£ million	£ million	£ million
At 1 January	**10.6**	**39.5**	**50.1**	8.7	31.2	39.9
Advances written off	**(0.7)**	**(34.2)**	**(34.9)**	(0.8)	(26.6)	(27.4)
Charge to the income statement	**2.2**	**42.0**	**44.2**	2.7	34.9	37.6
As at 31 December	**12.1**	**47.3**	**59.4**	10.6	39.5	50.1

Of the total allowance in respect of loans and advances to customers, £57.5 million (2016: £49.4 million) was assessed on a collective basis.

NOTE 9: TAXATION

(A) Analysis of the tax charge for the year

	2017	2016
	£ million	£ million
UK corporation tax		
Current tax on profit for the year	**(63.5)**	(40.3)
Adjustments in respect of prior years	**(0.6)**	0.4
Current tax charge	**(64.1)**	(39.9)
Deferred tax (refer note 21)		
Origination and reversal of temporary differences	**(6.9)**	(14.0)
Adjustments in respect of prior years	**0.9**	(0.2)
Reduction in UK corporation tax rate	**(0.4)**	(0.2)
Deferred tax charge to the income statement	**(6.4)**	(14.4)
Tax charge	**(70.5)**	(54.3)

Analysis of tax charge recognised in Other Comprehensive Income:

	2017	2016
	£ million	£ million
Current tax		
Cash flow hedge reserve	**2.4**	4.9
Deferred tax		
Revaluation reserve in respect of available-for-sale financial assets	**(0.1)**	(1.7)
Cash flow hedge reserve	**(5.0)**	1.4
Total (charge)/credit	**(2.7)**	4.6

(B) Factors affecting the tax charge for the year

A reconciliation of the charge that would result from applying the standard UK corporation tax rate to the profit before tax to the actual tax charge for the year is given below:

	2017	2016
	£ million	£ million
Profit before tax	**262.6**	194.4
Tax charge at standard tax rate of 19.25% (2016: 20%)	**(50.5)**	(38.9)
Factors affecting charge:		
Disallowed items	**(1.0)**	(1.8)
Bank corporation tax surcharge	**(18.9)**	(12.5)
UK corporation tax rate change	**(0.4)**	(0.2)
Deferred tax charge in respect of share schemes	**—**	(1.1)
Adjustments in respect of prior years	**0.3**	0.2
Total tax charge	**(70.5)**	(54.3)

The main rate of corporation tax reduced from 20% to 19% on 1 April 2017, and will reduce further to 17% on 1 April 2020 in accordance with the Finance Act 2016.

The charge in respect of the corporation tax surcharge for banks which was introduced from 1 January 2016 is £18.9 million in the year ended 31 December 2017. The surcharge imposes an 8% charge on the banking profits of the Group (less a £25 million allowance against those profits).

NOTE 10: EARNINGS PER SHARE

	2017 £ million	2016 £ million
Profit attributable to equity owners—basic and diluted	**192.1**	140.1
Distributions to Additional Tier 1 security holders (net of tax)	**(24.8)**	(10.1)
Profit attributable to equity shareholders for the purposes of basic and diluted EPS	**167.3**	130.0

	2017 Number of shares (million)	2016 Number of shares (million)
Weighted-average number of ordinary shares in issue—basic	**442.1**	442.8
Adjustment for share options and awards	**3.8**	4.7
Weighted-average number of ordinary shares in issue—diluted	**445.9**	447.5
Basic earnings per share (pence)	**37.8**	29.4
Diluted earnings per share (pence)	**37.5**	29.1

Basic earnings per share has been calculated after deducting 2.8 million (2016: 1.7 million) ordinary shares representing the weighted-average of the Group's holdings of own shares in respect of employee share schemes.

Of the total number of employee share options and share awards at 31 December 2017 none were anti-dilutive (2016: nil).

NOTE 11: DIVIDENDS

An interim dividend of 1.9 pence (2016: 1.6 pence) per Ordinary Share, amounting to £8.4 million (2016: £7.1 million), was paid in September 2017 and a final dividend in respect of the year ended 31 December 2016 of 3.5 pence (31 December 2015: 3.1 pence) per Ordinary Share amounting to £15.5 million (31 December 2015: £13.7 million), was paid in May 2017. These dividends were deducted from retained profits in the current year.

The Directors have recommended for approval at the 2018 AGM the payment of a final dividend in respect of the year ended 31 December 2017 of 4.1 pence per ordinary share, amounting to £18.1 million. If approved, this final dividend will be paid on 16 May 2018 to shareholders on the register at close of business on 6 April 2018. The financial statements for the year ended 31 December 2017 do not reflect this final dividend, which will be accounted for in shareholders' equity as an appropriation of retained profits in the year ending 31 December 2018.

Under the trust deed of the Employee Benefit Trust (EBT), a standing waiver is in force in respect of any dividends declared on shares held by the EBT.

NOTE 12: ANALYSIS OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES BY MEASUREMENT BASIS

	Held at amortised cost	Loans and receivables	Available-for-sale securities	Derivatives not designated as hedging instruments	Derivatives designated as hedging instruments		Total
					Fair value hedges	Cash flow hedges	
	£ million	£ million	£ million	£ million	£ million	£ million	£ million
As at 31 December 2017							
Financial assets							
Cash and balances at central banks	—	2,579.0	—	—	—	—	2,579.0
Derivative financial instruments	—	—	—	11.9	11.5	55.4	78.8
Loans and receivables:							
• Loans and advances to banks	—	359.4	—	—	—	—	359.4
• Loans and advances to customers	—	36,740.2	—	—	—	—	36,740.2
• Debt securities	—	0.3	—	—	—	—	0.3
Available-for-sale financial assets	—	—	1,051.8	—	—	—	1,051.8
Other assets	—	55.0	—	—	—	—	55.0
Total financial assets	—	39,733.9	1,051.8	11.9	11.5	55.4	40,864.5
Non financial assets							243.3
Total assets							41,107.8
Financial liabilities							
Deposits from banks	5,379.0	—	—	—	—	—	5,379.0
Customer deposits	30,808.4	—	—	—	—	—	30,808.4
Derivative financial instruments	—	—	—	10.7	82.5	0.3	93.5
Debt securities in issue	2,736.9	—	—	—	—	—	2,736.9
Other liabilities	215.1	—	—	—	—	—	215.1
Total financial liabilities	39,139.4	—	—	10.7	82.5	0.3	39,232.9
Non financial liabilities							50.0
Total liabilities							39,282.9
Equity							1,824.9
Total liabilities and equity							41,107.8

	Held at amortised cost	Loans and receivables	Available-for-sale securities	Derivatives not designated as hedging instruments	Derivatives designated as hedging instruments		Total
					Fair value hedges	Cash flow hedges	
	£ million	£ million	£ million	£ million	£ million	£ million	£ million
As at 31 December 2016							
Financial assets							
Cash and balances at central banks	—	786.3	—	—	—	—	786.3
Derivative financial instruments	—	—	—	18.5	21.0	64.7	104.2
Loans and receivables:							
• Loans and advances to banks	—	635.6	—	—	—	—	635.6
• Loans and advances to customers	—	32,367.1	—	—	—	—	32,367.1
• Debt securities	—	0.7	—	—	—	—	0.7
Available-for-sale financial assets	—	—	858.8	—	—	—	858.8
Other assets	—	68.8	—	—	—	—	68.8
Total financial assets	—	33,858.5	858.8	18.5	21.0	64.7	34,821.5
Non financial assets							234.1
Total assets							35,055.6
Financial liabilities							
Deposits from banks	2,132.5	—	—	—	—	—	2,132.5
Customer deposits	28,106.3	—	—	—	—	—	28,106.3
Derivative financial instruments	—	—	—	22.9	206.8	—	229.7
Debt securities in issue	2,600.0	—	—	—	—	—	2,600.0
Other liabilities	189.5	—	—	—	—	—	189.5
Total financial liabilities	33,028.3	—	—	22.9	206.8	—	33,258.0
Non financial liabilities							127.1
Total liabilities							33,385.1
Equity							1,670.5
Total liabilities and equity							35,055.6

NOTE 13: DERIVATIVE FINANCIAL INSTRUMENTS

The fair values and notional amounts of assets and liabilities recognised within Derivative financial instruments are set out in the following table.

	As at 31 December 2017			As at 31 December 2016		
	Contract/ notional amount	**Asset fair value**	**Liability fair value**	**Contract/ notional amount**	**Asset fair value**	**Liability fair value**
	£ million	**£ million**	**£ million**	**£ million**	**£ million**	**£ million**
Derivatives in accounting hedge relationships						
Derivatives designated as fair value hedges:						
Interest rate derivatives (gross)	**23,314.7**	**61.7**	**(91.0)**	21,584.8	34.7	(219.8)
Less: contracts centrally cleared	**(17,360.6)**	**(50.2)**	**8.5**	(8,194.1)	(13.7)	13.0
Interest rate derivatives (net)	**5,954.1**	**11.5**	**(82.5)**	13,390.7	21.0	(206.8)
Derivatives designated as cash flow hedges:						
Interest rate derivatives (gross)	**1,199.0**	**—**	**(2.9)**	1,287.0	3.5	(2.2)
Less: contracts centrally cleared	**(1,199.0)**	**—**	**2.9**	(1,287.0)	(3.5)	2.2
Interest rate derivatives (net)	**—**	**—**	**—**	—	—	—
Currency derivatives	**705.6**	**55.4**	**(0.3)**	520.3	64.7	—
Total derivative assets/(liabilities)— in accounting hedge relationships	**6,659.7**	**66.9**	**(82.8)**	13,911.0	85.7	(206.8)
Derivatives in economic hedging relationships but not in accounting hedge relationships						
Interest rate derivatives (gross)	**7,205.6**	**9.6**	**(10.4)**	7,549.6	15.7	(24.0)
Less: contracts centrally cleared	**(2,830.7)**	**(0.8)**	**2.8**	(3,665.1)	(2.5)	9.2
Interest rate derivatives (net)	**4,374.9**	**8.8**	**(7.6)**	3,884.5	13.2	(14.8)
Currency derivatives	**76.0**	**3.0**	**(3.1)**	56.0	3.4	(3.8)
Equity and other options	**25.7**	**0.1**	**—**	149.5	1.9	(4.3)
Total derivative assets/(liabilities)—in economic hedging relationship but not in accounting hedge relationships	**4,476.6**	**11.9**	**(10.7)**	4,090.0	18.5	(22.9)
Total recognised derivative assets/ (liabilities)	**11,136.3**	**78.8**	**(93.5)**	18,001.0	104.2	(229.7)

The notional amount of the contract does not represent the Group's real exposure to credit risk which is limited to the current cost of replacing contracts with a positive value to the Group should the counterparty default. To reduce credit risk the Group uses a variety of credit enhancement techniques such as netting and collateralisation, where security is provided against the exposure. Further details are provided in the Risk Management Report on page 155.

The fair values and notional amounts shown in the line 'Total recognised derivative assets/(liabilities)' above reflect amounts relating only to contracts that are not centrally cleared. Centrally cleared interest rate derivatives are set off in the balance sheet as they meet the offsetting criteria under IAS 32 (refer note 33).

Hedged cash flows

For designated cash flow hedges the following table shows when the Group's hedged cash flows are expected to occur and when they will impact income:

	2017	2016
	£ million	**£ million**
Within one year	**(7.2)**	(9.2)
In one to five years	**(15.5)**	(22.3)
Total	**(22.7)**	(31.5)

Fair value losses on financial instruments

	2017	2016
	£ million	**£ million**
Fair value gains/(losses) from derivatives designated as fair value hedges	**104.8**	(69.9)
Fair value (losses)/gains from underlying hedged risk	**(99.4)**	81.8
Fair value gain from fair value hedge accounting[(1)]	**5.4**	11.9
Fair value losses from cash flow hedges	**(12.6)**	(13.6)
Fair value gains/(losses) from other derivatives[(2)]	**3.9**	(7.2)
Fair value losses on financial instruments	**(3.3)**	(8.9)

(1) Gains or losses from fair value hedges can arise where there is an IAS 39 hedge accounting relationship in place and either:—the fair value of the derivative was not exactly offset by the change in fair value attributable to the hedged risk; or—the derivative was designated in or redesignated from the IAS 39 hedge accounting relationship and in the following months leads to amortisation of existing balance sheet positions.

(2) Other derivatives are those used for economic hedging but which are not in an IAS 39 hedge accounting relationship.

NOTE 14: LOANS AND ADVANCES TO BANKS

	2017	2016
	£ million	**£ million**
Balances within securitisation vehicles	**201.0**	354.3
Money market placements with banks	**13.8**	33.0
Cash collateral pledged to banks (refer note 17)	**93.0**	181.1
Other lending to banks	**51.6**	67.2
Total loans and advances to banks	**359.4**	635.6

NOTE 15: LOANS AND ADVANCES TO CUSTOMERS

	2017	2016
	£ million	**£ million**
Advances secured on residential property not subject to securitisation	**21,878.7**	19,375.2
Advances secured on residential property subject to securitisation	**5,438.5**	4,907.8
	27,317.2	24,283.0
Residential buy-to-let loans not subject to securitisation	**6,367.3**	5,468.4
Total loans and advances to customers secured on residential property	**33,684.5**	29,751.4
Unsecured receivables not subject to securitisation	**3,071.4**	2,486.6
Total loans and advances to customers before allowance for impairment losses	**36,755.9**	32,238.0
Allowance for impairment losses on loans and receivables (refer to note 8)	**(59.4)**	(50.1)
Total loans and advances to customers excluding portfolio hedging	**36,696.5**	32,187.9
Fair value of portfolio hedging	**43.7**	179.2
Total loans and advances to customers	**36,740.2**	32,367.1

The fair value of portfolio hedging represents an accounting adjustment which offsets the fair value movement on derivatives designated in IAS 39 hedge accounting relationships with the mortgage portfolio. Such relationships are established to protect the Group from interest rate risk on fixed rate products.

For collateral held in respect of the values included in the table above, refer to the Risk Management Report.

NOTE 16: AVAILABLE-FOR-SALE FINANCIAL ASSETS

	2017	2016
	£ million	£ million
At 1 January	**858.8**	1,296.9
Additions	**690.9**	670.0
Disposals (sales and redemptions)	**(483.2)**	(1,111.1)
Exchange differences	**1.2**	0.1
Changes due to amortisation and accrued interest	**(5.0)**	(11.6)
Net (losses)/gains on changes in fair value	**(10.9)**	14.5
At 31 December	**1,051.8**	858.8

Gains on sale of available-for-sale securities amounted to £8.4 million (2016: £6.8 million).

Analysis of the composition of debt securities categorised as available-for-sale financial assets is set out in the Risk Management Report on page 154. All assets have been individually assessed for impairment and following this assessment no write down of assets was required.

NOTE 17: COLLATERAL PLEDGED AND RECEIVED

The Group receives and accepts collateral in the form of cash and marketable securities in respect of derivatives, sale and repurchase and reverse sale and repurchase agreements, and secured loans.

Collateral in respect of derivatives is subject to the standard industry terms of ISDA Credit Support Annex. This means that securities received or given as collateral can be pledged or sold during the term of the transaction but must be returned on maturity of the transaction. The terms also give each counterparty the right to terminate the related transactions upon the counterparty's failure to post collateral.

At 31 December 2017 cash collateral of £101.5 million had been pledged by the Group, comprising £93.0 million recognised within loans and advances to banks and £8.5 million within other assets (2016: £235.0 million, comprising £181.1 million recognised within loans and advances to banks and £53.9 million within other assets) and £53.9 million (2016: £14.0 million) has been received as cash collateral by the Group, of which £13.0 million is recognised within deposits from banks (2016: £14.0 million) and £40.9 million within other liabilities (2016: £nil).

At 31 December 2017 available-for-sale financial assets of £nil (2016: £10.6 million) are pledged as collateral in respect of derivative transactions.

At 31 December 2017 loans and advances of £6,219.8 million (2016: £2,302.3 million) are pledged as collateral in respect of secured loans and sale and repurchase agreements under terms that are usual and customary for such activities.

NOTE 18: SECURITISATION

Securitisation programmes

Loans and advances to customers include loans securitised under the Group's Gosforth securitisation programmes, which have been sold by Virgin Money plc to bankruptcy remote SPVs. The transfers of the mortgage loans to the structured entities are not treated as sales by the Group. No gain or loss has been recognised on pledging the mortgages to the programmes.

The SPVs are principally engaged in providing long-term funding to the Group through the issue of amortising mortgage backed securities to investors on terms whereby the majority of the risks and rewards of the loans and advances are retained by Virgin Money plc. As a result, the SPVs are fully consolidated in these financial statements and all of the loans and advances are retained on the Group's balance sheet, with the related securities included within debt securities in issue.

	2017		2016	
	Loans and advances securitised	Securities in issue	Loans and advances securitised	Securities in issue
	£ million	£ million	£ million	£ million
Residential mortgage loans	**5,438.5**	**5,132.7**	4,907.8	4,616.7
Less: securities held by the Group	**—**	**(2,698.6)**	—	(2,322.5)
Total securitisation programmes	**5,438.5**	**2,434.1**	4,907.8	2,294.2

The full liabilities associated with the securitisation programme (excluding the proportion relating to securities retained) are recognised within debt securities in issue. However, the Group's obligations are limited to the cash flows generated from the underlying securitised assets.

At the reporting date the Group had over-collateralised the securitisation transactions, as set out in the table above, to meet the terms of the transaction and to provide operational flexibility. In addition, the Group held cash deposits and permitted investments of £350.4 million (2016: £354.3 million) supporting the securities issued. To satisfy transaction requirements the Group may provide additional support to the SPV in the form of increased cash reserves funded by further subordinated loans.

Transfers of financial assets

There were no transactions in the year involving the transfer of financial assets that were derecognised by the Group but with ongoing exposure (2016: none). There were also no transactions in the year where the Group transferred assets that should have been derecognised in their entirety (2016: none).

As noted above, loans and advances transferred to SPVs do not represent transfers of financial assets by the Group as all of the SPVs are consolidated in these financial statements.

NOTE 19: INTANGIBLE ASSETS

	Core deposit intangible	Software	Banking platforms	Total
	£ million	£ million	£ million	£ million
Cost:				
At 1 January 2016	4.8	85.1	21.5	111.4
Additions	—	31.6	—	31.6
Disposals	—	(2.1)	—	(2.1)
At 31 December 2016	4.8	114.6	21.5	140.9
Additions	—	**36.0**	**38.3**	**74.3**
Disposals	—	**(5.7)**	**—**	**(5.7)**
At 31 December 2017	**4.8**	**144.9**	**59.8**	**209.5**
Accumulated amortisation and impairment:				
At 1 January 2016	3.4	40.7	2.9	47.0
Charge for the year	1.4	10.4	3.6	15.4
Disposals	—	(2.1)	—	(2.1)
At 31 December 2016	4.8	49.0	6.5	60.3
Charge for the year	—	**18.1**	**3.6**	**21.7**
Disposals	—	**(5.7)**	—	**(5.7)**
Impairment	—	**4.8**	**—**	**4.8**
At 31 December 2017	**4.8**	**66.2**	**10.1**	**81.1**
Balance sheet amount at 31 December 2017	**—**	**78.7**	**49.7**	**128.4**
Balance sheet amount at 31 December 2016	—	65.6	15.0	80.6

Within Banking platforms at 31 December 2017 is £38.3 million of expenditure relating to the development of the Group's digital banking programme.

The impairment charge of £4.8 million in the year represents previous software development which has been discontinued in light of a strategic decision to consolidate activities within the digital banking programme.

NOTE 20: TANGIBLE FIXED ASSETS

	Land and buildings	Plant, equipment fixtures, fittings and vehicles	Total
	£ million	£ million	£ million
Cost:			
At 1 January 2016	63.3	39.5	102.8
Additions	1.8	6.8	8.6
Disposals	(0.6)	(3.0)	(3.6)
At 31 December 2016	64.5	43.3	107.8
Additions	**—**	**5.8**	**5.8**
Disposals	**—**	**(0.1)**	**(0.1)**
At 31 December 2017	**64.5**	**49.0**	**113.5**
Accumulated depreciation and impairment:			
At 1 January 2016	9.5	18.7	28.2
Depreciation charge for the year	0.1	5.5	5.6
Disposals	(0.5)	(2.9)	(3.4)
At 31 December 2016	9.1	21.3	30.4
Depreciation charge for the year	**2.4**	**6.3**	**8.7**
Disposals	**—**	**(0.1)**	**(0.1)**
At 31 December 2017	**11.5**	**27.5**	**39.0**
Balance sheet amount at 31 December 2017	**53.0**	**21.5**	**74.5**
Balance sheet amount at 31 December 2016	55.4	22.0	77.4

NOTE 21: DEFERRED TAX ASSETS

	2017	2016
	£ million	£ million
Deferred tax assets/(liabilities):		
Accelerated capital allowances	**10.8**	12.9
Revaluation reserve in respect of available-for-sale financial assets	**(2.1)**	(2.6)
Cash flow hedge reserve	**0.2**	5.2
Change in accounting basis on adoption of IFRS	**(3.2)**	(4.0)
Tax losses carried forward	**0.6**	7.3
Other temporary differences	**5.2**	4.2
Total deferred tax assets	**11.5**	23.0

The Group has not recognised deferred tax assets in respect of gross unused tax losses of £31.2 million (2016: £31.2 million).

The movement in the net deferred tax balance is as follows:

	2017 £ million	2016 £ million
At 1 January	**23.0**	38.0
Income statement (charge)/credit (refer note 9):		
Accelerated capital allowances	**(2.1)**	(2.2)
Tax losses carried forward	**(6.7)**	(10.7)
Other temporary differences	**2.4**	(1.5)
	(6.4)	(14.4)
Amounts (charged)/credited to equity:		
Available-for-sale financial assets	**(0.1)**	(1.7)
Cash flow hedges	**(5.0)**	1.4
Adjustments relating to share based payments	**—**	(0.3)
	(5.1)	(0.6)
At 31 December	**11.5**	23.0

NOTE 22: OTHER ASSETS

	2017 £ million	2016 £ million
Trade debtors	**6.3**	17.7
Prepayments and accrued income	**40.2**	27.9
Other	**37.4**	76.3
Total other assets	**83.9**	121.9

Included within 'Other' assets are amounts receivable from clearing houses on centrally cleared derivative financial instruments of £8.5 million (2016: £50.7 million) recorded on a net basis.

NOTE 23: DEPOSITS FROM BANKS

	2017 £ million	2016 £ million
Liabilities in respect of securities sold under repurchase agreements	**1,130.0**	850.0
Secured loans	**4,236.0**	1,268.0
Other deposits from banks	**13.0**	14.5
Total deposits from banks	**5,379.0**	2,132.5

Secured loans relate to the Group's drawings from the Bank of England's Term Funding Scheme.

NOTE 24: CUSTOMER DEPOSITS

	2017 £ million	2016 £ million
Savings and investment accounts	**30,393.0**	27,762.7
Personal current accounts	**415.4**	343.6
Total customer deposits	**30,808.4**	28,106.3

NOTE 25: DEBT SECURITIES IN ISSUE

	Securitisation programmes	Medium term notes	Total
	£ million	£ million	£ million
At 1 January 2016	1,741.9	297.5	2,039.4
Repayments	(798.1)	—	(798.1)
Issues	1,278.9	—	1,278.9
Revaluations	73.0	—	73.0
Other movements	(1.5)	8.3	6.8
At 31 December 2016	**2,294.2**	**305.8**	**2,600.0**
Repayments	**(608.3)**	**—**	**(608.3)**
Issues	**746.2**	**—**	**746.2**
Revaluations	**1.5**	**—**	**1.5**
Other movements	**0.5**	**(3.0)**	**(2.5)**
At 31 December 2017	**2,434.1**	**302.8**	**2,736.9**

Other movements comprise amortisation of issuance costs and hedge accounting adjustments.

Securitisation programmes

On 25 September 2017, the Group raised £746.2 million from institutional investors through the issuance of Residential Mortgage Backed Securities (RMBS) in the Gosforth Funding 2017-1 transaction in US Dollars and Sterling.

In 2016, the Group also raised £1,278.9 million through the issue of RMBS in the Gosforth Funding 2016-1 and Gosforth Funding 2016-2 transactions in Euro, US Dollars and Sterling.

For all RMBS funding raised in currencies other than Sterling, the Group enters into cross-currency derivatives which swap the foreign currency liabilities into Sterling.

Medium term notes

The Group's Medium Term Notes have a nominal value of £300 million at a coupon of 2.25% per annum and will be repayable on 21 April 2020. They were issued as part of the Group's £3 billion Global Medium Term Note programme.

NOTE 26: OTHER LIABILITIES

	2017	2016
	£ million	£ million
Trade creditors and accruals	**66.3**	59.0
Provisions	**7.5**	8.5
Deferred income	**2.3**	3.0
Accrued interest	**110.9**	127.2
Other liabilities	**54.5**	102.2
Total other liabilities	**241.5**	299.9

Deferred income represents income advanced from partners that will be recognised in future periods.

Accrued interest primarily represents interest which has accrued on savings and investment accounts.

NOTE 27: SHARE CAPITAL AND SHARE PREMIUM

	2017	2016
	£ million	£ million
Share capital	**0.1**	0.1
Share premium	**654.5**	654.5
Total share capital and share premium	**654.6**	654.6

Issued and fully paid share capital

	2017 Number of shares	2017	2016 Number of shares	2016
		£		£
Ordinary Shares of £0.0001 each				
At 1 January	**444,942,008**	**44,494**	443,711,458	44,371
Issued during year	**—**	**—**	1,230,550	123
At 31 December	**444,942,008**	**44,494**	444,942,008	44,494
Deferred Shares of £0.001 each				
At 1 January and at 31 December	**10,052,161**	**10,052**	10,052,161	10,052

As permitted by the Companies Act 2006, the Company's Articles of Association do not contain any references to authorised share capital.

The following describes the rights attaching to each share class at 31 December 2017:

Ordinary Shares

The holders of Ordinary Shares are entitled to one vote per share at meetings of the Group. All Ordinary Shares in issue in the Company rank equally and carry the same voting rights and the same rights to receive dividends and other distributions declared or paid by the Company. The shares represented 81.6 per cent of the total share capital at 31 December 2017 (2016:81.6 per cent).

There are no restrictions in the transfer of Ordinary Shares in the Company other than:

- certain restrictions which may from time to time be imposed by law and regulations (for example, insider trading laws);
- where Directors and certain employees of the Group require the approval of the Company to deal in the Company's Ordinary Shares; and
- pursuant to the rules of some of the Group's employee share plans where certain restrictions may apply while the Ordinary Shares are subject to the plan.

Deferred Shares

As set out in the Articles of Association adopted on listing (and pursuant to the provisions of the Companies Act 2006 in respect of shares held in own shares), the Deferred Shares have no voting or dividend rights and, on a return of capital on a winding up, have no valuable economic rights. No application has been made or is currently intended to be made for the Deferred Shares to be admitted to the Official List or to trade on the London Stock Exchange or any other investment exchange.

The Deferred Shares are held in treasury. This is to ensure that the aggregate nominal value of the Company's share capital will be not less than £50,000, which is the minimum level of nominal share capital required by the Companies Act 2006 for a company to be established as a public limited company. The shares represented 18.4 per cent of the total share capital at 31 December 2017 (2016: 18.4 per cent).

NOTE 28: OTHER EQUITY INSTRUMENTS

	2017	2016
	£ million	£ million
At 1 January	**384.1**	156.5
Additional Tier 1 securities issued in the year (net of issue costs)	**—**	227.6
At 31 December	**384.1**	384.1

The Company issued Fixed Rate Resettable Additional Tier 1 (AT1) securities on the Luxembourg Stock Exchange of £230.0 million on 10 November 2016 and £160.0 million on 31 July 2014. The issues are treated as equity instruments in accordance with IAS 32 'Financial Instruments: Presentation' with the proceeds included in equity, net of transaction costs of £5.9 million. Dividends and other returns to equity holders are treated as a deduction from equity.

The principal terms of the AT1 securities in issue are described below:

- the securities constitute direct, unsecured and subordinated obligations of the Company and rank pari passu with holders of other Tier 1 instruments and the holders of that class or classes of preference shares but rank junior to the claims of senior creditors;
- the securities bear a fixed rate of interest of 8.750% and 7.875% from their issue dates up to their first reset dates on 10 November 2021 and 31 July 2019 respectively;
- interest on the securities will be due and payable only at the sole discretion of the Company, and the Company has sole and absolute discretion at all times and for any reason to cancel (in whole or in part) any interest payment that would otherwise be payable on any interest payment date;
- the securities are perpetual with no fixed redemption date and are repayable, at the option of the Company, all (but not part) on the first reset date or any reset date thereafter. In addition, the AT1 securities are redeemable, at the option of the Company, in whole for certain regulatory or tax reasons. Any optional redemption requires the prior consent of the PRA; and
- all AT1 securities will be converted into Ordinary Shares of the Company, at a pre-determined price, should the Common Equity Tier 1 ratio of the Group fall below 7.0% as specified in the terms.

NOTE 29: OTHER RESERVES

	2017	2016
	£ million	£ million
Revaluation reserve in respect of available-for-sale financial assets		
At 1 January	**4.1**	(0.3)
Net gains from changes in fair value	**2.6**	52.8
Net gains on disposal transferred to net income	**(13.5)**	(38.3)
Amounts transferred to net income due to hedge accounting	**11.5**	(8.4)
Taxation	**(0.1)**	(1.7)
At 31 December	**4.6**	4.1

	2017	2016
	£ million	£ million
Cash flow hedge reserve		
At 1 January	**(31.5)**	(15.3)
Amounts recognised in equity	**(1.2)**	(36.1)
Amounts transferred to income statement	**12.6**	13.6
Taxation	**(2.6)**	6.3
At 31 December	**(22.7)**	(31.5)

NOTE 30: RETAINED EARNINGS

	2017	2016
	£ million	£ million
At 1 January	**659.2**	544.8
Profit for the year	**192.1**	140.1
Dividends paid to ordinary shareholders	**(23.9)**	(20.8)
Distributions to Additional Tier 1 security holders (net of tax)	**(24.3)**	(10.1)
Purchase of own shares	**(8.5)**	(7.3)
Share based payments (including deferred tax)	**9.9**	12.5
Other distributions	**(0.2)**	—
As at 31 December	**804.3**	659.2

Other distributions represent distributions paid by certain SPVs currently in the process of liquidation.

Employee Benefit Trust (EBT)

Retained earnings are stated after deducting £8.0 million (2016: £6.9 million) representing 2,868,458 (2016: 2,922,220) own shares held in an EBT.

The Company established an EBT in 2011 in connection with the operation of the Company's share plans. The Company funded the EBT by means of a cash loan and is therefore considered to be the sponsoring entity. The EBT purchased shares in the Company using the cash loan which is accounted for as a purchase of own shares by the Company. The investment in own shares at 31 December 2017 is £8.0 million (2016: £6.9 million). The market value of the shares held in the EBT at 31 December 2017 was £8.2 million (2016: £8.8 million).

NOTE 31: CONTINGENT LIABILITIES AND COMMITMENTS

Contingent Liabilities

The Board was not aware of any significant contingent liabilities as at 31 December 2017 (31 December 2016: none).

The Company is, from time to time and in the normal course of business, subject to a variety of legal or regulatory claims, actions or proceedings. When such circumstances arise, the Board considers the likelihood of a material outflow of economic resources and provides for its best estimate of costs where an outflow of economic resources is considered probable. While there can be no assurances, the Directors believe, based on information currently available to them, that the likelihood of material outflows from such matters is remote.

The Board does not expect the ultimate resolution of any other threatened or actual legal proceedings to have a significant adverse effect on the financial position of the Group.

Loan commitments

Contractual amounts to which the Group is committed for extension of credit to customers.

	2017	2016
	£ million	£ million
Not later than 1 year	**5,815.9**	4,854.3
Later than one year and not later than 5 years	**97.1**	88.2
Later than 5 years	**280.5**	346.6
Total loan commitments	**6,193.5**	5,289.1

Operating lease commitments—land and buildings

Minimum future lease payments under non-cancellable operating leases:

	2017	2016
	£ million	£ million
Not later than 1 year	**7.5**	7.1
Later than one year and not later than 5 years	**26.0**	25.0
Later than 5 years	**18.7**	20.0
Total operating lease commitments—land and buildings	**52.2**	52.1

Operating lease commitments—other operating leases

Minimum future lease payments under non-cancellable operating leases:

	2017	2016
	£ million	£ million
Not later than 1 year	**4.6**	4.6
Later than one year and not later than 5 years	**—**	4.6
Later than 5 years	**—**	—
Total operating leases commitments—other operating leases	**4.6**	9.2

Capital commitments

Capital commitments for the acquisition of fixed assets:

	2017	2016
	£ million	£ million
Not later than 1 year	**1.1**	1.0
Later than one year and not later than 5 years	—	—
Later than 5 years	—	—
Total capital commitments	**1.1**	1.0

NOTE 32: FAIR VALUE OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

Fair value of financial assets and liabilities recognised at cost

The following table summarises the fair values of those financial assets and liabilities not presented on the Group's balance sheet at their fair value, by the level in the fair value hierarchy into which each fair value measurement is categorised. The accounting policy in note 1.9 (j) sets out the key principles for estimating the fair values of financial instruments.

	Level 1	Level 2	Level 3	Total fair value	Total carrying value
	£ million	£ million	£ million	£ million	£ million
At 31 December 2017					
Cash and balances at central banks	—	**2,579.0**	—	**2,579.0**	**2579.0**
Loans and advances to banks	—	**359.4**	—	**359.4**	**359.4**
Loans and advances to customers	—	—	**36,951.6**	**36,951.6**	**36,740.2**
Debt securities classified as loans and receivables	**0.3**	—	—	**0.3**	**0.3**
Available-for-sale financial assets	—	—	**0.3**	**0.3**	**0.3**
Other assets	—	**55.0**	—	**55.0**	**55.0**
Total financial assets at fair value	**0.3**	**2,993.4**	**36,951.9**	**39,945.6**	**39,734.2**
Deposits from banks	—	**5,379.0**	—	**5,379.0**	**5,379.0**
Customer deposits	—	**30,800.5**	—	**30,800.5**	**30,808.4**
Debt securities in issue	**2,748.3**	—	—	**2,748.3**	**2,736.9**
Other liabilities	—	**215.1**	—	**215.1**	**215.1**
Total financial liabilities at fair value	**2,748.3**	**36,394.6**	—	**39,142.9**	**39,139.4**

	Level 1	Level 2	Level 3	Total fair value	Total carrying value
	£ million	£ million	£ million	£ million	£ million
At 31 December 2016					
Cash and balances at central banks	—	786.3	—	786.3	786.3
Loans and advances to banks	—	635.6	—	635.6	635.6
Loans and advances to customers	—	—	32,514.0	32,514.0	32,367.1
Debt securities classified as loans and receivables	0.7	—	—	0.7	0.7
Available-for-sale financial assets	—	—	0.3	0.3	0.3
Other assets	—	68.8	—	68.8	68.8
Total financial assets at fair value	0.7	1,490.7	32,514.3	34,005.7	33,858.8
Deposits from banks	—	2,132.5	—	2,132.5	2,132.5
Customer deposits	—	28,222.7	—	28,222.7	28,106.3
Debt securities in issue	2,610.8	—	—	2,610.8	2,600.0
Other liabilities	—	189.5	—	189.5	189.5
Total financial liabilities at fair value	2,610.8	30,544.7	—	33,155.5	33,028.3

Fair value hierarchy

The table above summarises the carrying value and fair value of assets and liabilities held on the balance sheet. There are three levels to the hierarchy as follows:

Level 1—Quoted prices (unadjusted) in active markets for identical assets and liabilities.

Level 2—Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, whether directly (i.e. as prices) or indirectly (i.e. derived from prices).

Level 3—Inputs for the asset or liability that are not based on observable market data (unobservable inputs).

Valuation methods for calculations of fair values of financial assets and liabilities recognised at cost are set out below:

Cash and balances at central banks

Fair value approximates to carrying value because cash and balances at central banks have minimal credit losses and are either short-term in nature or reprice frequently. Loans and advances to banks Fair value was estimated by using discounted cash flows applying either market rates where practicable or rates offered by other financial institutions for loans with similar characteristics. The fair value of floating rate placements, fixed rate placements with less than six months to maturity and overnight deposits is considered to approximate to their carrying amount.

Loans and advances to customers

The Group provides loans of varying rates and maturities to customers. The fair value of loans with variable interest rates is considered to approximate to carrying value as the interest rate can be moved in line with market conditions. For loans with fixed interest rates, fair value was estimated by discounting cash flows using market rates or rates normally offered by the Group. The change in interest rates since the majority of these loans were originated means that their fair value can vary significantly from their carrying value. However, the Group's policy is to hedge fixed rate loans in respect of interest rate risk, which limits the Group's exposure to this difference in value to be within the Group's risk appetite.

Loans and advances to customers are categorised as Level 3 as unobservable pre-payment rates are applied.

Debt securities classified as loans and receivables

Fair values are based on quoted prices, where available, or by discounting cash flows using market rates.

Available-for-sale financial assets

These are unquoted equity securities held by the Group and relating to participation in banking and credit card operations. They are categorised as Level 3 as the fair value of these securities cannot be reliably measured, due to the lack of equivalent instruments with observable prices.

Other assets and liabilities—trade debtors/creditors, accrued income and accrued interest

Fair value is deemed to approximate the carrying value.

Deposits from banks and customer deposits

Fair values of deposit liabilities repayable on demand or with variable interest rates are considered to approximate to carrying value. The fair value of fixed interest deposits with less than six months to maturity is their carrying amount. The fair value of all other deposit liabilities was estimated by discounting cash flows, using market rates or rates currently offered by the Group for deposits of similar remaining maturities.

Debt securities in issue

Fair values are based on quoted prices where available or by discounting cash flows using market rates.

Fair value of financial assets and liabilities recognised at fair value

The following table summarises the fair values of those financial assets and liabilities recognised at fair value, by the level in the fair value hierarchy into which each fair value measurement is categorised. The accounting policy in note 1.9(j) sets out the key principles for estimating the fair values of financial instruments.

	Level 1	Level 2	Level 3	Total
	£ million	£ million	£ million	£ million
2017				
Financial assets				
Derivative financial instruments	—	**78.8**	—	**78.8**
Available-for-sale financial assets	**1,048.7**	**—**	**2.8**	**1,051.5**
Financial liabilities				
Derivative financial instruments	—	**93.5**	—	**93.5**

	Level 1	Level 2	Level 3	Total
	£ million	£ million	£ million	£ million
2016				
Financial assets				
Derivative financial instruments	—	104.2	—	104.2
Available-for-sale financial assets	850.9	—	7.6	858.5
Financial liabilities				
Derivative financial instruments	—	229.7	—	229.7

Level 1 Valuations

The fair value of debt securities categorised as available-for-sale financial assets is derived from unadjusted quoted prices in an active market.

Level 2 Valuations

The fair values of derivative instruments are calculated by discounted cash flow models using yield curves that are based on observable market data or are based on valuations obtained from counterparties.

Level 3 Valuations

Level 3 available-for-sale financial assets represent the Group's best estimates of the value of certain equity investments in unlisted companies and of unlisted preferred stock. The valuations take into account relevant information on the individual investments, with discounts applied to reflect their illiquid nature and, in respect of the preferred stock, risks of reduction in conversion rights. The discounts applied are the most significant unobservable valuation inputs.

The Group's shares in VocaLink Holdings Limited (Vocalink) were included within this category at 31 December 2016. The shares were sold in April 2017 following regulatory approval of Mastercard's acquisition of Vocalink, resulting in recognition of a gain on disposal of £6.1 million, included within other operating income.

NOTE 33: OFFSETTING OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

	Gross amounts of assets and liabilities	Amounts offset in the balance sheet[(1)]	Net amounts presented in the balance sheet	Related amounts where set off in the balance sheet not permitted[(2)]		Net amounts
				Subject to master netting agreements	Collateral received/ pledged	
	£ million	£ million	£ million	£ million	£ million	£ million
As at 31 December 2017						
Financial assets						
Derivative financial instruments	**129.8**	**(51.0)**	**78.8**	**(11.5)**	**(67.3)**	**–**
Loans and advances to banks	**359.4**	**–**	**359.4**	**–**	**(74.6)**	**284.8**
Financial liabilities						
Deposits from banks	**5,379.0**	–	**5,379.0**	–	**(8.4)**	**5,370.6**
Derivative financial instruments	**107.7**	**(14.2)**	**93.5**	**(11.5)**	**(63.6)**	**18.4**
Other liabilities	**251.9**	**(36.8)**	**215.1**	**–**	**–**	**215.1**

	Gross amounts of assets and liabilities	Amounts offset in the balance sheet[(1)]	Net amounts presented in the balance sheet	Related amounts where set off in the balance sheet not permitted[(2)]		Net amounts
				Subject to master netting agreements	Collateral received/ pledged	
	£ million	£ million	£ million	£ million	£ million	£ million
As at 31 December 2016						
Financial assets						
Derivative financial instruments	123.9	(19.7)	104.2	(25.4)	(78.8)	—
Loans and advances to banks	635.6	—	635.6	—	(168.1)	467.5
Other assets	72.0	(3.2)	68.8	—	—	68.8
Financial liabilities						
Deposits from banks	2,132.5	—	2,132.5	—	(10.7)	2,121.8
Derivative financial instruments	254.1	(24.4)	229.7	(25.4)	(168.1)	36.2
Other liabilities	188.0	1.5	189.5	—	—	189.5

(1) The amounts set off in the balance sheet as shown above represent derivatives and variation margin cash collateral with central clearing houses which meet the criteria for offsetting under IAS 32.

(2) The Group enters into derivatives with various counterparties which are governed by industry standard master netting agreements. The Group holds and provides cash and securities collateral in respect of derivative transactions covered by these agreements. The right to set off balances under these master netting agreements or to set off cash and securities collateral only arises in the event of non-payment or default and, as a result, these arrangements do not qualify for offsetting under IAS 32.

The effects of over collateralisation have not been taken into account in the above table.

NOTE 34: CASH FLOW STATEMENTS

(a) Change in operating assets

	2017	2016
	£ million	£ million
Change in loans and advances to customers	**(4,417.3)**	(5,295.7)
Change in derivative financial assets	**25.4**	(21.9)
Change in other operating assets	**34.1**	(69.7)
Change in operating assets	**(4,357.8)**	(5,387.3)

(b) Change in operating liabilities

	2017 £ million	2016 £ million
Change in deposits from banks	**3,247.1**	833.2
Change in customer deposits	**2,702.1**	2,961.4
Change in derivative financial liabilities	**(136.2)**	73.7
Change in other operating liabilities	**(6.4)**	89.0
Change in operating liabilities	**5,806.6**	3,957.3

(c) Non-cash and other items

	2017 £ million	2016 £ million
Depreciation, amortisation and impairment	**35.2**	21.0
Other non-cash items	**13.0**	39.3
Total non-cash and other items	**48.2**	60.3

(d) Analysis of cash and cash equivalents as shown in the balance sheet

	2017 £ million	2016 £ million
Cash and balances at central banks	**2,579.0**	786.3
Less: mandatory reserve deposits[1]	**(53.0)**	(49.1)
	2,526.0	737.2
Loans and advances to banks	**359.4**	635.6
Available-for-sale financial assets (with a maturity of less than 3 months)	**149.4**	—
Deposits from banks	**(5,379.0)**	(2,132.5)
Less: amounts not repayable on demand	**5,379.0**	2,131.9
	—	(0.6)
Total cash and cash equivalents	**3,034.8**	1,372.2

NOTE 35: RELATED PARTY TRANSACTIONS

Key Management Personnel

Key Management Personnel refer to the Executive Committee of the Group, Non-Executive Directors and Directors of subsidiary companies.

	2017 £ million	2016 £ million
Compensation		
Salaries and other short-term benefits	**6.7**	7.4
Share based payments (refer note 7)	**6.1**	7.6
Post-employment benefits	**0.9**	0.8
Total compensation	**13.7**	**15.8**

Aggregate contributions in respect of Key Management Personnel to defined contribution pension schemes £0.9 million (2016:

	2017 £ million	2016 £ million
Deposits		
At 1 January	**1.4**	2.2
Placed (includes deposits of appointed Key Management Personnel)	**0.6**	1.5
Withdrawn (includes deposits of former Key Management Personnel)	**(0.9)**	(2.3)
Deposits outstanding at 31 December	**1.1**	1.4

Deposits placed by Key Management Personnel attracted interest rates of up to 3.0% (2016: 3.0%). At 31 December 2017, the Group did not provide any guarantees in respect of Key Management Personnel (2016: none).

At 31 December 2017, transactions, arrangements and agreements entered into by the Group's banking subsidiaries with Key Management Personnel included amounts outstanding in respect of loans and credit card transactions of £0.6 million with 7 Key Management Personnel (2016: £0.9 million with 7 Key Management Personnel).

Subsidiaries

Transactions and balances with subsidiaries have been eliminated on consolidation. A full list of the Company's subsidiaries and SPVs included within the consolidation is provided in note 2 to the parent company financial statements.

Other transactions

	2017 £ million	2016 £ million
Transaction value at year end:		
Trademark licence fees to Virgin Enterprises Limited	**(8.0)**	(7.0)
Commissions received and charges paid to Virgin Atlantic Airways Limited	**0.5**	0.4
Donations to The Virgin Money Foundation	**(1.4)**	(1.4)
Dividend payment to Virgin Group Holdings Limited	**(8.4)**	(7.3)
Other costs paid to Virgin Management Group Companies	**(0.3)**	(0.3)

	2017 £ million	2016 £ million
Balance outstanding at year end:		
Trademark licence fees to Virgin Enterprises Limited	**(0.6)**	(0.6)
Commissions received and charges paid to Virgin Atlantic Airways Limited	**0.1**	0.1
Asset recognised in relation to Virgin Atlantic Airways Limited agreement	**10.0**	—
Liability recognised in relation to Virgin Atlantic Airways Limited agreement	**(10.0)**	—
Donations to The Virgin Money Foundation	**—**	(0.2)
Other costs to Virgin Management Group Companies	**—**	(0.1)

Trademark licence fees paid to Virgin Enterprises Limited

Licence fees are payable to Virgin Enterprises Limited for the use of the Virgin Money brand trademark.

Virgin Atlantic Airways Limited

The Group receives credit card commissions and incurs air mile charges to Virgin Atlantic Airways Limited (VAA) in respect of an agreement between the two parties.

In June 2017 an agreement was signed with VAA which will give rise to related party transactions in future periods. An asset and liability has been recognised during the year in relation to a committed payment under this agreement.

Donations to The Virgin Money Foundation (the Foundation)

The Group has made donations to the Foundation in both the current and prior year to enable the Foundation to pursue its charitable objectives. The Group has also provided a number of support services to the Foundation on a pro bono basis, including use of facilities and employee time. The estimated gift in kind for support services provided during the year was £0.4 million (2016: £0.3 million).

Dividend payment to Virgin Group Holdings Limited

The Group made dividend payments totalling £8.4 million to Virgin Group Holdings Limited in the year which represented that company's proportionate share of the total final 2016 dividend and the total interim 2017 dividend. In the prior year, the Group made dividend payments totalling £7.3 million to Virgin Group Holdings

Limited, which represented that company's proportionate share of the total final 2015 dividend and the total interim 2016 dividend.

Other costs paid to Virgin Management Group Companies

These costs include transactions with other companies in the Virgin Group.

NOTE 36: EVENTS AFTER BALANCE SHEET DATE

There have been no significant events between 31 December 2017 and the date of approval of the financial statements which would require a change or additional disclosure in the financial statements.

NOTE 37: FUTURE ACCOUNTING DEVELOPMENTS

A number of new accounting standards and amendments to accounting standards have been issued by the IASB, however are not yet effective and have not been early adopted by the Group. Those which may be relevant to the Group are set out below.

(a) IFRS 9 'Financial instruments' (Effective 1 January 2018, EU endorsed on 22 November 2016)

Background

In July 2014, the IASB issued the final version of IFRS 9 'Financial Instruments' which replaces IAS 39 'Financial Instruments: Recognition and Measurement'. This new accounting standard is effective from 1 January 2018 and has three core areas of change: Classification and Measurement; Hedge Accounting; and Impairment. The most significant impacts on the Group are from the changes to impairment.

Classification and Measurement

The Classification and Measurement requirements of IFRS 9 require financial assets to be classified into one of three measurement categories, fair value through profit or loss (FVTPL), fair value through other comprehensive income (FVOCI) and amortised cost. For financial assets classification is based on the objectives of the entity's business model for managing its financial assets and the contractual cash flow characteristics of the instruments. IFRS 9 retains most of the existing classification requirements for financial liabilities.

In relation to Classification and Measurement, IFRS 9 will not result in a significant change to current asset and liability measurement bases. The Group's debt security investment portfolio, which is classified as Available-for-Sale under IAS 39, will be reclassified into the FVOCI category on 1 January 2018, with no change in measurement basis and no impact to the Group's financial position. The Group's small number of equity investments, which are classified as Available-for-Sale under IAS 39, will be reclassified to either FVOCI or FVTPL on a case by case basis, with no change in measurement basis.

Hedge Accounting

The hedge accounting requirements of IFRS 9 are more closely aligned with risk management practices and follow a more principle-based approach. IFRS 9 includes an accounting policy choice to maintain existing IAS 39 hedge accounting rules until the IASB completes its project on macro hedging. The Group has decided to apply this accounting policy choice and will continue applying IAS 39 hedge accounting.

Impairment (Expected Credit Loss)

The impairment requirements of IFRS 9 replaces the existing 'incurred loss' impairment approach with an expected credit loss approach, resulting in earlier recognition of credit losses. The IFRS 9 impairment model has three stages. Entities are required to recognise a 12 month expected loss allowance on initial recognition (stage 1) and a lifetime expected loss allowance when there has been a significant increase in credit risk (stage 2).

Stage 3 requires objective evidence that an asset is credit-impaired, which is similar to the guidance on incurred losses in IAS 39. Loan commitments and financial guarantees not measured at fair value through profit or loss are also in scope for impairment. The assessment of whether a significant increase in credit risk has occurred is a key aspect of the IFRS 9 methodology. It involves quantitative and qualitative measures and therefore requires considerable management judgement. In addition IFRS 9 also requires the use of more forward-looking information including reasonable and supportable forecasts of future economic conditions.

Key accounting judgements

The Group undertook a full technical assessment of IFRS 9 which highlighted certain significant accounting policies and judgements. These areas include the selection of quantitative and qualitative criteria for the determination of significant increase in credit risk and the application of forward-looking data into the expected credit loss calculations, including multiple economic scenarios. The following summarises the key accounting judgements the Group will apply on adoption of IFRS 9:

Measurement of Expected Credit Loss

Expected credit loss is measured on either a 12 month or lifetime basis depending on whether a significant increase in credit risk has occurred since initial recognition or whether the asset meets the definition of default. Expected credit loss is the product of the probability of default (PD), exposure at default (EAD) and loss given default (LGD), discounted at the effective interest rate.

Significant Increase in Credit Risk (movement from stage 1 to stage 2)

The Group has identified a series of quantitative, qualitative and backstop criteria that will be used to determine if an account has demonstrated a significant increase in credit risk, and therefore should move from stage 1 to stage 2:

- Quantitative measures consider the increase in an accounts remaining lifetime PD compared to the expected residual lifetime PD when the account was originated. The Group will segment its credit portfolios into PD bands and has determined a relevant threshold for each PD band, where a movement in excess of threshold is considered to be significant. These thresholds have been determined separately for each portfolio based on historical evidence of delinquency.
- Qualitative measures include the observation of specific events such as short-term forbearance, payment cancellation, historical arrears or extension to customer terms.
- IFRS 9 includes a rebuttable presumption that 30 days past due is an indicator of a significant increase in credit risk. The Group considers 30 days past due to be an appropriate backstop measure and will not rebut this presumption.

Definition of default (movement to stage 3)

The Group has identified a series of quantitative and qualitative criteria that will be used to determine if an account meets the definition of default, and therefore should move to stage 3:

- IFRS 9 includes a rebuttable presumption that 90 days past due is an indicator of default. The Group considers 90 days past due to be an appropriate measure of default and will not rebut this presumption.
- Qualitative measures include the observation of specific events such as insolvency or enforcement activity.

Forward-looking information and multiple economic scenarios

The assessment of significant increase in credit risk and the calculation of expected credit loss both incorporate forwardlooking information. The Group has identified the most significant macroeconomic factors including house price inflation, unemployment rate and Bank Base Rate. These variables and their associated impact on PD, EAD and LGD have been factored into the credit loss models.

The Group has determined an approach to the selection and application of multiple scenarios. The Group does not have an in-house economics function and will therefore source economic scenarios from a third party source to form the basis of the economic scenarios used. The Group will consider a minimum of three scenarios on a probability-weighted approach. These scenarios include a base, an upside and a downside scenario.

IFRS 9 implementation programme and governance

The Group has managed the transition to IFRS 9 through an IFRS 9 delivery programme to ensure a high-quality implementation in compliance with the accounting and regulatory guidance. The Audit Committee has had oversight responsibility for the implementation of IFRS 9.

The Group has developed and built new expected credit loss models for the key retail portfolios (secured and unsecured). The Group has run these models during the second half of 2017 in a period of parallel run to ensure full readiness in advance of implementation from 1 January 2018. The Group is in the process of completing the refinement and validation of these models. The Group's auditors have undertaken extensive audit procedures during the course of 2017 to provide proactive assurance over the new expected credit loss models and the Group's IFRS 9 accounting policies.

The Group continues to monitor the wider market developments in relation to IFRS 9, including evolving disclosure requirements and regulatory developments such as potential capital transitionary rules.

Impact of transition to IFRS 9

The Group will record an adjustment to its opening 1 January 2018 retained earnings to reflect the application of the new requirements of IFRS 9 and will not restate comparative periods.

The Group estimates the transition to IFRS 9 will reduce shareholders' equity by approximately £35 million after deferred tax as at 1 January 2018. The impact on the Group's CET1 ratio will reflect the recently published capital transitional arrangements. This adjustment arises from the increase in the Group's balance sheet loan loss allowances as a result of the application of IFRS 9 requirements, with the Group's retail credit card portfolio being the most significantly impacted.

The Group continues to refine, monitor and validate certain elements of the impairment models and related controls ahead of full reporting of IFRS 9 impacts later in 2018.

(b) IFRS 15 'Revenue from Contracts with Customers' (Effective 1 January 2018, EU endorsed on 22 September 2016)

IFRS 15 replaces IAS 18 'Revenue' and IAS 11 'Construction contracts' as a comprehensive standard to address current inconsistencies in accounting practice for revenue recognition. Financial instruments and other contractual rights or obligations within the scope of IFRS 9 are excluded from the scope of this standard.

The Group has reviewed the requirements of the new standard and it is not expected to have a significant impact, as a substantial proportion of the Group's income is generated from financial instruments.

(c) IFRS 16 'Leases' (Effective 1 January 2019, EU endorsed on 31 October 2017)

This standard replaces IAS 17 'Leases' and will result in most leases for lessees being brought on to the Balance Sheet under a single lease model, removing the distinction between finance and operating leases. It requires a lessee to recognise a 'right-of-use' asset and a lease liability. Lessor accounting remains largely unchanged.

This will mainly impact properties the Group currently accounts for as operating leases. A project is in place and the Group is currently undertaking a review of its lease agreements. No decisions have been made yet in relation to transition options.

NOTE 38: COUNTRY BY COUNTRY REPORTING

The Capital Requirements (Country by Country Reporting) Regulations came into effect on 1 January 2014 and place certain reporting obligations on financial institutions within CRD IV.

The activities of the Group are described in the Strategic Report.

All companies consolidated within the Group's financial statements are UK registered entities.

	UK
Number of employees (average FTE)	2,959
Turnover (total income)	£662.7m
Pre-tax profit	£262.6m
Corporation tax paid	£ 45.1m
Public subsidies received	£ 0.0m

The Group received no public subsidies during the year.

FULL ANALYSIS OF RISK CLASSES

Credit risk

Definition

Credit risk is defined as the risk that a borrower or counterparty fails to pay the interest or the capital due on a loan or other financial instrument (both on and off-balance sheet).

Risk appetite

The Group has appetite for high-quality credit exposures including retail lending and liquid wholesale investments.

Exposures

The principal credit risks arise from loans and advances to customers, debt securities and derivatives. The credit risk exposures of the Group are set out on page 138. Credit risk exposures are categorised as retail (secured and unsecured) and wholesale.

In terms of loans and advances, credit risk arises both from amounts lent and commitments to extend credit to a customer. This applies to the secured and unsecured portfolios.

Retail mortgages expose the Group to customer re-mortgage risk. Re-mortgage risk is the possibility that an outstanding exposure cannot be repaid at its contractual maturity date. The debt management strategies employed by the Group are detailed on page 151.

The Group's buy-to-let lending policy is targeted towards retail customers rather than professional landlords, with specific restrictions in place on total exposures by loan amount and number of properties.

The Group's unsecured portfolio has grown in line with expectations and within strict underwriting criteria. The Group has increased scorecard cut-offs for some customer segments during 2017. The Group assesses customer affordability rigorously and takes into account the total unsecured debt held by a customer, and their ability to repay existing debt as well as the additional credit requested.

Credit risk in the wholesale portfolio arises from debt securities and derivatives. The Group's wholesale credit risk exposure is covered on page 153.

Measurement

The Group uses statistical models, supported by both internal and external data, to measure retail credit risk exposures.

The models reflect three components: (i) the 'probability of default' (PD) by the borrowers on their contractual obligations, (ii) current exposures to the borrowers and their likely future development ('exposure at default'), and (iii) the likely loss ratio on the defaulted obligations (the 'loss given default'). These parameters are used in order to derive an expected loss and assess capital allocation.

Portfolios are assessed by using segmentation for measurement and reporting purposes. Details of the classifications used for asset quality can be found on page 137.

The Group uses Advanced Internal Ratings Based (AIRB) models in measuring the credit risk of secured loans and advances to customers. All retail unsecured and wholesale exposures are measured under the Standardised Approach for regulatory capital.

The Group's credit portfolios are subject to regular stress testing. Further information on the stress testing process, methodology and governance can be found on page 129.

Page 143 provides details of the Group's approach to the impairment of financial assets. Refer to note 1 to the financial statements. From 1 January 2018, the Group will transition to the new accounting requirements of IFRS 9.

Mitigation

The Group uses a range of approaches to mitigate credit risk.

Credit policy

The Risk function uses risk appetite to set the credit policy for each type of credit risk. These policies are supported by lending manuals which define the responsibilities of underwriters and provide a rule set for credit decisions. The risk appetite, target market and risk acceptance criteria are reviewed at least annually. Risk oversight teams monitor early warning indicators, credit performance trends, and key risk indicators, and review and challenge exceptions to planned outcomes. Counterparty exposures are regularly reviewed and action taken where necessary. Risk Assurance perform independent risk-based reviews to provide an assessment of the effectiveness of internal controls and risk management practices. Oversight and review is also undertaken by Internal Audit.

Controls over AIRB rating systems

The Group has an established Independent Model Validation team that sets common minimum standards for predictive modelling development and operations. The standards are designed to ensure risk models and associated AIRB rating systems are developed consistently, and are of sufficient quality to support business decisions and meet regulatory requirements.

Credit underwriting

The Group uses a variety of lending criteria when assessing applications for secured and unsecured lending. The general approval process uses credit acceptance scorecards and involves a review of an applicant's previous credit history using information held by credit reference agencies.

The Group assesses the affordability of the borrower under stressed scenarios including increased interest rates. In addition, the Group has in place limits on permitted indebtedness which take into account the debt customers hold with other lenders.

The Group rejects any application for a product where a customer is registered as bankrupt or insolvent, or has a County Court Judgement registered at a credit reference agency used by the Group. In addition, the Group's approach to underwriting applications takes into account the total unsecured debt held by a customer and their ability to afford that debt.

For residential mortgages, the Group's policy is to accept only standard applications with a loan-to-value (LTV) of less than 95%[1]. The Group has maximum % LTV limits which depend upon the loan size. Residential mortgage limits are:

Loan size from	To	Maximum LTV
£1	£ 500,000	95% (purchase) 90% (re-mortgage)
£500,001	£1,000,000	80%

Buy-to-let is limited to a maximum of 75% LTV and residential interest only is limited to a maximum of 70% LTV, regardless of loan size. Residential mortgage applications in excess of £1 million are approved by exception.

The PRA introduced more rigorous stress testing for landlords with four or more mortgaged buy-to let properties, effective from September 2017. The Group has taken a conservative approach to applying these minimum standards and will continue to review buy-to-let lending policy. The number of buy-to-let mortgages held by a customer is capped at three and the maximum customer exposure is capped at £2 million.

The Group's approach to underwriting applications for unsecured products takes into account the total unsecured debt held by a customer and their ability to afford to repay that debt.

The Group uses statistically based decisioning techniques (primarily credit scoring models) for its retail portfolios.

Debt management for customers in financial difficulty

The Group's aim in offering forbearance and other assistance to retail customers in financial distress is to benefit both the customer and the Group by discharging the Group's responsibilities to support customers and act in their best long-term interests. This allows customer credit facilities to be brought back into a sustainable position. The Group offers a range of tools and assistance to support customers who are encountering financial

[1] All originations included in the comparative period to 31 December 2016 which were between 90% and 95% LTV were only permitted under the Help to Buy loan guarantee scheme.

difficulties. Cases are managed on an individual basis, with the circumstances of each customer considered separately and the action taken designed to be affordable and sustainable for the customer.

Customers are assisted by the Debt Management function where tailored repayment programmes can be agreed. Customers are actively supported and referred to free money advice agencies in instances where they have multiple credit facilities, including those at other lenders, which require restructuring.

Specific tools are available to assist customers which vary by product and the customer's status. Further details can be found on page 151.

Income and expenditure assessments are undertaken for all customers entering into a long-term repayment plan. This ensures that customers are provided with a sustainable and affordable solution that allows them a realistic opportunity to repay their debt in the short to medium term. In addition, the Group will advise customers to contact debt management companies such as Citizens Advice Bureau, StepChange and PayPlan. These companies do not charge any fees and will offer advice to customers as well as work with creditors to agree affordable repayment plans. Understanding what has changed and establishing the customers' current and future financial situation is imperative to ensuring that the right level of support is offered and that customers receive the appropriate solution to help them manage their debt when in financial difficulty.

Collateral for secured retail and wholesale exposures

The sole collateral type for secured loans is residential real estate. Property offered as collateral must be of acceptable construction and located in England, Wales, Scotland or Northern Ireland. Title to the property must be good, marketable and free from onerous restrictions and conditions. The Group requires first legal charge over the property offered as collateral and does not accept charges over part of the collateral. The Group does not lend where the collateral is land only.

Collateral held as security for financial assets other than loans and advances is determined by the nature of the instrument. Debt securities, treasury and other bills are generally unsecured, with the exception of asset-backed securities and similar instruments such as covered bonds, which are secured by portfolios of financial assets. Collateral is generally not held against loans and advances to financial institutions, except where a collateral agreement has been entered into under a master netting agreement.

All new eligible derivative transactions with wholesale counterparties are centrally cleared with cash posted as collateral to further mitigate credit risk. Residual and non-eligible trades are collateralised under a Credit Support Annex in conjunction with the ISDA Master Agreement. The Group will receive additional collateral from certain counterparties in the event their external credit rating falls below contractually set triggers as agreed in the Credit Support Annex. It is the Group's policy that, at the time of borrowing, collateral should always be realistically valued by an appropriately qualified source, independent of both the credit decision process and the customer. Collateral valuation is reviewed on a regular basis.

Monitoring

The Group produces regular portfolio monitoring reports for review by Senior Management. The Risk function produces a review of credit risk throughout the Group, including reports on significant credit exposures, which are presented to the Risk Management Committee and the Board Risk Committee.

The performance of all rating models is monitored on a regular basis to ensure that:

- appropriate risk differentiation capability is provided;
- generated ratings remain as accurate and robust as practical; and
- appropriate risk estimates are assigned to grades and pools of accounts.

In the event that the monitoring identifies material exceptions or deviations from expected outcomes, these are escalated for resolution.

Forbearance and provisioning

The Group's approach is to ensure that provisioning models, supported by management judgement, appropriately reflect the incurred loss risk of exposures. The Group uses behavioural scoring to assess customers' credit risk and the models take into account a range of potential indicators of customer financial distress.

Impaired assets are reviewed on an ongoing basis. Regular detailed analysis of impairment provisions is undertaken recognising the impact of forbearance activities. Further details on forbearance can be found on page 151.

Credit quality of assets

Loans and receivables

The Group defines three classifications of credit quality (low risk, medium risk and higher risk) for all credit exposures.

Secured credit exposures are segmented according to the credit quality classification and a point-in-time PD. The point- in-time PD is an internal parameter used within the Group's AIRB capital models which aims to estimate the probability of default over the next 12 months based on account characteristics and customer behavioural data. Default occurs where the borrower has missed six months of mortgage repayments or the borrower is deemed to be unlikely to repay their loan. Exposures are categorised as:

- higher risk where assets are past due or have a point in time PD greater than 2%;
- medium risk where assets are not past due and have a PD greater than 0.8% and less than or equal to 2%; and
- low risk where assets are not past due and have a PD less than or equal to 0.8%.

Unsecured exposures are categorised as:

- higher risk where assets are past due;
- medium risk where assets are currently not past due but are benefitting from a forbearance solution; and
- low risk where assets are neither past due nor in forbearance.

Wholesale credit exposures are assessed by reference to credit rating. The Group's wholesale exposures are investment grade and therefore classified as low risk.

No wholesale credit exposures were past due or impaired as at 31 December 2017 and 31 December 2016.

Further asset quality categorisation is disclosed on page 140, which reflects the impairment status of assets.

Credit risk portfolio as at 31 December 2017

The tables below show the total credit risk exposures for the Group's retail and wholesale portfolios.

	Secured		**Unsecured**		**Wholesale**		
2017 (audited)	**Residential mortgage loans**	**Residential buy-to-let mortgage loans**	**Credit cards**	**Overdrafts**	**Treasury assets**	**Derivative exposures**	**Total**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Total gross loans and advances to customers	**27,317.2**	**6,367.3**	**3,071.3**	**0.1**	**—**	**—**	**36,755.9**
• *of which are low risk*	*26,770.5*	*6,322.5*	*3,025.2*	*0.1*	—	—	*36,118.3*
• *of which are medium risk*	*220.0*	*11.7*	*3.5*	—	—	—	*235.2*
• *of which are higher risk*	*326.7*	*33.1*	*42.6*	—	—	—	*402.4*
Loans and advances to banks	—	—	—	—	**359.4**	**—**	**359.4**
Cash and balances at central banks	—	—	—	—	**2,579.0**	**—**	**2,579.0**
Debt securities classified as loans and receivables	—	—	—	—	**0.3**	**—**	**0.3**
Available-for-sale financial assets	—	—	—	—	**1,051.8**	**—**	**1,051.8**
Gross positive fair value of derivative assets	—	—	—	—	**—**	**78.8**	**78.8**
Total	**27,317.2**	**6,367.3**	**3,071.3**	**0.1**	**3,990.5**	**78.8**	**40,825.2**

All of the Group's wholesale exposures are categorised as low risk.

2016 (audited)	Secured Residential mortgage loans	 Residential buy-to-let mortgage loans	Unsecured Credit cards	 Overdrafts	Wholesale Treasury assets	 Derivative exposures	Total
	£m	£m	£m	£m	£m	£m	£m
Total gross loans and advances to customers	24,283.0	5,468.4	2,486.5	0.1	—	—	32,238.0
• *of which are low risk*	*21,565.5*	*5,256.8*	*2,451.2*	*0.1*	—	—	*29,273.6*
• *of which are medium risk*	*1,699.5*	*172.1*	*2.9*	—	—	—	*1,874.5*
• *of which are higher risk*	*1,018.0*	*39.5*	*32.4*	—	—	—	*1,089.9*
Loans and advances to banks	—	—	—	—	635.6		635.6
Cash and balances at central banks	—	—	—	—	786.3	—	786.3
Debt securities classified as loans and receivables	—	—	—	—	0.7	—	0.7
Available-for-sale financial assets	—	—	—	—	858.8	—	858.8
Gross positive fair value of derivative assets	—	—	—	—	—	104.2	104.2
Total	**24,283.0**	**5,468.4**	**2,486.5**	**0.1**	**2,281.4**	**104.2**	**34,623.6**

In addition, the maximum credit risk exposure of the Group includes off-balance sheet items.

These items relate to applications that have been approved and have not yet been drawn by the customer, and undrawn loan commitments. These commitments represent agreements to lend in the future and may be decreased or removed by the Group, subject to product notice requirements. No account is taken of any collateral held, other credit enhancements or provisions for impairment. As at 31 December 2017, off-balance sheet items totalled £6.2 billion (2016: £5.3 billion) and were all classified as low risk.

Loans and advances to customers comprise:

(audited)	2017 £m	2016 £m
Advances secured on residential property not subject to securitisation	**21,878.7**	19,375.2
Advances secured on residential property subject to securitisation	**5,438.5**	4,907.8
Total advances secured on residential property	**27,317.2**	24,283.0
Residential buy-to-let loans not subject to securitisation	**6,367.3**	5,468.4
Total loans and advances to customers secured on residential property	**33,684.5**	29,751.4
Allowance for impairment—secured	**(12.1)**	(10.6)
Total loans and advances to customers—secured	**33,672.4**	29,740.8
Credit cards	**3,071.3**	2,486.5
Overdrafts	**0.1**	0.1
Unsecured receivables not subject to securitisation	**3,071.4**	2,486.6
Allowance for impairment—unsecured	**(47.3)**	(39.5)
Total loans and advances to customers—unsecured	**3,024.1**	2,447.1
Total loans and advances to customers excluding portfolio hedging adjustment	**36,696.5**	32,187.9

The mortgage portfolio is secured on residential and buy-to-let properties and represented 91.6% of total loans and advances to customers at 31 December 2017. Residential lending grew by 12.5% (£3.0 billion) during the year and credit quality remained strong with 99.0% of loans classified as neither past due nor impaired. Buy-to-let loans grew by 16.4% (£0.90 billion) to £6.4 billion and remained low as a percentage of total secured loans at 18.9% (31 December 2016:18.4%).

The Group's credit card portfolio represented 8.4% of total loans and advances to customers at 31 December 2017 (2016: 7.7%). Unsecured credit card lending increased by £584.8 million since 31 December 2016 to £3.1 billion and the quality of new business remained strong. New lending was well within approved policy, lending and concentration limits. Further details on impaired assets and impairment allowances can be found on page 143.

Credit risk categorisation	Description	Reference
Arrears	For secured lending, where the customer's payment shortfall exceeds 1% of the current monthly contractual payment amount. For unsecured lending, customers are classified as in arrears at one day past due.	
Neither past due nor impaired	Loans that are not in arrears and which do not meet the impaired asset definition. This segment can include assets subject to forbearance solutions.	Page 142
Neither past due nor impaired and in forbearance	Loans that are categorised as neither past due nor impaired, and are currently subject to one of the defined forbearance solutions. Further information on forbearance solutions can be found on page 151.	Page 142
Past due and not impaired	Loans that are in arrears or where there is objective evidence of impairment and the asset does not meet the definition of impaired assets, as the expected recoverable amount exceeds the carrying amount. This category is not applicable for unsecured lending.	Page 143
Impaired assets	Loans that are in arrears and where the carrying amount of the loan exceeds the expected recoverable amount. All mortgage expired terms, fraud and operational risk loans are categorised as impaired irrespective of the expected recoverable amount. Unsecured lending assets are treated as impaired at one day past due.	Page 143

The overall credit quality of retail assets has remained stable and is detailed in the tables below. Analysis of the movement in impaired assets is provided on page 144.

	Secured				Unsecured					
2017 (audited)	**Residential mortgage loans**		**Residential buy-to-let mortgage loans**		**Credit cards**		**Overdrafts**		**Total**	
	£m	**%**	**£m**	**%**	**£m**	**%**	**£m**	**%**	**£m**	**%**
Neither past due nor impaired	27,026.2	99.0	6,336.5	99.5	3,028.7	98.6	0.1	100.0	36,391.5	99.0
> *of which in receipt of forbearance*[(1)]	133.8	0.5	15.8	0.2	3.5	0.1	—	—	153.1	0.4
Past due and not impaired	168.2	0.6	18.7	0.3	—	—	—	—	186.9	0.5
Impaired	122.8	0.4	12.1	0.2	42.6	1.4	—	—	177.5	0.5
Total	**27,317.2**	**100.0**	**6,367.3**	**100.0**	**3,071.3**	**100.0**	**0.1**	**100.0**	**36,755.9**	**100.0**

(1) This category reflects accounts which are neither past due nor impaired and subject to forbearance solutions. Accounts in this category are also included in the neither past due nor impaired categorisation. Full forbearance disclosures can be found on page 151.

2016 (audited)	Secured				Unsecured				Total	
	Residential mortgage loans		Residential buy-to-let mortgage loans		Credit cards		Overdrafts			
	£m	%	£m	%	£m	%	£m	%	£m	%
Neither past due nor impaired	24,047.8	99.1	5,441.8	99.5	2,454.1	98.7	0.1	100.0	31,943.8	99.1
> *of which in receipt of forbearance*[(1)]	108.6	0.4	12.2	0.2	2.9	0.1	—	—	123.7	0.4
Past due and not impaired	151.3	0.6	17.6	0.3	—	—	—	—	168.9	0.5
Impaired	83.9	0.3	9.0	0.2	32.4	1.3	—	—	125.3	0.4
Total	**24,283.0**	**100.0**	**5,468.4**	**100.0**	**2,486.5**	**100.0**	**0.1**	**100.0**	**32,238.0**	**100.0**

(1) This category reflects accounts which are neither past due nor impaired and subject to forbearance solutions. Accounts in this category are also included in the neither past due nor impaired categorisation. Forbearance disclosures have been restated to remove term extensions captured as part of the mortgage review process. Full forbearance disclosures can be found on page 151.

The criteria the Group uses to determine that there is objective evidence of impairment are disclosed on page 140. All loans, where specific circumstances indicate that a loss is likely to be incurred (for example, mortgage accounts which have entered possession or loans where fraud has been confirmed), are individually assessed for impairment by reviewing expected future cash flows including those that could arise from the realisation of security.

Loans and advances which are neither past due nor impaired

Loans which were neither past due nor impaired have increased by £3.9 billion in the year to 31 December 2017 and represent 99.0% of total secured loans. The proportion of secured loans and advances classified as low risk has increased over the period from 90.9% to 99.2%. Model development work undertaken during the year, to better align the Group's internal rating systems with portfolio performance, has led to improvements in credit quality measurements across the portfolio. In addition, third party process improvements in relation to data matching have improved the accuracy of certain customers' risk classifications, increasing the proportion of loans classified as low risk. Additionally, new lending during the period, although having a diluting effect, showed strong arrears performance.

The segmentation for low, medium and higher risk categories for the unsecured portfolio can be found on page 137.

The tables below show the details of the credit quality for neither past due nor impaired loans.

2017 (audited)	Residential mortgage loans		Residential buy-to-let mortgage loans		Total	
	£m	%	£m	%	£m	%
PD by internal ratings						
Low risk	26,770.5	99.1	6,322.5	99.8	33,093.0	99.2
Medium risk	220.0	0.8	11.7	0.2	231.7	0.7
Higher risk	35.7	0.1	2.3	—	38.0	0.1
Total neither past due nor impaired	**27,026.2**	**100.0**	**6,336.5**	**100.0**	**33,362.7**	**100.0**

2016 (audited)	Residential mortgage loans		Residential buy-to-let mortgage loans		Total	
	£m	%	£m	%	£m	%
PD by internal ratings						
Low risk	21,565.5	89.7	5,256.8	96.6	26,822.3	90.9
Medium risk	1,699.5	7.1	172.1	3.2	1,871.6	6.3
Higher risk	782.8	3.2	12.9	0.2	795.7	2.8
Total neither past due nor impaired	**24,047.8**	**100.0**	**5,441.8**	**100.0**	**29,489.6**	**100.0**

Loans and advances which are past due and not impaired

The balance of mortgages which were past due and not impaired totalled £186.9 million at 31 December 2017. These assets represented 0.6% of secured loans at 31 December 2017 (31 December 2016: 0.6%). All unsecured assets which are past due are treated as impaired. All loans and advances which are past due and not impaired are classified as higher risk. The tables below show loans and advances which are past due and not impaired by overdue term.

2017 (audited)	Residential mortgage loans		Residential buy-to-let mortgage loans		Total	
	£m	%	£m	%	£m	%
Up to one month	70.1	41.7	6.4	34.3	76.5	40.8
One to three months	74.3	44.2	9.9	52.9	84.2	45.1
Three to six months	16.5	9.8	2.1	11.2	18.6	10.0
Over six months	7.3	4.3	0.3	1.6	7.6	4.1
Total past due and not impaired	**168.2**	**100.0**	**18.7**	**100.0**	**186.9**	**100.0**

2016 (audited)	Residential mortgage loans		Residential buy-to-let mortgage loans		Total	
	£m	%	£m	%	£m	%
Up to one month	57.1	37.8	4.3	24.4	61.4	36.4
One to three months	63.9	42.2	10.8	61.4	74.7	44.2
Three to six months	21.4	14.1	2.1	11.9	23.5	13.9
Over six months	8.9	5.9	0.4	2.3	9.3	5.5
Total past due and not impaired	**151.3**	**100.0**	**17.6**	**100.0**	**168.9**	**100.0**

Impaired assets

Total impaired assets as a proportion of total assets has remained stable at 0.4% (2016: 0.4%). The Group's definition of impaired assets includes accounts that are in arrears and accounts that may not be in arrears but are showing non-delinquency impairment indicators such as expired contractual terms or fraud. Balances with these indicators are categorised as impaired irrespective of arrears status or expected recoverable amount.

As at 31 December 2017, the balance of impaired assets in arrears was £89.0 million[2] (2016: £74.6 million)[2]. The remainder of the impaired assets balance relates to:

- interest only expired term loans which have an average LTV of 25.8% and do not attract significant impairment provisions; and
- fraud balances, which have an average LTV of 57.2%. These balances account for less than 0.1% of the portfolio, are managed at account level, and provisioning reflects the estimated credit loss associated with the individual account.

The balances not in arrears but showing non-delinquency impairment indicators, by their nature, typically give rise to lower levels of loss and, as a result, attract lower levels of impairment provision.

Unsecured impaired assets increased by 31.5% to £42.6 million, representing 1.4% of total unsecured loans. This is driven both by an increase in arrears balances, consistent with book growth, and by the expected seasoning of older assets on the portfolio. The performance of more recent cohorts is in line with or better than vintage cohorts at a similar stage of maturity. Arrears emergence on all cohorts remains in line with performance expectations.

2 Includes assets where the borrower's property was in possession.

The tables below show the movement of impaired loan balances during 2017 and 2016.

2017 (audited)	Secured: Residential mortgage loans	Secured: Residential buy-to-let mortgage loans	Unsecured: Credit cards	Unsecured: Overdrafts	Wholesale: Treasury assets	Wholesale: Derivative exposures	Total
	£m	£m	£m	£m	£m	£m	£m
As at 1 January 2017	**83.9**	**9.0**	**32.4**	—	—	—	**125.3**
Classified as impaired during the year	**229.9**	**26.4**	**95.6**	—	—	—	**351.9**
Transferred from impaired to unimpaired	**(141.9)**	**(20.4)**	**(34.9)**	—	—	—	**(197.2)**
Amounts written off	**(0.6)**	**(0.1)**	**(43.4)**	—	—	—	**(44.1)**
Repayments	**(48.5)**	**(2.8)**	**(7.1)**	—	—	—	**(58.4)**
As at 31 December 2017	**122.8**	**12.1**	**42.6**	—	—	—	**177.5**

2016 (audited)	Secured: Residential mortgage loans	Secured: Residential buy-to-let mortgage loans	Unsecured: Credit cards	Unsecured: Overdrafts	Wholesale: Treasury assets	Wholesale: Derivative exposure	Total
	£m	£m	£m	£m	£m	£m	£m
As at 1 January 2016	77.6	7.0	27.4	—	—	—	112.0
Classified as impaired during the year	132.3	20.4	85.0	—	—	—	237.7
Transferred from impaired to unimpaired	(112.9)	(17.7)	(38.3)	—	—	—	(168.9)
Amounts written off	(0.6)	(0.2)	(32.3)	—	—	—	(33.1)
Repayments	(12.5)	(0.5)	(9.4)	—	—	—	(22.4)
As at 31 December 2016	**83.9**	**9.0**	**32.4**	—	—	—	**125.3**

An analysis of impaired assets by overdue term and assets where the borrower's property was in possession is provided in the tables below. All impaired loans and advances are classified as higher risk.

2017 (audited)	Residential mortgage loans		Residential buy-to-let mortgage loans		Credit cards		Overdrafts		Total	
	£m	%	£m	%	£m	%	£m	%	£m	%
Up to date	**80.3**	**65.5**	**7.9**	**65.3**	**0.3**	**0.7**	—	—	**88.5**	**49.8**
Up to one month	**17.6**	**14.3**	**0.8**	**6.6**	**15.5**	**36.3**	—	—	**33.9**	**19.1**
One to three months	**20.4**	**16.6**	**2.7**	**22.3**	**13.4**	**31.5**	—	—	**36.5**	**20.6**
Three to six months	**2.5**	**2.0**	**0.3**	**2.5**	**13.1**	**30.8**	—	—	**15.9**	**9.0**
Over six months	**1.5**	**1.2**	**0.3**	**2.5**	**0.3**	**0.7**	—	—	**2.1**	**1.2**
Possession	**0.5**	**0.4**	**0.1**	**0.8**	—	—	—	—	**0.6**	**0.3**
Total impaired assets	**122.8**	**100.0**	**12.1**	**100.0**	**42.6**	**100.0**	—	—	**177.5**	**100.0**

2016 (audited)	Residential mortgage loans		Residential buy-to-let mortgage loans		Credit cards		Overdrafts		Total	
	£m	%	£m	%	£m	%	£m	%	£m	%
Up to date	45.7	54.5	4.9	54.5	0.1	0.3	—	—	50.7	40.4
Up to one month	10.0	11.9	1.3	14.5	13.1	40.5	—	—	24.4	19.5
One to three months	19.9	23.7	2.2	24.4	9.3	28.7	—	—	31.4	25.1
Three to six months	4.1	4.9	0.3	3.3	9.6	29.6	—	—	14.0	11.2
Over six months	3.9	4.6	0.2	2.2	0.3	0.9	—	—	4.4	3.5
Possession	0.3	0.4	0.1	1.1	—	—	—	—	0.4	0.3
Total impaired assets	**83.9**	**100.0**	**9.0**	**100.0**	**32.4**	**100.0**	—	—	**125.3**	**100.0**

Impairment provisions

Secured impairment provisions have increased by £1.5 million, in line with book growth, representing 0.04% as a proportion of gross balances as at 31 December 2017 and 31 December 2016. Secured impairment coverage has fallen from 11.4% at 31 December 2016, to 9.0% as at 31 December 2017 due to the impact of expired term and fraud loan balances.

Unsecured impairment provisions increased by £7.8 million during the period and have reduced as a percentage of gross balances from 1.59% at 31 December 2016 to 1.54% at 31 December 2017. Impairment provisions as a proportion of impaired balances decreased, from 121.9% to 111.0% during the year. The reduction in impairment provision coverage is a result of improved debt recovery rates, which reduces the estimated credit loss attributable to these assets.

The tables below show impaired assets and impairment provisions.

2017 (audited)	Gross balances	Impaired balances	Impaired balances as a % of gross Balances	Impairment provisions	Impairment provisions as a % of impaired balances
	£m	£m	%	£m	%
Residential mortgage loans	27,317.2	122.8	0.4	10.8	8.8
Residential buy-to-let mortgage loans	6,367.3	12.1	0.2	1.3	10.7
Total secured	**33,684.5**	**134.9**	**0.4**	**12.1**	**9.0**
Credit cards	3,071.3	42.6	1.4	47.2	110.8
Overdrafts	0.1	—	—	0.1	—
Total unsecured	**3,071.4**	**42.6**	**1.4**	**47.3**	**111.0**
Wholesale treasury assets	3,990.5	—	—	—	—
Wholesale derivative exposures	78.8	—	—	—	—
Total wholesale	**4,069.3**	—	—	—	—
Total	**40,825.2**	**177.5**	**0.4**	**59.4**	**33.5**

2016 (audited)	Gross balances	Impaired balances	Impaired balances as a % of gross balances	Impairment provisions	Impairment provisions as a % of impaired balances
	£m	£m	%	£m	%
Residential mortgage loans	24,283.0	83.9	0.3	9.4	11.2
Residential buy-to-let mortgage loans	5,468.4	9.0	0.2	1.2	13.3
Total secured	**29,751.4**	**92.9**	**0.3**	**10.6**	**11.4**
Credit cards	2,486.5	32.4	1.3	39.4	121.6
Overdrafts	0.1	—	—	0.1	—
Total unsecured	**2,486.6**	**32.4**	**1.3**	**39.5**	**121.9**
Wholesale treasury assets	2,281.4	—	—	—	—
Wholesale derivative exposures	104.2	—	—	—	—
Total wholesale	**2,385.6**	—	—	—	—
Total	**34,623.6**	**125.3**	**0.4**	**50.1**	**40.0**

The table below shows the movement of impairment provisions during the year.

	Secured		Unsecured		Wholesale		
	On advances secured on residential property	On advances secured on residential buy-to-let property	Credit cards	Overdrafts	Treasury assets	Derivative exposures	Total
	£m	£m	£m	£m	£m	£m	£m
As at 1 January 2016	7.7	1.0	31.1	0.1	—	—	39.9
Advances written off	(0.6)	(0.2)	(26.6)	—	—	—	(27.4)
Gross charge to the income statements	2.3	0.4	34.9	—	—	—	37.6
As at 1 January 2017	**9.4**	**1.2**	**39.4**	**0.1**	—	—	**50.1**
Advances written off	**(0.6)**	**(0.1)**	**(34.2)**	—	—	—	**(34.9)**
Gross charge to the income statement	**2.0**	**0.2**	**42.0**	—	—	—	**44.2**
As at 31 December 2017	**10.8**	**1.3**	**47.2**	**0.1**	—	—	**59.4**

Of the total allowance in respect of loans and advances to customers, £57.5 million (2016: £49.4 million) was assessed on a collective basis.

Collateral held as security for loans and receivables to customers

A general description of collateral held as security in respect of financial instruments is provided on page 136. The Group holds collateral against loans and receivables in the mortgage portfolio. Quantitative and, where appropriate, qualitative information is provided in respect of this collateral on page 149.

The Group holds collateral in respect of loans and advances to customers as set out on page 136. The Group does not hold collateral against debt securities, comprising asset-backed securities and corporate and other debt securities, which are classified as loans and receivables. The tables overleaf show the distribution of retail secured loans by LTV banding.

2017 (audited)	Residential mortgage loans		Residential buy-to-let mortgage loans		Total	
	£m	%	£m	%	£m	%
<50%	10,249.6	37.6	2,293.5	36.1	12,543.1	37.2
50%–<60%	5,362.9	19.6	1,851.5	29.1	7,214.4	21.4
60%–<70%	4,508.4	16.5	1,441.4	22.6	5,949.8	17.7
70%–<80%	4,022.9	14.7	778.1	12.2	4,801.0	14.3
80%–<90%	2,725.7	10.0	1.9	—	2,727.6	8.1
90%–<100%	444.6	1.6	0.6	—	445.2	1.3
>100%	3.1	—	0.3	—	3.4	—
Total	**27,317.2**	**100.0**	**6,367.3**	**100.0**	**33,684.5**	**100.0**
Average LTV(1) of stock—indexed		**56.1%**		**54.1%**		**55.8%**
Average LTV of new business		**70.0%**		**59.7%**		**68.1%**

(1) The average LTV of stock and new business is balance weighted.

2016 (audited)	Residential mortgage loans		Residential buy-to-let mortgage loans		Total	
	£m	%	£m	%	£m	%
<50%	9,476.6	39.1	1,922.8	35.2	11,399.4	38.3
50%–<60%	4,958.1	20.4	1,454.8	26.6	6,412.9	21.6
60%–<70%	3,918.9	16.1	1,271.8	23.3	5,190.7	17.4
70%–<80%	3,162.8	13.0	796.4	14.6	3,959.2	13.3
80%–<90%	2,307.7	9.5	19.0	0.3	2,326.7	7.8
90%–<100%	445.1	1.8	2.2	—	447.3	1.5
>100%	13.8	0.1	1.4	—	15.2	0.1
Total	**24,283.0**	**100.0**	**5,468.4**	**100.0**	**29,751.4**	**100.0**
Average LTV[(1)] of stock—indexed		**55.6%**		**54.8%**		**55.4%**
Average LTV of new business		**69.8%**		**60.5%**		**68.0%**

(1) The average LTV of stock and new business is balance weighted.

The average indexed LTV of the overall mortgage portfolio increased by 0.4 percentage points as at 31 December 2017. This is well within the current Group portfolio risk appetite limit of 70%. The average LTV for new business remained broadly flat at 68.1% as at 31 December 2017.

Collateral held in relation to secured loans is capped at the amount outstanding on an individual loan basis. The percentages in the tables below represent the value of collateral, capped at loan amount, divided by the total loan amount in each category.

2017[(1)] (audited)	Collateral value of residential mortgage loans		Collateral value of residential buy-to-let mortgage loans		Total collateral value	
	£m	%	£m	%	£m	%
Neither past due nor impaired	27,025.9	100.0	6,336.5	100.0	33,362.4	100.0
> *of which in receipt of forbearance*	*133.8*	*100.0*	*15.8*	*100.0*	*149.6*	*100.0*
Past due and not impaired	168.2	100.0	18.7	100.0	186.9	100.0
Impaired	122.8	100.0	12.1	100.0	134.9	100.0
> *of which in possession*	*0.5*	*100.0*	*0.1*	*100.0*	*0.6*	*100.0*
Total	**27,316.9**	**100.0**	**6,367.3**	**100.0**	**33,684.2**	**100.0**

(1) Some segments may appear fully collateralised due to immaterial balances in negative equity. Due to rounding these do not change the overall collateralised percentage shown.

2016[(1)] (audited)	Collateral value of residential mortgage loans		Collateral value of residential buy-to-let mortgage loans		Total collateral value	
	£m	%	£m	%	£m	%
Neither past due nor impaired	24,046.6	100.0	5,441.7	100.0	29,488.3	100.0
> *of which in receipt of forbearance*	*108.6*	*100.0*	*12.2*	*100.0*	*120.8*	*100.0*
Past due and not impaired	151.3	100.0	17.6	100.0	168.9	100.0
Impaired	83.7	99.8	9.0	100.0	92.7	99.8
> *of which in possession*	*0.3*	*100.0*	*0.1*	*100.0*	*0.4*	*100.0*
Total	**24,281.6**	**100.0**	**5,468.3**	**100.0**	**29,749.9**	**100.0**

(1) Some segments may appear fully collateralised due to immaterial balances in negative equity. Due to rounding these do not change the overall collateralised percentage shown.

(2) Forbearance disclosures have been restated to exclude term extensions captured as part of the mortgage review process. Further details can be found on page 151.

As at 31 December 2017, there was £0.3 million (2016: £1.4 million) excess between the balance of residential mortgage loans with a LTV of greater than 100% and the collateral held against them. All these mortgage balances were classified as neither past due nor impaired (2016: £1.2 million). The recoverable amount used for impairment provision purposes reflects this level of collateral.

Repossessions

The Group works with customers who have difficulty paying their mortgages, and will repossess a property only when all other possibilities have been exhausted. Where properties have been repossessed, the Group will obtain the best price, taking into account factors such as property and market conditions.

The Group uses external asset management specialists to realise the value as soon as practicable to settle indebtedness. Any surplus funds are returned to the borrower or are otherwise dealt with in accordance with appropriate insolvency regulations.

The Group held ten repossessed properties as at 31 December 2017 compared to six as at 31 December 2016. The total number of properties taken into possession during the year reduced to 12, from 36 in 2016.

Interest only mortgages

The Group provides interest only mortgages to customers, whereby payments made by the customer comprise interest for the term of the mortgage, with the customer responsible for repaying the principal outstanding at the end of the loan term.

The tables below provide details of balances which are on an interest only basis, analysed by maturity. This includes the interest only balances for loans that provide the customer with the flexibility to choose to pay a proportion of the loan on a capital repayment basis and a proportion on interest only (part-and-part loans).

The Group's interest only exposure for customers on both interest only and part-and-part for the year to 31 December 2017 reduced to 27.6% of total secured balances, from 29.9% at 31 December 2016.

	Residential mortgage loans	Residential buy-to-let mortgage loans	Total
2017 (audited)	**£m**	**£m**	**£m**
Term expired (still open)	46.0	3.5	49.5
Due within 2 years	156.2	16.3	172.5
Due after 2 years and before 5 years	432.0	112.4	544.4
Due after 5 years and before 10 years	1,047.5	677.4	1,724.9
Due after more than 10 years	2,296.9	4,499.4	6,796.3
Total	**3,978.6**	**5,309.0**	**9,287.6**
> *of which are impaired*	11.1	61.4	72.5
% of total secured loans and advances to customers	**14.6**	**83.4**	**27.6**
Average LTV (%)	**40.6**	**55.2**	**49.5**

	Residential mortgage loans	Residential buy-to-let mortgage loans	Total
2016 (audited)	**£m**	**£m**	**£m**
Term expired (still open)	30.1	1.9	32.0
Due within 2 years	167.5	16.4	183.9
Due after 2 years and before 5 years	405.2	77.8	483.0
Due after 5 years and before 10 years	1,012.9	591.8	1,604.7
Due after more than 10 years	2,726.0	3,852.6	6,578.6
Total	**4,341.7**	**4,540.5**	**8,882.2**
> *of which are impaired*	8.6	47.8	56.4
% of total secured loans and advances to customers	**17.9**	**83.0**	**29.9**
Average LTV (%)	**42.1**	**55.8**	**49.6**

The Group contacts customers who have an interest only mortgage scheduled to mature within the next ten years, to confirm that their strategy to repay the mortgage loan in full at the end of the agreed term remains on track. If not, the Group will discuss a range of options, including a mortgage review, to ensure the customers' individual needs continue to be met.

Interest only balances due to mature in the next two years represent 1.9% of total interest only balances, totalling £172.5 million at 31 December 2017. The increase in interest only expired term loans of £17.5 million is in line with expectations. Strategies exist to help customers who may not be able to repay the full amount of principal balance at maturity.

All expired term balances are categorised as impaired loans, regardless of estimated credit loss. Less than 0.2% of the secured portfolio relates to expired term loan balances. The average balance of expired term loans which are more than six months past their maturity date is £87,573 with an average LTV of 25.8%.

The Group offers interest only loans to applicants who have credible means to repay the mortgage loan at maturity other than sale of main residence. The flow of new interest only residential balances has remained low during 2017, representing 2.2% of residential completions. As a result, the proportion of residential interest only mortgages (excluding part-and-part) in the portfolio continues to reduce, moving from 15.0% to 12.3% during 2017.

The Group regularly reviews the effectiveness of its interest only policy and contact strategies.

Forbearance

The Group operates a number of treatments to assist borrowers who are experiencing financial distress. In defining these treatments, the Group distinguishes between the following categories for secured assets:

- payment arrangements: a temporary arrangement for customers in financial distress where arrears accrue at the contractual payment, for example, short-term arrangements to pay less than the contractual payment;
- transfers to interest only: an account change to assist customers through periods of financial difficulty where arrears do not accrue at the original contractual payment. Any arrears of capital repayment existing at the commencement of the arrangement remain outstanding;
- term extensions: a permanent account change for customers in financial distress where the overall term of the mortgage is extended, resulting in a lower contractual monthly payment; and
- discretionary payment holidays: a temporary account change to assist customers through periods of financial difficulty where arrears do not accrue at the original contractual payment.

Loans which are subject to forbearance are grouped with other assets with similar risk characteristics and assessed collectively for impairment. Loans are not considered as impaired loans unless they meet the Group's definition of an impaired asset.

The value of forbearance stock totalled £176.4 million at 31 December 2017 (2016: £141.3 million). £161.2 million (31 December 2016: £128.6 million) of retail secured loans and advances were subject to forbearance, representing 0.48% of total secured loans and advances (2016: 0.43%). This increase in forbearance is consistent with portfolio growth and reflects the Group's focus on proactive debt management due to the low level of arrears emergence.

During 2017, the Group amended its secured forbearance capture to exclude routine term extensions processed as part of the mortgage review process, where there is no forbearance. Such cases had been captured prudently as forborne in prior reporting periods. The 2016 comparative has been restated to reflect this change.

The tables below show analysis by forbearance category.

2017 (audited)	Neither past due nor impaired		Past due not impaired		Impaired		Total	
	£m	%	£m	%	£m	%	£m	%
Secured								
Payment arrangement	0.6	0.5	1.4	15.7	—	—	2.0	1.2
Transfer to interest only	29.2	19.5	1.4	15.7	0.3	11.1	30.9	19.2
Term extension	59.0	39.4	3.2	36.0	2.1	77.8	64.3	39.9
Payment holiday	60.8	40.6	2.9	32.6	0.3	11.1	64.0	39.7
Total secured Forbearance	**149.6**	**100.0**	**8.9**	**100.0**	**2.7**	**100.0**	**161.2**	**100.0**
Unsecured								
Accounts where the customer has been approved on a repayment plan	3.5	100.0	—	—	11.7	100.0	15.2	100.0
Total Forbearance	**153.1**	**100.0**	**8.9**	**100.0**	**14.4**	**100.0**	**176.4**	**100.0**

2016 (audited)	Neither past due nor impaired		Past due not impaired		Impaired		Total	
	£m	%	£m	%	£m	%	£m	%
Secured								
Payment arrangement	0.1	0.1	0.6	11.0	0.2	8.7	0.9	0.7
Transfer to interest only	21.8	18.0	1.8	32.7	0.6	26.1	24.2	18.8
Term extension	44.5	36.9	1.9	34.5	0.8	34.8	47.2	36.8
Payment holiday	54.4	45.0	1.2	21.8	0.7	30.4	56.3	43.8
Total secured forbearance	**120.8**	**100.0**	**5.5**	**100.0**	**2.3**	**100.0**	**128.6**	**100.0**
Unsecured								
Accounts where the customer has been approved on a repayment plan	2.9	100.0	—	—	9.8	100.0	12.7	100.0
Total forbearance	**123.7**	**100.0**	**5.5**	**100.0**	**12.1**	**100.0**	**141.3**	**100.0**

Wholesale credit risk

Wholesale credit risk exposures increased by £1.7 billion during the year to £4.1 billion at 31 December 2017. This partly reflects the replacement of off-balance sheet liquidity from the Bank of England's Funding for Lending Scheme (FLS) with on-balance sheet liquidity. The table below shows the wholesale credit risk exposures of the Group. Reserves placed with the Bank of England are included as wholesale credit exposures within the table.

(audited)	2017 £m	2016 £m
Loans and advances to banks excluding Bank of England	359.4	635.6
Bank of England	2,579.0	786.3
Debt securities classified as loans and receivables	0.3	0.7
Debt securities classified as available-for-sale financial assets	1,048.7	850.9
Gross positive fair value of derivative contracts	78.8	104.2
Total	**4,066.2**	**2,377.7**

The Group has increased its holdings of high-quality available-for-sale wholesale assets during the year including gilts, supranational, covered bonds and RMBS investments. Wholesale credit risk exposures are assessed by reference to credit rating. All of the Group's wholesale exposures were investment grade and classified as low risk at 31 December 2017. Full disclosure of the Group's portfolio of liquid assets can be found on page 176.

At 31 December 2017, the single largest exposure to any single counterparty, which is not a sovereign or a supranational, was £108.4 million (2016: £115.9 million). The table below shows the credit ratings of loans and advances to banks excluding the Bank of England, which has a credit rating of AA (2016: AA).

	2017	2016
(audited)	**£m**	**£m**
AA+	—	56.8
AA−	100.3	115.9
A+	145.5	208.4
A	79.4	187.4
A−	14.8	35.2
BBB+	19.4	31.9
Total	**359.4**	**635.6**

The table below shows debt securities classified as loans and receivables and debt securities classified as available-for-sale financial assets.

	2017		2016	
	Debt securities classified as loans and receivables	**Debt securities classified as available-For-sale financial assets**	**Debt securities classified as loans and receivables**	**Debt securities classified as available-for-sale financial assets**
(audited)	**£m**	**£m**	**£m**	**£m**
UK sovereign exposures	—	356.7	—	317.3
Supranational	—	234.1	—	129.3
Residential mortgage-backed securities	0.3	61.4	0.7	52.2
Covered bonds	—	396.5	—	327.1
Debt securities issued by banks	—	—	—	25.0
Total	**0.3**	**1,048.7**	**0.7**	**850.9**

The table below shows the credit rating of debt securities classified as loans and receivables and debt securities classified as available-for-sale financial assets.

	2017	2016
(audited)	**£m**	**£m**
AAA	692.0	508.6
AA+	—	—
AA	356.7	317.3
AA−	—	25.0
A+	—	—
A	0.3	0.7
Total	**1,049.0**	**851.6**

The credit rating of the debt securities remains high, with 100.0% rated AA or higher at 31 December 2017 (2016: 97.0%).

Derivative financial instruments

The Group reduces exposure to credit risk through central clearing for eligible derivatives and daily posting of cash collateral on such transactions, as detailed in notes 13 and 33 to the financial statements. For derivatives not eligible for central clearing, exposure is reduced by the use of master netting agreements and by obtaining collateral in the form of cash or highly liquid securities. In respect of the Group's maximum credit risk relating to derivative assets of £78.8 million (2016: £104.2 million), collateral of £84.4 million (2016: £86.4 million) was held.

The Group measures exposure in derivatives using the gross positive fair value of contracts outstanding with a counterparty, increased by potential future rises in fair value and reduced by gross negative fair value of contracts and collateral received.

While exposures are managed on a net basis, they are represented on the balance sheet on a gross basis unless the IAS 32 offsetting rules are met. Derivative contracts which do not meet the IAS 32 offsetting rules, and have positive fair values, are disclosed as assets in the balance sheet. Those with negative fair values are disclosed as liabilities.

Cash collateral received is classified as deposits from banks, and cash collateral posted is classified as loans and advances to banks. The notes to the financial statements provide further information on collateral.

The table below details derivative exposures, excluding those that are centrally cleared.

(audited)	2017 £m	2016 £m
Gross positive fair value of derivative contracts	78.8	104.2
Netting with gross negative fair value of derivative contracts[1]	(11.5)	(25.4)
Potential future incremental exposure	47.3	61.2
Collateral received (deposits from banks)	(84.4)	(86.4)
Net derivative exposures	**30.2**	**53.6**

(1) The use of netting allows positions on all bilateral transactions with any given counterparty to be offset.

The table below provides a summary of net derivative liabilities, excluding those that are centrally cleared.

(audited)	2017 £m	2016 £m
Gross negative fair value of derivative contracts	(84.3)	(222.3)
Netting with gross positive fair value of derivative contracts[1]	11.5	25.4
Collateral pledged (loans and advances to banks)	74.6	168.1
Net derivative liability	**1.8**	**(28.8)**

(1) The use of netting allows positions on all bilateral transactions with any given counterparty to be offset.

The only netting agreements in place are in relation to derivative financial instruments and repurchase transactions. In respect of repurchase transactions, only the difference between the asset pledged and deposit received is classed as an exposure given the balance sheet maintains the exposure to the underlying obligor.

The table below provides credit quality analysis of the gross derivative exposures, excluding those that are centrally cleared, by credit rating of the counterparties.

	2017		2016	
(audited)	£m	%	£m	%
AA−	1.7	2.2	5.6	5.4
A+	6.5	8.2	0.6	0.6
A	67.0	85.0	84.5	81.1
A−	0.3	0.4	12.7	12.2
BBB+	0.2	0.3	0.8	0.7
NR	3.1	3.9	—	—
Total	**78.8**	**100.0**	**104.2**	**100.0**

Market risk

Definition

Market risk is defined as the risk that the value of, or net income arising from, assets and liabilities changes as a result of interest rate or exchange rate movements. Market risk for the Group arises as a natural consequence of carrying out and supporting core business activities. The Group does not trade or make markets and transacts foreign exchange for limited operational purposes only. As a result, interest rate risk is the only material market risk for the Group.

Risk appetite

The Group has limited risk appetite for exposures to interest rate risk in the banking book (IRRBB), in terms of both potential changes to economic value, and changes to expected net interest income or earnings. Risk appetite limits and metrics are set with reference to stress scenarios using measures described in this section.

Exposures

The Group's banking activities expose it to the risk of adverse movements in interest rates and exchange rates.

Term mismatch risk in the Group's portfolio arises from the different re-pricing characteristics of the Group's assets, liabilities and off-balance sheet exposures. Term mismatch risk arises predominantly from the mismatch between assets and liabilities either maturing or the amount resetting in any given time period, and the investment term of capital and reserves, and the need to stabilise earnings in order to minimise income volatility.

Basis risk arises from possible changes in spreads, between different reference rates, for example, where assets and liabilities reprice at the same time and the scale of rate movement differs. The Group is exposed to Bank Base Rate and LIBOR. If the spread between these rates moves adversely, the Group may experience a reduction in income on unhedged exposures.

Pipeline risk arises where new business volumes are higher or lower than forecast, requiring the business to unwind or execute additional hedging at rates unfavourable to those that were expected. Variations in business volume outturn to forecast arise from changes in customer behaviour and relative product competitiveness.

Product optionality risk arises when customer balances reduce more quickly or slowly than anticipated due to economic conditions or customers' responses to changes in interest rates or other economic conditions differing from expectations.

Swap spread risk arises through the hedging of the repricing risk of fixed rate securities (e.g. gilt securities) with derivatives. The yields in securities and swap markets for a given tenor may not change by the same amount as each other. Such differences cause spread risk to arise.

Foreign currency risk arises as a result of having assets, liabilities and derivative items denominated in currencies other than Sterling as a result of banking activities. The Group has minimal exposure to foreign currency risk.

Measurement

The Group quantifies the impact to economic value and earnings arising from a shift to interest rates using stress scenarios. These scenarios examine the interest rate re- pricing gaps, asset and liability interest rate bases and product optionality.

The Group maintains IRRBB management practices in line with applicable regulatory expectations.

Interest rate risk exposure is measured as follows:

- Capital at Risk (CaR) is considered for assets and liabilities in all interest rate risk re-pricing periods. This is expressed as the present value of the negative impact of a sensitivity test on the Group's capital position.
- Earnings at Risk (EaR) is considered for assets and liabilities on the forecast balance sheet over a 12 month period, measuring the adverse change to net interest income from a change in interest rates.

IRRBB is measured considering both positive and negative instantaneous shocks to interest rates. The measurement is enhanced with non-parallel stress scenarios (basis risk), swap spread risk and behavioural volume stresses (pipeline and optionality risk). Both EaR and CaR are controlled by a defined risk appetite limit and supporting metrics.

CaR measurements are based on a 2% parallel stress over the balance sheet horizon, for term mismatch. EaR measurements are based on a 1% parallel stress over a 12 month period. The stress scenarios capture the risk of negative interest rates. The magnitude of stress used within the Group's internal risk appetite differs from the standardised regulatory stress, based on observed rate movements and internally defined exposure holding periods. In the case of basis risk, the Group uses an internal stress test outcome for CaR and EaR.

The Group has an integrated Asset and Liability Management system which allows it to measure and manage interest rate re-pricing profiles (including behavioural assumptions), perform stress testing and produce forecasts.

Mitigation

The Group uses derivative financial instruments to bring its residual net exposure within risk appetite. The residual net exposure takes account of natural offsets between assets and liabilities.

As defined within the scope of the Group's IRRBB Policy, the Interest Rate Risk Transfer Pricing framework is used for interest rate risk arising from commercial product lines that can be hedged. Treasury is responsible for managing risk and does this through natural offsets of matching assets and liabilities where possible.

Appropriate hedging activity of residual exposures is undertaken, subject to the authorisation and mandate of the Asset and Liability Committee, within the Board-approved risk appetite. Certain residual interest rate risks may remain due to differences in basis and profile mismatches arising from customer behaviour.

Where possible, the Group mitigates basis risk by creating natural offsets. When required, the Group uses basis derivatives to maintain the residual exposure within risk appetite.

The Group is exposed to fair value interest rate risk on fixed rate customer loans and deposits and to cash flow interest rate risk on variable rate loans and deposits. Accounting methodology for derivative financial instruments and hedge accounting is captured within the notes to the consolidated financial statements.

Monitoring

Interest rate risk is monitored centrally on a day-to-day basis using the measures described above and other key risk indicators.

The Asset and Liability Committee and the Risk Management Committee regularly review market risk exposure as part of the wider risk management framework. The Asset and Liability Committee reviews and approves strategies to manage IRRBB.

Capital at Risk

CaR as at 31 December 2017 increased to £25.5 million from £14.1 million at 31 December 2016 in a negative rate shock scenario. In a positive rate shock scenario, it increased to £52.2 million at 31 December 2017 from £34.2 million as at 31 December 2016. In both rate shock scenarios this was due to the increase in the balance sheet, and the consequential increase in interest rate mismatch risk, and optionality risk arising from the increase in potential mortgage early repayments and savings redemptions.

The table below shows CaR measurements, based on a 2% parallel stress over the balance sheet horizon.

	2017		2016	
	Positive 2% rate shock	Negative 2% rate shock	Positive 2% rate shock	Negative 2% rate shock
	£m	£m	£m	£m
Interest rate mismatch risk	(6.3)	0.4	1.6	0.7
Basis Risk	(1.4)	(1.4)	—	—
Pipeline risk	(4.7)	(5.5)	(5.7)	(7.1)
Optionality risk	(39.8)	(19.0)	(30.1)	(7.7)
Total interest rate risk—Capital at Risk	**(52.2)**	**(25.5)**	**(34.2)**	**(14.1)**

Earnings at Risk

EaR has decreased over the year by £36.1 million in a positive rate shock scenario and by £11.9 million in a negative rate shock scenario. These improvements are due to the Group's savings pricing strategy and changes in customer terms and conditions, which has benefited interest rate mismatch risk. Additionally, the further utilisation of basis swapped positions has reduced the level of basis risk arising in these rate shock scenarios.

The table below shows that, due to reductions in the structural mismatches of assets and liabilities on the balance sheet across the year, the Group's net interest income at 31 December 2017 is significantly less likely to suffer from a large, sudden shock to interest rates than it was at 31 December 2016.

	2017		2016	
	Positive 1% rate shock	Negative 1% rate shock	Positive 1% rate shock	Negative 1% rate shock
	£m	£m	£m	£m
Interest rate mismatch risk	21.3	2.2	(1.7)	(1.4)
Basis risk	(0.1)	(9.0)	(10.4)	(17.6)
Pipeline risk	(2.5)	(1.3)	(3.0)	(2.3)
Optionality risk	(6.3)	(1.6)	(8.6)	(0.3)
Total interest rate risk—Earnings at Risk	12.4	(9.7)	(23.7)	(21.6)

Foreign currency assets and liabilities

Exposures to adverse changes in currency exchange rates have been reduced by using cross-currency swaps, resulting in a minimal net exposure. The table below shows assets and liabilities in foreign currency at Sterling carrying values.

(audited)	2017 US$ in	€ in	2016 US$	€ in
	£m	£m	£m	£m
Assets				
Loans and advances to banks	0.7	0.9	0.7	0.9
Available-for-sale financial assets	1.4	54.0	1.5	—
Intangible assets	0.1	0.1	0.1	0.1
Other assets	—	0.6	—	0.4
Total assets	**2.2**	**55.6**	**2.3**	**1.4**
Liabilities				
Debt securities in issue	377.0	387.0	175.7	412.4
Other liabilities	0.7	0.5	0.4	0.5
Total liabilities	**377.7**	**387.5**	**176.1**	**412.9**
Notional value of derivatives affecting currency exposures	(375.4)	(332.9)	(174.1)	(412.4)
Net position	**(0.1)**	**1.0**	**0.3**	**0.9**

Interest rate re-pricing of assets and liabilities

The following tables provide an analysis of the contractual re-pricing periods of assets and liabilities on the balance sheet. Mismatches in the re-pricing timing of assets, liabilities, and off-balance sheet positions create interest rate risk quantified in CaR and EaR.

2017[1] (audited)	**Within 3 months**	**After 3 months and within 6 months**	**After 6 months and within 1 year**	**After 1 year and within 5 years**	**After 5 years**	**Non-interest bearing instruments**	**Total**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Assets							
Cash and balances at central banks	2,521.3	—	—	—	—	57.7	2,579.0
Loans and receivables:							
Loans and advances to banks	352.0	—	—	—	—	7.4	359.4
Loans and advances to customers	7,281.3	2,137.5	4,843.8	21,650.2	532.8	294.6	36,740.2
Debt securities	0.3	—	—	—	—	—	0.3
Available-for-sale financial assets	406.8	13.1	5.0	122.8	444.8	59.3	1,051.8
Other assets	(32.5)	—	—	—	—	409.6	377.1
Total assets	**10,529.2**	**2,150.6**	**4,848.8**	**21,773.0**	**977.6**	**828.6**	**41,107.8**
Liabilities							
Deposits from banks	5,379.0	—	—	—	—	—	5,379.0
Customer deposits	17,022.0	2,256.0	5,275.7	6,245.5	0.6	8.6	30,808.4
Debt securities in issue	2,439.3	—	—	300.0	—	(2.4)	2,736.9
Other liabilities	—	—	—	—	—	358.6	358.6
Equity	—	—	—	390.0	—	1,434.9	1,824.9
Total liabilities and equity	**24,840.3**	**2,256.0**	**5,275.7**	**6,935.5**	**0.6**	**1,799.7**	**41,107.8**
Notional values of derivatives affecting interest rate sensitivity	12,799.6	676.0	674.8	(12,749.6)	(1,343.6)	(57.2)	—
Total interest rate sensitivity gap	**(1,511.5)**	**570.6**	**247.9**	**2,087.9**	**(366.6)**	**(1,028.3)**	—
Cumulative interest rate sensitivity gap	(1,511.5)	(940.9)	(693.0)	1,394.9	1,028.3	—	—

(1) Items are allocated to time bands in the table above by reference to the earlier of the next contractual interest rate re-pricing date and the residual maturity date.

2016[1] (audited)	Within 3 months	After 3 months and within 6 months	After 6 months and within 1 year	After 1 year and within 5 years	After 5 years	Non-interest bearing instruments	Total
	£m	£m	£m	£m	£m	£m	£m
Assets							
Cash and balances at central banks	732.0	—	—	—	—	54.3	786.3
Loans and receivables:							
Loans and advances to banks	630.1	—	—	—	—	5.5	635.6
Loans and advances to customers	8,074.2	1,871.1	3,425.2	18,365.1	298.5	333.0	32,367.1
Debt securities	0.7	—	—	—	—	—	0.7
Available-for-sale financial assets	212.9	—	—	154.5	426.0	65.4	858.8
Other assets	54.0	—	—	—	—	353.1	407.1
Total assets	**9,703.9**	**1,871.1**	**3,425.2**	**18,519.6**	**724.5**	**811.3**	**35,055.6**
Liabilities							
Deposits from banks	2,132.5	—	—	—	—	—	2,132.5
Customer deposits	18,027.5	1,157.1	4,081.4	4,810.2	—	30.1	28,106.3
Debt securities in issue	2,299.9	—	—	300.0	—	0.1	2,600.0
Other liabilities	—	—	—	—	—	546.3	546.3
Equity	—	—	—	390.0	—	1,280.5	1,670.5
Total liabilities and equity	**22,459.9**	**1,157.1**	**4,081.4**	**5,500.2**	—	**1,857.0**	**35,055.6**
Notional values of derivatives affecting interest rate sensitivity	10,864.0	(548.2)	1,388.0	(10,395.4)	(1,240.7)	(67.7)	—
Total interest rate sensitivity gap	**(1,892.0)**	**165.8**	**731.8**	**2,624.0**	**(516.2)**	**(1,113.4)**	—
Cumulative interest rate sensitivity gap	(1,892.0)	(1,726.2)	(994.4)	1,629.6	1,113.4	—	—

(1) Items are allocated to time bands in the table above by reference to the earlier of the next contractual interest rate re-pricing date and the residual maturity date.

The interest rate re-pricing tables shown above reflect the re-pricing of assets and liabilities without adjustments to the re- pricing profile that reflect future pricing assumptions. Expected future business that the Group hedges ahead of entering into a customer contract is not taken into account. The Group manages interest rate risk on this basis. Therefore, the gap profile shown above does not directly translate to the CaR and EaR term mismatch quantification.

Operational risk

Definition

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. It also includes legal risk.

Risk appetite

The Group's operational risk appetite is designed to safeguard the interests of customers, internal and external stakeholders, and shareholders.

Exposures

The principal operational risks to the Group are:

- IT systems and resilience risk arising from failure to develop, deliver and maintain effective IT solutions;
- information security risk arising from information leakage, loss or theft;

- external fraud arising from an act of deception or omission;
- cyber-crime arising from malicious attacks on the Group via technology, networks and systems;
- service disruption;
- failure of a third party corporate partner or strategic supplier; and
- normal business operational risk including transaction processing, information capture and implementation of change.

Measurement

A variety of measures are used to monitor operational risk, such as scoring of potential risks, considering impact and likelihood, assessing the effectiveness of controls, monitoring of events and losses by size, functional area and internal risk categories. The Group maintains a formal approach to operational risk event escalation. Material events are identified, captured and escalated. The root cause of events are determined and action plans put in place to ensure an optimum level of control. This ensures the Group keeps customers and the business safe, reduces costs, and improves efficiency.

Mitigation

The Group's control environment is regularly reviewed and reporting on material risks is discussed monthly by Senior Management. Risks are managed through a range of strategies such as mitigation, transfer (including insurance), and acceptance. Contingency plans are maintained for a range of potential scenarios with regular disaster recovery exercises.

Mitigating actions for the principal risks include:

- investment in IT infrastructure to ensure continued availability, security and resilience;
- investment in information security capability to protect customers and the Group;
- investment in the protection of customer information, including access to key systems and the security, durability and accessibility of critical records;
- a risk-based approach to mitigate the fi crime risks the Group faces, reflecting the current and emerging financial crime risks within the market. The Group has developed a comprehensive financial crime operating model. The Group's fraud awareness programme is a key component of the financial crime control environment; and
- operational resilience measures and recovery planning to ensure an appropriate and consistent approach to the management of continuity risks, including potential interruptions from a range of internal and external incidents or threats.

Monitoring

Monitoring and reporting of operational risk is undertaken at Board and Executive Committees. A combination of systems, monthly reports, oversight and challenge from the Risk function, Internal Audit and assurance teams ensures that key risks are regularly presented and considered by Executive management.

Key operational risks are appropriately insured, where possible. The insurance programme is monitored and reviewed regularly, with recommendations made to Executive management prior to each renewal.

Conduct risk and compliance

Definition

Conduct risk and compliance is defined as the risk that the Group's operating model, culture or actions result in unfair outcomes for customers, and the risk of regulatory sanction, material financial loss or reputational damage if the Group fails to design and implement effective operational processes, systems and controls and maintain compliance with all applicable regulatory requirements.

Risk appetite

The Group has no appetite for failure to remediate regulatory breaches and no tolerance for failing to deliver fair customer outcomes, whether through product design, sales or after sales processes.

Exposures

The Group manages conduct risk in relation to products and services, sales processes and complaint handling.

A series of change programmes drives new legislation and regulation into day-to-day operational and business practices across the Group.

The Group is unburdened with legacy conduct risk issues such as PPI, investments or derivatives mis-selling, LIBOR manipulation and distressed asset portfolios.

Measurement

Risk assessments are regularly reviewed and include assessments of control and material regulatory rule breaches, complaints and whistleblowing.

Mitigation

The Group takes a range of mitigating actions with respect to conduct risk and compliance. They include:

- promoting a culture throughout the business that places the customer at the heart of decision-making, business planning and culture;
- policies, processes and standards which provide a framework for the business to operate in accordance with the relevant laws and regulations;
- using a risk assessment framework that ensures product design and sales processes off customers value for money, meet the needs of the target market, and deliver fair outcomes to customers, including vulnerable customers;
- focusing on recruitment and training and how the Group manages colleagues' performance in relation to fair customer outcomes;
- regulatory horizon scanning; and
- using oversight and assurance themed reviews to assess compliance with rules, regulations and policies.

Monitoring

A robust assurance and quality monitoring regime is in place to test the performance of customer critical activities. Customer metrics are proactively used when reviewing business performance and feedback mechanisms have been established to learn from any issues identified.

The Risk function reports on conduct risk and compliance exposure. The report forms the basis of challenge to the business at the monthly Operational Risk, Conduct Risk and Compliance Committee.

Concentration risk

Definition

Concentration risk is defined as the exposure of the Group to credit concentrations in relation to retail and wholesale portfolios, products and counterparty levels. Concentration risk is the most significant component of financial risk and therefore has been disclosed in detail.

Risk appetite

The Group has limited appetite for concentrated exposures by country, region, loan size and type.

Exposures

The principal source of concentration risk is from loans and advances to customers in relation to:

- geography (see page 165);
- loan size (see page 166); and
- loan type (see page 168).

In addition, concentration risk arises from cash, debt securities and derivatives in relation to individual counterparty and country of exposure.

The Group has no significant concentrations of risk in the credit card portfolio.

Measurement

Credit concentration risk is measured through the application of limits relating to each concentration category.

Mitigation

Credit risk management includes portfolio controls on product lines and risk segments to reflect risk appetite and individual limit guidelines. Credit policy is aligned to the Group's risk appetite, restricts exposure to higher risk sectors and segments and manages overall portfolio concentrations.

Monitoring

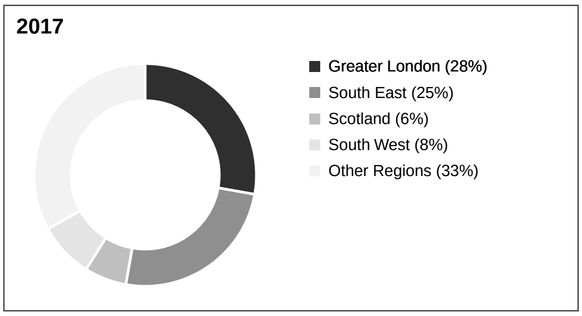
Monthly reporting on concentration risk exposures is made to the Board.

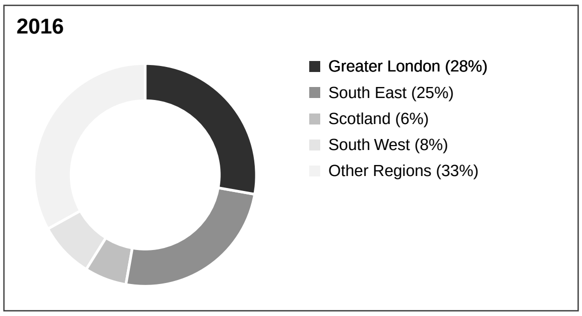
Secured credit

The Group's large exposures are reported in accordance with regulatory reporting requirements. Since the end of 2013 London and the South East have experienced higher levels of house price growth than the rest of the UK. Whilst demand for London property may be influenced by the international market, concerns over an asset bubble forming in these two regions are based on the rate of growth relative to other regions, a potential divergence in supply and demand for property, and customer affordability being stretched. The Group's policy restricts LTV for higher value loans, resulting in the lower average new lending LTVs observed in London (59%) and the South East (65%) compared to other regions (72%). The Group made changes to its lending policy in March 2016 in response to this risk through an income multiple cap.

The table below shows the geographical concentration of the mortgage portfolio.

	2017		**2016**	
(audited)	**£m**	**%**	**£m**	**%**
East Anglia	**862.4**	**2.6**	726.0	2.6
East Midlands	**1,784.3**	**5.3**	1,556.4	5.2
North	**1,118.2**	**3.3**	1,025.3	3.4
Yorkshire & Humberside	**1,881.5**	**5.6**	1,640.3	5.5
North West	**2,512.2**	**7.5**	2,209.3	7.4
West Midlands	**1,785.5**	**5.3**	1,560.9	5.2
South West	**2,676.6**	**7.9**	2,320.6	7.8
South East	**8,447.1**	**25.1**	7,365.7	24.8
Greater London	**9,297.2**	**27.6**	8,365.9	28.1
Wales	**753.7**	**2.2**	673.9	2.3
Scotland	**2,030.3**	**6.0**	1,828.0	6.1
Northern Ireland	**534.0**	**1.6**	478.3	1.6
Other	**1.5**	**—**	0.8	—
Total	**33,684.5**	**100.0**	**29,751.4**	**100.0**



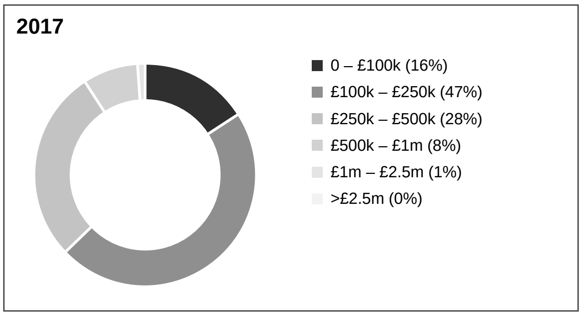


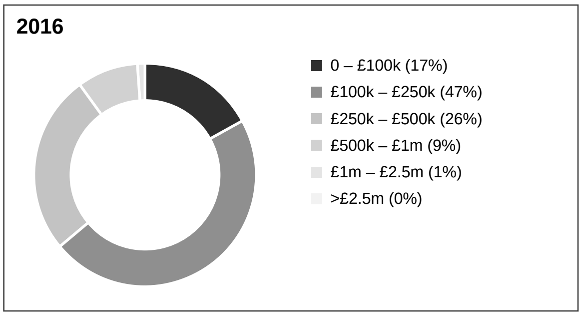
The geographical split of the portfolio remains broadly unchanged.

The table below shows retail secured credit concentrations by loan size.

	2017		2016	
(audited)	£m	%	£m	%
0–£100k	**5,324.4**	**15.9**	5,169.9	17.4
£100k–£250k	**16,023.6**	**47.6**	13,989.5	47.1
£250k–£500k	**9,569.0**	**28.4**	7,835.2	26.3
£500k–£1m	**2,542.0**	**7.5**	2,536.2	8.5
£1m–£2.5m	**215.5**	**0.6**	207.4	0.7
>£2.5m	**10.0**	**—**	13.2	—
Total	**33,684.5**	**100.0**	**29,751.4**	**100.0**

As at 31 December 2017, 0.7% (2016: 0.7%) of mortgage balances consisted of loans in excess of £1 million.





The value of loans with balances of up to £250,000 increased by £2,188.6 million during 2017. This represents 56% of the total secured loans portfolio growth of £3,933.1 million.

The tables below show retail secured credit average LTV by loan size.

2017 (audited)	Residential mortgage loans	Residential buy-to-let mortgage loans	Total
	%	%	%
0–£100k	**42.1**	**56.1**	**47.5**
£100k–£250k	**58.9**	**54.9**	**58.1**
£250k–£500k	**59.1**	**50.3**	**58.2**
£500k–£1m	**50.9**	**43.7**	**50.2**
£1m–£2.5m	**43.1**	**38.7**	**42.3**
>£2.5m	**34.0**	**—**	**34.0**
Total	**56.1**	**54.1**	**55.8**

2016 (audited)	Residential mortgage loans	Residential buy-to-let mortgage loans	Total
	%	%	%
0–£100k	42.6	58.2	48.4
£100k–£250k	58.9	55.2	58.2
£250k–£500k	57.9	49.0	57.1
£500k–£1m	51.0	42.7	50.3
£1m–£2.5m	43.7	34.9	42.2
>£2.5m	35.8	—	35.8
Total	**55.6**	**54.8**	**55.4**

The Group's policy restricts LTV for higher value loans. The average LTV for each loan band demonstrates that, excluding loans under £100,000, higher value loans have lower LTVs, primarily due to seasoning of the portfolio and tightened underwriting practices. The average indexed LTV across the loan size bands has reduced in the majority of bands reflecting positive house price index movements throughout 2017.

Loan type

The residential mortgage loan portfolio comprises three principal loan repayment types:

- capital repayment loans amortise monthly through customer repayments which comprise an interest payment and contribution to the principal loan balance;
- part-and-part loans provide customers with the flexibility to choose to pay a proportion of the loan on a capital repayment basis and a proportion on interest only, with the interest only element repaid from an acceptable repayment vehicle; and
- interest only loans allow borrowers to pay only the interest on the loan each month, with the capital to be repaid in full at the end of the loan period from an acceptable repayment vehicle.

For residential mortgage customers, the Group continues to apply strict affordability criteria and restricts applicant LTV. For buy-to-let customers, interest only mortgages continue to be the predominant repayment method, with the majority of customers looking to the sale of the mortgaged property as the ultimate loan repayment vehicle. These loans are also subject to stringent lending standards.

The tables below show retail secured credit concentrations by loan type.

2017 (audited)	Residential mortgage loans		Residential buy-to-let mortgage loans		Total	
	£m	%	£m	%	£m	%
Capital repayment	**22,963.2**	**84.0**	**1,040.0**	**16.4**	**24,003.2**	**71.3**
Part-and-part	**1,007.1**	**3.7**	**46.8**	**0.7**	**1,053.9**	**3.1**
Interest only	**3,346.9**	**12.3**	**5,280.5**	**82.9**	**8,627.4**	**25.6**
Total	**27,317.2**	**100.0**	**6,367.3**	**100.0**	**33,684.5**	**100.0**

2016 (audited)	Residential mortgage loans		Residential buy-to-let mortgage loans		Total	
	£m	%	£m	%	£m	%
Capital repayment	19,521.7	80.4	913.0	16.7	20,434.7	68.7
Part-and-part	1,115.6	4.6	37.3	0.7	1,152.9	3.9
Interest only	3,645.7	15.0	4,518.1	82.6	8,163.8	27.4
Total	**24,283.0**	**100.0**	**5,468.4**	**100.0**	**29,751.4**	**100.0**

Wholesale

Concentration risk is managed for both individual counterparties and for country of exposure. The Group does not set a limit on exposures to the Bank of England and the UK Sovereign.

The table below shows wholesale credit risk exposures by country.

(audited)	2017	2016
	£m	£m
Australia	**8.5**	19.3
Canada	**170.3**	169.0
France	**83.1**	105.3
UK	**3,532.8**	1,747.5
Netherlands	—	102.7
USA	**37.4**	104.6
Supranational	**234.1**	129.3
Total	**4,066.2**	2,377.7

The Group's wholesale credit risk exposure outside the UK remains well-diversified. UK exposures have increased by £1,785.3 million during the year due to further drawings from the TFS.

Funding and liquidity risk

Definition

Funding risk is defined as the inability to raise and maintain sufficient cost-effective funding in quality and quantity to support the delivery of the business plan. Sound funding risk management reduces the likelihood of liquidity risks occurring through minimising refinancing concentration.

Liquidity risk is defined as the inability to accommodate liability maturities and withdrawals, fund asset growth and otherwise meet contractual obligations to make payments as they fall due.

Risk appetite

The Group funds before it lends, and has a clear framework for balance sheet structure in order to control funding, refinancing and liquidity risk. The Group operates an investment strategy for wholesale investments which prioritises liquidity and ensures that the Group holds a liquid asset buffer in excess of both regulatory and internally assessed requirements.

Exposures

Liquidity exposure represents the amount of potential stressed outflows in any future period less expected inflows.

The Group's primary liquidity risk exposure arises through the redemption of retail deposits where customers are permitted to withdraw funds with limited or no notice. Additional exposures exist in relation to pipeline mortgage business, undrawn card balances and wholesale funding.

The Group is exposed to refinancing risk at the point of contractual maturity. The risk arises from both wholesale and retail funding sources.

Measurement

A series of measures are used across the Group to monitor both short and long-term liquidity requirements including ratios, cash outflow triggers, wholesale and retail funding maturity profile, early warning indicators and stress test survival periods. Liquidity risk appetite covers a range of metrics considered key to maintaining a strong liquidity and funding position. Strict criteria and limits are in place to ensure highly liquid marketable securities are available as part of the portfolio of liquid assets.

The measurement framework has two other important components:

- the volume and quality of the Group's liquid asset portfolio is defined through a series of stress tests across a range of time horizons and stress conditions. The Group ensures a liquidity surplus is held during normal market conditions above liquidity stress outflow requirements. Stress cash outflow assumptions have been established for individual liquidity risk drivers across idiosyncratic and market wide stresses.

Internal and regulatory liquidity requirements are quantified on a daily basis, with holdings assessed against a full suite of liquidity stresses weekly.

As the Group is predominantly retail funded, the largest potential source of liquidity stress is the unexpected outflow of retail customer deposits.

The key risk driver assumptions applied to the scenarios are:

Liquidity risk driver	Modelling assumption
Retail funding	Severe unexpected withdrawal of retail deposits by customers arising from redemption or refinancing risk. No additional deposit inflows are assumed.
Wholesale funding . .	Limited opportunity to refinance wholesale contractual maturities. Full outflow of secured and unsecured funding during the refinancing period, with no reinvestment of funding.
Off-balance sheet . . .	Cash outflows during the period of stress as a result of off-balance sheet commitments such as mortgage pipeline, undrawn credit card facilities and collateral commitments.
Franchise viability . .	Lending outflows, over and above contractual obligations, are honoured as the Group preserves ongoing franchise viability.
Liquid assets	The liquidity portfolio value is reduced, reflecting stressed market conditions.

The scenarios and the assumptions are reviewed to ensure that they continue to be relevant to the nature of the business. The Group's liquidity risk appetite is calibrated against a number of stressed metrics. The funding plan is also stressed against a range of macro-economic scenarios; and

- the Group maintains a Liquidity Contingency Plan which is designed to provide an early warning indicator for liquidity concerns and a list of potential actions to address a liquidity shortfall. As a result, mitigating actions can be taken to avoid a more serious situation developing.

Mitigation

The most material component of the Group's funding and liquidity position is the customer deposit base, which is supplemented by wholesale funding providing a source of stable funding for balance sheet growth. Where funding concentrations exist, for example refinancing at maturity, these are managed within the appropriate internal risk appetite, to control the size of the exposure. Refinancing is planned in advance of maturity with liquidity held to mitigate the potential exposure. Longer term funding is used to manage the Group's strategic liquidity profile in line with limits.

The Group operates a Funds Transfer Pricing (FTP) mechanism which supports customer pricing and the overall Group balance sheet strategy.

FTP makes use of behavioural maturity profiles, taking account of expected customer loan prepayments and the stability of customer deposits. Such behavioural maturity assumptions are subject to formal governance and reviewed periodically.

The ability to deploy assets quickly, either through the repo market or through outright sale, is also an important source of liquidity for the Group. In addition to central bank reserves, the Group holds sizeable balances of high-quality marketable debt securities. Such securities can be sold to provide, or used to secure, additional cash inflows from market counterparties or central bank facilities (Bank of England), should the need arise.

Monitoring

Liquidity is actively monitored by the Group. Reporting is conducted through the Asset and Liability Committee and the Board Risk Committee. In a stress situation the level of monitoring and reporting is increased commensurate with the nature of the stress event.

Daily monitoring and control processes are in place to address internal and regulatory liquidity requirements. The Group monitors a range of market and internal early warning indicators on a daily basis for early signs of liquidity risk in the market or specific to the Group. These are a mixture of quantitative and qualitative measures including daily variation of customer balances, cash outflows, changes in primary liquidity portfolio, credit default swap spreads and changing funding costs.

Funding and liquidity management in 2017

During 2017, the Group maintained a strong funding and liquidity position in excess of risk appetite and the short- term liquidity stress metric, the Liquidity Coverage Ratio (LCR). The Group's LCR as at 31 December 2017 was 203.1%, representing a material surplus above the UK regulatory minimum requirement of 90%. The LCR improved from 153.7% at 31 December 2016 due to strong deposit raising activity throughout the year, net TFS drawings made during the year, and an RMBS issuance in September 2017, increasing High Quality Liquid Assets (HQLA). The Group monitors the NSFR based on its own interpretations of current guidance available for CRD IV NSFR reporting.

Wholesale funding is used to support balance sheet growth, lengthen the contractual tenor of funding and diversify sources of funding. The Group has made use of the TFS during the year, taking overall drawings to £4.2 billion.

Funding sources

The Group is funded predominantly through retail customer deposits. During 2017, the Group maintained a strong presence in the retail savings market. Total customer deposits increased by £2.7 billion in the year and represented 75.6% of the Group's funding at 31 December 2017. The Group's retail funding portfolio demonstrated resilience and stability throughout 2017. The retention performance was in line with plan following repricing activities and the retail product mix moved towards fixed rate products, with overall contractual tenor increasing.

The Group's loan-to-deposit ratio increased to 119.1% as planned during 2017 from 114.5% at 31 December 2016.

The table below shows the Group's funding position.

(audited)	**2017**	**2016**
	£m	**£m**
Loans and advances to customers	**36,740.2**	32,367.1
Loans and advances to banks	**359.4**	635.6
Debt securities classified as loans and receivables	**0.3**	0.7
Available-for-sale financial assets (encumbered)	**149.4**	10.6
Cash and balances at central banks (encumbered)	**215.7**	168.1
Funded assets	**37,465.0**	33,182.1
Other assets	**377.1**	407.1
Total assets (excluding liquid assets)	**37,842.1**	33,589.2
On balance sheet primary liquidity assets		
Cash and balances at central banks - primary	**2,363.3**	618.2
Available-for-sale financial assets (unencumbered)	**902.4**	848.2
Total assets	**41,107.8**	35,055.6
Less: Other liabilities	**(371.6)**	(560.8)
Funding requirement	**40,736.2**	34,494.8
Funded by		
Customer deposits	**30,808.4**	28,106.3
Wholesale funding	**8,102.9**	4,718.0
Total equity	**1,824.9**	1,670.5
Total Funding	**40,736.2**	34,494.8

The table below shows the sources of wholesale funding.

(audited)	**2017**	**2016**
	£m	**£m**
Debt securities in issue	**2,736.9**	2,600.0
Liabilities in respect of securities sold under repurchase agreements	**1,130.0**	850.0
Secured loans	**4,236.0**	1,268.0
Total on-balance sheet sources of Funds	**8,102.9**	4,718.0
Treasury bills raised through FLS	**2,033.5**	2,683.7
Total	**10,136.4**	7,401.7

Secured loans relate to the Group's drawings from the Bank of England's TFS. The increase is due to further TFS drawings that were made during the year.

The tables below show residual maturity of the wholesale funding book.

2017 (audited)	Within 3 months	3–12 months	1–5 years	After 5 years	Total
	£m	£m	£m	£m	£m
Debt securities in issue	—	—	**302.8**	**2,434.1**	**2,736.9**
Liabilities in respect of securities sold under repurchase agreements	**5.0**	**850.0**	**275.0**	—	**1,130.0**
Secured loans	—	—	**4,236.0**	—	**4,236.0**
Total on-balance sheet sources of Funds	**5.0**	**850.0**	**4,813.8**	**2,434.1**	**8,102.9**
Treasury bills raised through FLS	—	**1,098.5**	**935.0**	—	**2,033.5**
Total	**5.0**	**1,948.5**	**5,748.8**	**2,434.1**	**10,136.4**

2016 (audited)	Within 3 months	3–12 months	1–5 years	After 5 years	Total
	£m	£m	£m	£m	£m
Debt securities in issue	—	—	305.8	2,294.2	2,600.0
Liabilities in respect of securities sold under repurchase agreements	500.0	75.0	275.0	—	850.0
Secured loans	—	—	1,268.0	—	1,268.0
Total on-balance sheet sources of funds	500.0	75.0	1,848.8	2,294.2	4,718.0
Treasury bills raised through FLS	—	649.2	2,034.5	—	2,683.7
Total	**500.0**	**724.2**	**3,883.3**	**2,294.2**	**7,401.7**

An increase in average tenor of wholesale funding during 2017 is driven by the drawings of TFS, which are categorised as 1–5 years maturity.

Encumbered assets

The Group's assets can be used to support funding collateral requirements for central bank operations or third party re-purchase transactions. Assets that have been set aside for such purposes are classified as 'encumbered and pledged assets' and cannot be used for other purposes.

The tables below show the total asset encumbrance position of the Group for 2017 and 2016.

	Encumbered assets		Unencumbered assets		
2017 (audited)	Pledged as collateral[(1)]	Other[(2)]	Available as collateral[(3)]	Other[(4)]	Total
	£m	£m	£m	£m	£m
Cash and balances at central banks	—	**215.7**	—	**2,363.3**	**2,579.0**
Debt securities classified as loans and receivables	—	—	**0.3**	—	**0.3**
Available-for-sale financial assets	—	**149.4**	**899.3**	**3.1**	**1,051.8**
Derivative financial assets	—	—	—	**78.8**	**78.8**
Loans and advances to banks	**93.0**	**201.1**	—	**65.3**	**359.4**
Loans and advances to customers	**13,109.4**	—	**4,670.3**	**18,960.5**	**36,740.2**
Other assets	**8.5**	—	—	**289.8**	**298.3**
Total assets	**13,210.9**	**566.2**	**5,569.9**	**21,760.8**	**41,107.8**
Treasury bills raised through FLS held off balance sheet[(5)]	**182.9**	—	**1,850.6**	—	**2,033.5**
Total assets plus off-balance sheet Treasury bills raised through FLS	**13,393.8**	**566.2**	**7,420.5**	**21,760.8**	**43,141.3**

2016 (audited)	Encumbered assets: Pledged as collateral[1]	Encumbered assets: Other[2]	Unencumbered assets: Available as collateral[3]	Unencumbered assets: Other[4]	Total
	£m	£m	£m	£m	£m
Cash and balances at central banks	—	168.1	—	618.2	786.3
Debt securities classified as loans and receivables	—	—	0.7	—	0.7
Available-for-sale financial assets	10.6	—	840.3	7.9	858.8
Derivative financial assets	—	—	—	104.2	104.2
Loans and advances to banks	181.1	354.4	—	100.1	635.6
Loans and advances to customers	9,425.6	—	2,932.9	20,008.6	32,367.1
Other assets	53.9	—	—	249.0	302.9
Total assets	**9,671.2**	**522.5**	**3,773.9**	**21,088.0**	**35,055.6**
Treasury bills raised through FLS held off balance sheet[5]	—	—	2,683.7	—	2,683.7
Total assets plus off-balance sheet Treasury bills raised through FLS	**9,671.2**	**522.5**	**6,457.6**	**21,088.0**	**37,739.3**

(1) Encumbered assets pledged as collateral include amounts to derivative counterparties of £93.0 million (2016: £181.1 million) and amounts in respect of centrally cleared derivatives of £8.5 million (2016: £53.9 million). Encumbered loans and advances to customers of £13,109.4 million (2016: £9,425.6 million) consist of securitised mortgages and other loan pools positioned with the Bank of England that have been pledged as collateral for funding and liquidity transactions. As at 31 December 2017, £6,219.8 million (2016: £2,302.3 million) of loan pools have been pledged as collateral in respect of secured loans and repo agreements.

(2) Other encumbered assets are assets that cannot be used for secured funding due to legal or other reasons. These comprise the mandatory reserve and the minimum requirement for the BACS payment system of £215.7 million (2016: £168.1 million) and cash reserves supporting secured funding structures of £201.1 million (2016: £354.4 million).

(3) Unencumbered asserts which are classified as 'Available for collateral' are readily available to secure funding or to meet collateral requirements. Loans and advances to customers are classified as 'Available for collateral' only if they are already in such a form that they can be used immediately to raise funding.

(4) Other unencumbered assets are assets which are not subject to any restrictions but are not readily available for use.

(5) These amounts represent Treasury Bills received by the Group through FLS, which are not recognised on the balance sheet. The Group is permitted to re-pledge these securities to generate on-balance sheet financial assets, such as cash, or to fund lending. These items are classified as encumbered where the Group has used them in repurchase transactions or unencumbered where it has not.

The Group's total level of asset encumbrance increased by £3.8 billion to 32.4% at 31 December 2017. This was primarily due to using the TFS to support increased lending, which took total drawings to date to £4.2 billion. The Group manages the volume of available unencumbered collateral to meet requirements arising from current and future secured funding transactions.

Liquid asset portfolio

The Group maintains a portfolio of liquid assets, predominantly in high-quality unencumbered securities issued by the UK Government or supranational institutions and deposits with the Bank of England. The portfolio mix is aligned to the liquidity coverage requirement defined in European liquidity regulatory standards. Other liquidity resources represent additional unencumbered liquid assets held over and above high-quality liquid assets. These are intended to cover more extreme stress events and provide flexibility for liquidity management.

The table below shows the composition of the liquidity portfolio.

	2017	2017 Average	2016	2016 Average
	£m	£m	£m	£m
Level 1				
Cash and balances at central banks	**2,525.9**	**1,923.0**	737.2	819.6
UK Government securities	**207.3**	**221.8**	306.7	339.3
Other HOLA level 1 eligible	—	—	—	33.8
Supranational securities	**234.1**	**178.0**	129.3	222.0
Treasury bills raised through FLS	**1,850.6**	**2,219.7**	2,683.7	2,528.2
Covered bonds (Level 1 eligible)	**374.7**	**378.8**	304.9	434.4
Total level 1	**5,192.6**	**4,921.3**	4,161.8	4,377.3
Level 2a				
Covered bonds (Level 2a eligible)	**21.7**	**22.2**	22.2	22.4
Total level 2a	**21.7**	**22.2**	22.2	22.4
Level 2b				
Eligible RMBS	**50.1**	**52.6**	38.6	49.1
Total level 2b	**50.1**	**52.6**	38.6	49.1
High quality liquid assets (Level 1 + 2a + 2b)	**5,264.4**	**4,996.1**	4,222.6	4,448.8
Other liquidity resources				
Covered bonds	—	—	—	1.2
Non-eligible RMBS	**11.4**	**8.6**	13.6	11.6
Certificates of deposit	—	**40.8**	—	44.5
Floating rate notes	—	**6.3**	25.0	9.6
Money market loans	**13.8**	**13.3**	26.0	38.8
Total other liquidity resources	**25.2**	**69.0**	64.6	105.7
Self-issued RMBS	**601.7**	**958.2**	1,306.4	550.8
Total liquidity	**5,891.3**	**6,023.3**	5,593.6	5,105.3

The Group holds sufficient liquidity to meet all internal and regulatory liquidity requirements.

The following tables analyse assets and liabilities of the Group into relevant maturity groupings based on the remaining contractual period at the balance sheet date. The Group's assets and liabilities may be repaid or otherwise mature earlier or later than implied by their contractual terms.

In particular, the majority of customer deposits are contractually payable on demand or at short notice. In practice, these deposits are not usually withdrawn on their contractual maturity. Amounts in respect of RMBS in issue have a maximum contractual maturity consistent with underlying mortgage assets (in excess of five years); the cash flow profile below reflects that securitisation documents will require repayment of the securities in line with repayments of the underlying mortgages, which may be in advance of the legal maturity date.

2017 (audited)	Within 3 months	3–12 months	1–5 years	After 5 years	Total
	£m	£m	£m	£m	£m
Assets					
Cash and balances at central banks	**2,526.0**	—	—	**53.0**	**2,579.0**
Derivative financial instruments	**0.5**	**1.4**	**76.8**	**0.1**	**78.8**
Loans and receivables:					
Loans and advances to banks	**359.4**	—	—	—	**359.4**
Loans and advances to customers	**3,328.0**	**794.2**	**4,429.1**	**28,188.9**	**36,740.2**
Debt securities	—	—	—	**0.3**	**0.3**
Available-for-sale financial assets	**159.4**	**18.9**	**314.9**	**558.6**	**1,051.8**
Other assets	**75.7**	**7.3**	**60.3**	**155.0**	**298.3**
Total assets	**6,449.0**	**821.8**	**4,881.1**	**28,955.9**	**41,107.8**
Liabilities					
Deposits from banks	**18.0**	**850.0**	**4,511.0**	—	**5,379.0**
Customer deposits	**27,268.6**	**2,144.2**	**1,395.0**	**0.6**	**30,808.4**
Derivative financial instruments	**9.4**	**4.4**	**64.3**	**15.4**	**93.5**
Debt securities in issue	—	—	**302.8**	**2,434.1**	**2,736.9**
Other liabilities	**185.8**	**70.2**	**5.7**	**3.4**	**265.1**
Total liabilities	**27,481.8**	**3,068.8**	**6,278.8**	**2,453.5**	**39,282.9**
Net liquidity (gap) / surplus	**(21,032.8)**	**(2,247.0)**	**(1,397.7)**	**26,502.4**	**1,824.9**

2016 (audited)	Within 3 months	3–12 months	1–5 years	After 5 years	Total
	£m	£m	£m	£m	£m
Assets					
Cash and balances at central banks	737.2	—	—	49.1	786.3
Derivative financial instruments	1.4	1.5	99.8	1.5	104.2
Loans and receivables:					
Loans and advances to banks	635.6	—	—	—	635.6
Loans and advances to customers	2,700.3	720.1	3,910.6	25,036.1	32,367.1
Debt securities	—	—	—	0.7	0.7
Available-for-sale financial assets	—	25.0	283.2	550.6	858.8
Other assets	99.2	25.3	10.8	167.6	302.9
Total assets	**4,173.7**	**771.9**	**4,304.4**	**25,805.6**	**35,055.6**
Liabilities					
Deposits from banks	514.5	75.0	1,543.0	—	2,132.5
Customer deposits	24,540.2	1,883.6	1,682.5	—	28,106.3
Derivative financial instruments	8.2	8.6	185.6	27.3	229.7
Debt securities in issue	—	—	305.8	2,294.2	2,600.0
Other liabilities	240.7	67.0	5.0	3.9	316.6
Total liabilities	**25,303.6**	**2,034.2**	**3,721.9**	**2,325.4**	**33,385.1**
Net liquidity (gap) / surplus	(21,129.9)	(1,262.3)	582.5	23,480.2	1,670.5

Cash flow profile

The tables below allocate the Group's non-derivative cash outflows into relevant maturity groupings based on the remaining period between the balance sheet date and the contractual maturity date. The amounts disclosed are the contractual undiscounted cash flows. These differ from balance sheet values due to the effects of discounting on certain balance sheet items and due to the inclusion of contractual future interest flows.

2017 (audited)	Within 3 months	3–6 months	6–12 months	1–5 years	Over 5 years	Total
	£m	£m	£m	£m	£m	£m
Deposits from banks	**23.2**	**858.9**	**12.4**	**4,567.9**	—	**5,462.4**
Customer deposits	**27,338.1**	**847.3**	**1,495.7**	**1,571.6**	**0.6**	**31,253.3**
Debt securities in issue	**169.4**	**169.7**	**335.4**	**2,102.3**	—	**2,776.8**
Total	**27,530.7**	**1,875.9**	**1,843.5**	**8,241.8**	**0.6**	**39,492.5**

2016 (audited)	Within 3 months	3–6 months	6–12 months	1–5 years	Over 5 years	Total
	£m	£m	£m	£m	£m	£m
Deposits from banks	514.1	76.7	3.1	1,556.8	—	2,150.7
Customer deposits	24,628.0	680.8	1,371.3	1,835.9	—	28,516.0
Debt securities in issue	158.7	161.2	297.3	2,056.5	—	2,673.7
Total	**25,300.8**	**918.7**	**1,671.7**	**5,449.2**	—	**33,340.4**

The following tables display future derivative cash flows in the relevant maturity groupings in which they fall due. Cash flows for the floating legs of derivative transactions are calculated using the forward interest rate curve. These cash flows are not discounted in the same way that derivative valuations are, and totals will therefore not be identical to those reported on derivatives in the notes to the financial statements.

2017 (audited)	Within 3 months	3–6 months	6–12 months	1–5 years	Over 5 years	Total
	£m	£m	£m	£m	£m	£m
Settled on a net basis						
Derivatives in economic and not accounting hedges	**(1.5)**	**(0.1)**	**(1.5)**	**(4.4)**	—	**(7.5)**
Derivatives in accounting hedge relationships	**(12.9)**	**(8.1)**	**(14.1)**	**(32.3)**	**(7.6)**	**(75.0)**
	(14.4)	**(8.2)**	**(15.6)**	**(36.7)**	**(7.6)**	**(82.5)**
Settled on a gross basis						
Outflows	**30.0**	**28.9**	**54.7**	**224.9**	—	**338.5**
Inflows	**(29.4)**	**(28.4)**	**(53.9)**	**(230.0)**	—	**(341.7)**
Total	**(13.8)**	**(7.7)**	**(14.8)**	**(41.8)**	**(7.6)**	**(85.7)**

2016 (audited)	Within 3 months	3–6 months	6–12 months	1–5 years	Over 5 years	Total
	£m	£m	£m	£m	£m	£m
Settled on a net basis						
Derivatives in economic and not accounting hedges	(1.8)	(0.5)	(4.5)	(12.2)	(0.3)	(19.3)
Derivatives in accounting hedge relationships	(26.1)	(21.2)	(37.6)	(110.0)	(6.2)	(201.1)
	(27.9)	(21.7)	(42.1)	(122.2)	(6.5)	(220.4)
Settled on a gross basis						
Outflows	1.4	2.6	2.5	23.3	—	29.8
Inflows	(1.5)	(3.0)	(2.8)	(26.6)	—	(33.9)
Total	**(28.0)**	**(22.1)**	**(42.4)**	**(125.5)**	**(6.5)**	**(224.5)**

External credit ratings

Virgin Money Holdings (UK) plc does not have an external credit rating. Disclosures below relate to its subsidiary, Virgin Money plc. Virgin Money plc's short and long-term credit ratings as at 31 December 2017 are as follows.

	Long term	Short term	Outlook	Date of last rating action	Rating action type
Fitch	BBB+	F2	Stable	7 September 2017	Affirmed
Moody's	Baa2	P2	Stable	26 June 2017	Assigned

In September 2017, the rating agency Fitch maintained Virgin Money plc's outlook as Stable and affirmed its long-term rating at BBB+. On 26 June 2017, the rating agency Moody's assigned Virgin Money plc's outlook as Stable and its long-term rating as Baa2.

The table below sets out the amount of additional collateral the Company would need to provide in the event of a one and two notch downgrade by external credit ratings agencies.

	Cumulative adjustment for a one-notch downgrade	Cumulative adjustment for a two-notch downgrade
	£m	£m
2017	—	—
2016	—	10.0

In addition, the Group could be required to post further collateral for payment systems, clearing houses and to support secured funding transactions. These requirements can be directly linked to the Group's external credit rating or driven by other factors. The Group monitors the related collateral requirements and includes these in liquidity stress requirements.

SECTION B:
HISTORICAL FINANCIAL INFORMATION RELATING TO THE VIRGIN MONEY GROUP FOR THE YEAR ENDED 31 DECEMBER 2016

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF VIRGIN MONEY HOLDINGS (UK) PLC

REPORT ON THE FINANCIAL STATEMENTS

Our opinion

In our opinion:

- Virgin Money Holdings (UK) plc's consolidated financial statements and Parent Company financial statements (the financial statements) give a true and fair view of the state of the Group's and of the Parent Company's affairs as at 31 December 2016 and of the Group's profit and the Group's and the Parent Company's cash flows for the year then ended;
- the consolidated financial statements have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union;
- the Parent Company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the consolidated financial statements, Article 4 of the IAS Regulation.

What we have audited

The financial statements, included within the Annual Report and Accounts (the Annual Report), comprise:

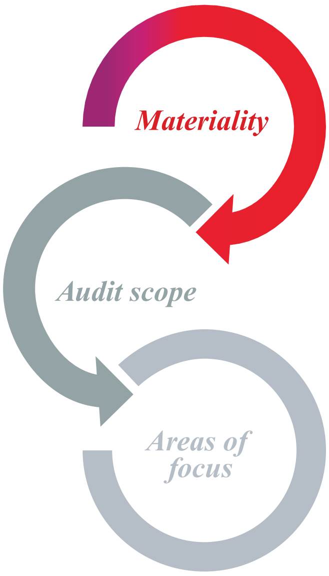
- the consolidated income statement and the consolidated statement of comprehensive income for the year then ended;
- the consolidated and Parent Company balance sheet as at 31 December 2016;
- the consolidated and Parent Company statement of changes in equity for the year then ended;
- the consolidated and Parent Company cash flow statement for the year then ended; and
- the consolidated and Parent Company notes to the financial statements, which include a summary of significant accounting policies and other explanatory information.

Certain required disclosures have been presented elsewhere in the Annual Report, rather than in the notes to the financial statements. These are cross-referenced from the financial statements and are identified as audited.

The financial reporting framework that has been applied in the preparation of the financial statements is IFRSs as adopted by the European Union and, as regards the Parent Company financial statements, as applied in accordance with the provisions of the Companies Act 2006, and applicable law.

Our audit approach

Overview



Overall Group materiality: £9.8 million which represents 5 per cent of profit before tax adjusted for £2.4 million of strategic items (as detailed on page 54), as these are not considered to be recurring. This adjusted measure of profit is deemed as the most appropriate measure of underlying business performance and hence an appropriate benchmark upon which to base our materiality.

The consolidated financial statements include its five 100% owned subsidiaries as well as a number of securitisation related Special Purpose Vehicles (SPVs). As the statutory audit of subsidiaries is undertaken concurrently with the Group audit, all five subsidiaries were designated as in-scope components for Group purposes. Additionally certain SPV balances were scoped in on a line by line basis based on their contribution to the consolidated financial statement line item. 99% of Revenue, 99% of profit before tax (99% of the adjusted profit before tax figure as used for our overall materiality calculation) and 99% of Total Assets were subject to audit.

- Impairment of loans and advances to customers;
- Revenue recognition—Effective Interest Rate (EIR) accounting; and
- Impairment of intangible assets.

The scope of our audit and our areas of focus

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) (ISAs (UK & Ireland)).

We designed our audit by determining materiality and assessing the risks of material misstatement in the financial statements. In particular, we looked at where the Directors made subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. As in all of our audits we also addressed the risk of management override of internal controls, including evaluating whether there was evidence of bias by the Directors that represented a risk of material misstatement due to fraud.

The risks of material misstatement that had the greatest effect on our audit, including the allocation of our resources and effort, are identified as 'areas of focus' in the table below. We have also set out how we tailored our audit to address these specific areas in order to provide an opinion on the financial statements as a whole, and any comments we make on the results of our procedures should be read in this context. This is not a complete list of all risks identified by our audit.

Area of focus	How our audit addressed the area of focus
Impairment of loans and advances to customers	
See note 1 of the financial statements for the Directors' disclosure of the related accounting policies and also page 99 for the Audit Committee's consideration of principal risks. The impairment provision of £50.1 million consists of provisions of £10.6 million in relation to secured lending and £39.5 million in relation to unsecured lending. Total loans and advances as at 31 December 2016 relating to secured lending was £29.8 billion and £2.5 billion for unsecured lending. We focused on this area because the Directors make complex and subjective judgments over both the timing of recognition and the size of provisions for impairment of the Group's loans and advances. This judgement includes considering the completeness of	We assessed and tested the design and operating effectiveness of the controls over data flows and model governance. Our detailed work in auditing the impairment provisions included: • Using credit risk modelling specialists to assess the provision and material assumption calculation methodology applied by the Group in the context of industry practice and the requirements of accounting standards; • Testing key assumptions used within the models to internal and external information where appropriate;

Area of focus	How our audit addressed the area of focus
the provisions and whether any specific judgemental overlays are required to recognise the impact of emerging trends not captured in the impairment models. The Group have developed historic data based models that derive key assumptions used within the provision calculation such as Probability of Default and Loss Given Default. The output of these models is then applied to the provision calculation with other information including the selection of an appropriate Loss Emergence Period and the Exposure at Default.	• Comparing the key assumptions within the models with our industry experience; • Reading the model calculation scripts to ensure that their application was consistent with our understanding of the Group's methodology and the requirements of accounting standards; • Examining the basis for the judgemental overlays made to the results produced by models and agreeing the rationale for the adjustments to supporting data; and • Considering the appropriateness of judgemental overlays applied in the context of our industry experience. We found the approach taken in relation to the Group's impairment provisions to be consistent with the requirements of accounting standards. Our testing did not result in any material matters that we considered necessary to report to the Audit Committee.
Revenue Recognition—EIR accounting See note 1 of the financial statements for the Directors' disclosure of the related accounting policies and also page 98 for the Audit Committee's consideration of principal risks. The Group's total loans and advances to customers balance of £32.4 billion and net interest income of £522.4 million include certain EIR adjustments as per the requirements of IAS 39. The vast majority of the Group's income is system generated and requires minimal judgement, therefore we focused our work in relation to the risk of fraud in revenue recognition on EIR accounting due to the inherent subjectivity involved in forecasting future customer behaviour that is included in the EIR adjustment calculation. Changes in assumptions used in the forecasting model could have a material impact on EIR adjustments and hence, the revenue recognised in any one accounting period. The most significant assumption for secured lending EIR is the estimation of the expected life of the product over which fees are spread. In relation to unsecured lending, additional judgement is applied in calculating the EIR adjustment, by considering movements in customer balances over the expected life and the related future revenue associated with these balances in the context of the Group's historic experience of expected life cash flows on similar products.	Across both the secured and unsecured lending EIR calculation models, we tested controls over data input and checked the accuracy of model calculations by reading the formulas used and considering these with our expectation for an EIR calculation. In relation to secured lending EIR we completed the following testing: • Substantively tested a sample of fees incorporated within the calculation back to underlying secured lending agreements; and • Assessed the Group's estimate of the expected life applied and forecast cash flows during this life by comparing to recent Group experience and our industry experience. • In relation to unsecured lending EIR we completed the following testing: • Tested controls over the Group's ongoing monitoring of actual vs. expected cash flows and compared 2016 experience with expected experience for that period on a sample basis; • Assessed the Group's assumption over expected life by comparing to recent Group experience and our industry experience; and • Performed sensitivity analyses of key judgements to understand the materiality of impact that potential realistic changes in assumptions may have, either individually or in combination, on the EIR asset. Our testing did not result in any material matters that we considered necessary to report to the Audit Committee.

Area of focus	How our audit addressed the area of focus
Impairment of intangible assets See note 1 of the financial statements for the Directors' disclosure of the related accounting policies and also page 99 for the Audit Committee's consideration of principal risks. A fast changing economic and competitive landscape requires constant innovation and investment by banks in keeping up with consumer expectations. As technology and customer expectations continue to change there is a risk that certain technology assets may not generate the return that the Group had initially anticipated and therefore may be subject to impairment.	We read the Group's capitalisation policy to check that it met the requirements of IAS 38. We tested the design and operating effectiveness of the control environment in relation to the recording, budgeting and approval of project costs which form the basis of capitalisation accounting entries. We selected a sample of intangible assets and undertook the following procedures: • Substantively tested a selection of costs to check that these meet the criteria of IAS 38 for capitalisation as intangible assets; • Discussed the Group's stock of material capitalised assets with management to identify any that may be at higher risk of potential impairment; and • Where higher risk items were noted, we discussed the asset and related forecast economic benefits this would bring with management to inform our independent consideration as to whether any possible impairment triggers existed. Our testing did not identify any material matters which we considered necessary to report to the Audit Committee.

How we tailored the audit scope

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the financial statements as a whole, taking into account the geographic structure of the Group, the accounting processes and controls, and the industry in which the Group operates.

Because this was our first year as the Group's external auditors, we performed specific procedures over opening balances by shadowing the prior year audit clearance and year end Audit Committee meetings, reviewing the predecessor auditors' working papers and re-evaluating the key management judgements in the opening balance sheet at 1 January 2016.

We then performed year one process walkthroughs to understand and evaluate the key financial processes and controls across the Group and, in accordance with International Standard on Review Engagements (UK and Ireland) 2410, a review of the half year financial information. Following this work, we planned our audit and presented our audit plan to the Audit Committee. As we conducted our audit procedures, we identified changes that we needed to make to that initial plan and tailored our work accordingly. As required by ISAs (UK&I), we communicated these changes and the reasons for them, to the Audit Committee. These changes did not affect our assessment of the audit risk associated with any of the areas of focus described above. Following the changes in our audit approach, we were able to obtain sufficient appropriate audit evidence to form a basis for our audit opinion.

The consolidated financial statements include its five 100% owned subsidiaries as well as a number of securitisation related Special Purpose Vehicles (SPVs). As the statutory audit of subsidiaries is undertaken concurrently with the Group audit, all five subsidiaries were designated as in-scope components for Group purposes. Additionally certain SPV balances were scoped in on a line by line basis based on their contribution to the consolidated financial statement line item. 99% of Revenue, 99% of profit before tax (99% of the adjusted profit before tax figure as used for our overall materiality calculation) and 99% of Total Assets were subject to audit.

In establishing the overall approach to the Group audit, we determined the type of work that needed to be performed over the components. All of the audit work was completed by the Group engagement team.

OTHER REQUIRED REPORTING

Materiality

The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures on the individual financial statement line items and disclosures and in evaluating the effect of misstatements, both individually and on the financial statements as a whole.

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

Overall Group materiality	£9.8 million
How we determined it	5 per cent of profit before tax adjusted for £2.4 million of strategic items (as detailed on page 54), as these are not considered to be recurring
Rationale for benchmark applied	This adjusted measure of profit is deemed as the most appropriate measure of underlying business performance and hence an appropriate benchmark upon which to base our materiality

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £0.47 million as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Going concern

Under the Listing Rules we are required to review the Directors' statement, set out on page 126, in relation to going concern. We have nothing to report having performed our review.

Under ISAs (UK & Ireland) we are required to report to you if we have anything material to add or to draw attention to in relation to the Directors' statement about whether they considered it appropriate to adopt the going concern basis in preparing the financial statements. We have nothing material to add or to draw attention to.

As noted in the Directors' statement, the Directors have concluded that it is appropriate to adopt the going concern basis in preparing the financial statements. The going concern basis presumes that the Group and Parent Company have adequate resources to remain in operation, and that the Directors intend them to do so, for at least one year from the date the financial statements were signed. As part of our audit we have concluded that the Directors' use of the going concern basis is appropriate. However, because not all future events or conditions can be predicted, these statements are not a guarantee as to the Group's and Parent Company's ability to continue as a going concern.

Consistency of other information and compliance with applicable requirements

Companies Act 2006 reporting

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

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

In addition, in light of the knowledge and understanding of the Group, the Parent Company and their environment obtained in the course of the audit, we are required to report if we have identified any material misstatements in the Strategic Report and the Directors' Report. We have nothing to report in this respect.

ISAs (UK & Ireland) reporting

Under ISAs (UK & Ireland) we are required to report to you if, in our opinion:

- information in the Annual Report is:
  - materially inconsistent with the information in the audited financial statements; or
  - apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Group and Parent Company acquired in the course of performing our audit; or
  - otherwise misleading.

  We have no exceptions to report.

- the statement given by the Directors on page 131, in accordance with provision C.1.1 of the UK Corporate Governance Code (the Code), that they consider the Annual Report taken as a whole to be fair, balanced and understandable and provides the information necessary for members to assess the Group's and Parent Company's position and performance, business model and strategy is materially inconsistent with our knowledge of the Group and Parent Company acquired in the course of performing our audit.

  We have no exceptions to report.

- the section of the Annual Report on pages 98 and 99, as required by provision C.3.8 of the Code, We have no exceptions to report. describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee.

  We have no exceptions to report.

The Directors' assessment of the prospects of the Group and of the principal risks that would threaten the solvency or liquidity of the Group

Under ISAs (UK & Ireland) we are required to report to you if we have anything material to add or to draw attention to in relation to:

- the Directors' confirmation on page 138 of the Annual Report, in accordance with provision C.2.1 of the Code, that they have carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency or liquidity.

  We have nothing material to add or to draw attention to.

- the disclosures in the Annual Report that describe those risks and explain how they are being managed or mitigated.

  We have nothing material to add or to draw attention to.

- the Directors' explanation on pages 126 and 127 of the Annual Report, in accordance with provision C.2.2 of the Code, as to how they have assessed the prospects of the Group, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

  We have nothing material to add or to draw attention to.

Under the Listing Rules we are required to review the Directors' statement that they have carried out a robust assessment of the principal risks facing the Group and the Directors' statement in relation to the longer-term viability of the Group. Our review was substantially less in scope than an audit and only consisted of making inquiries and considering the Directors' process supporting their statements; checking that the statements are in alignment with the relevant provisions of the Code; and considering whether the statements are consistent with the knowledge acquired by us in the course of performing our audit. We have nothing to report having performed our review.

Adequacy of accounting records and information and explanations received

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

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept by the Parent Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the Parent Company financial statements and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

Directors' remuneration

Directors' remuneration report—Companies Act 2006 opinion

In our opinion, the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006.

Other Companies Act 2006 reporting

Under the 2006 Act we are required to report to you if, in our opinion, certain disclosures of Directors' remuneration specified by law are not made. We have no exceptions to report arising from this responsibility.

Corporate governance statement

Under the Listing Rules we are required to review the part of the Corporate Governance Statement relating to ten further provisions of the Code. We have nothing to report having performed our review.

RESPONSIBILITIES FOR THE FINANCIAL STATEMENTS AND THE AUDIT

Our responsibilities and those of the Directors

As explained more fully in the Statement of Directors' responsibilities set out on pages 130 and 131, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and ISAs (UK & Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the Parent Company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

What an audit of financial statements involves

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of:

- whether the accounting policies are appropriate to the Group's and the Parent Company's circumstances and have been consistently applied and adequately disclosed;
- the reasonableness of significant accounting estimates made by the Directors; and
- the overall presentation of the financial statements.

We primarily focus our work in these areas by assessing the Directors' judgements against available evidence, forming our own judgements, and evaluating the disclosures in the financial statements.

We test and examine information, using sampling and other auditing techniques, to the extent we consider necessary to provide a reasonable basis for us to draw conclusions. We obtain audit evidence through testing the effectiveness of controls, substantive procedures or a combination of both.

In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performingvthe audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report. With respect to the Strategic Report and Directors' Report, we consider whether those reports include the disclosures required by applicable legal requirements.

Catrin Thomas (Senior Statutory Auditor)

for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors Edinburgh

27 February 2017

CONSOLIDATED INCOME STATEMENT

For the year ended 31 December

	Note	2016	2015
		£ million	£ million
Interest and similar income		**948.1**	839.3
Interest and similar expense		**(425.7)**	(384.5)
Net interest income	3	**522.4**	454.8
Fee and commission income		**28.8**	**27.4**
Fee and commission expense		**(1.2)**	**(1.2)**
Net fee and commission income	4	**27.6**	**26.2**
Other operating income	5	**40.3**	**41.3**
Fair value losses on financial instruments	13	**(8.9)**	**(0.4)**
Other income		**59.0**	67.1
Total income		**581.4**	521.9
Operating expenses	6	**(349.4)**	(353.6)
Profit before tax from operating activities		**232.0**	168.3
Impairment	8	**(37.6)**	(30.3)
Profit before tax		**194.4**	138.0
Taxation	9	**(54.3)**	(26.8)
Profit for the year		**140.1**	111.2
Profit attributable to equity owners		**140.1**	111.2
Profit for the year		**140.1**	111.2
Basic earnings per share (pence)	10	**29.4**	22.9
Diluted earnings per share (pence)	10	**29.1**	22.7

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December

	Note	2016 £ million	2015 £ million
Profit for the year		**140.1**	111.2
Other comprehensive income			
Items that may subsequently be reclassified to profit or loss:			
Movements in revaluation reserve in respect of available-for-sale financial assets:			
Change in fair value	30	**44.4**	25.1
Income statement transfers in respect of disposals	30	**(38.3)**	(33.6)
Taxation	30	**(1.7)**	1.2
		4.4	(7.3)
Movements in cash flow hedge reserve:			
Effective portion of changes in fair value taken to other comprehensive income	30	**(36.1)**	(13.2)
Net income statement transfers	30	**13.6**	5.1
Taxation	30	**6.3**	1.6
		(16.2)	(6.5)
Other comprehensive expense for the year, net of tax		**(11.8)**	(13.8)
Total comprehensive income for the year		**128.3**	97.4
Total comprehensive income attributable to equity owners		**128.3**	97.4

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED BALANCE SHEET

As at 31 December

	Note	2016 £ million	2015 £ million
Assets			
Cash and balances at central banks		**786.3**	888.6
Derivative financial instruments	13	**104.2**	82.3
Loans and receivables:			
• Loans and advances to banks	14	**635.6**	614.5
• Loans and advances to customers	15	**32,367.1**	27,109.0
• Debt securities		**0.7**	1.1
		33,003.4	27,724.6
Available-for-sale financial assets	16	**858.8**	1,296.9
Intangible assets	19	**80.6**	64.4
Tangible fixed assets	20	**77.4**	74.6
Deferred tax assets	21	**23.0**	38.0
Other assets	22	**121.9**	59.6
Total assets		**35,055.6**	30,229.0
Equity and liabilities			
Liabilities			
Deposits from banks	23	**2,132.5**	1,298.7
Customer deposits	24	**28,106.3**	25,144.9
Derivative financial instruments	13	**229.7**	156.0
Debt securities in issue	25	**2,600.0**	2,039.4
Provisions	26	**8.5**	8.4
Other liabilities	27	**291.4**	235.0
Current tax liabilities		**16.7**	6.3
Total liabilities		**33,385.1**	28,888.7
Equity			
Share capital and share premium	28	**654.6**	654.6
Other equity instruments	29	**384.1**	156.5
Other reserves	30	**(27.4)**	(15.6)
Retained earnings	31	**659.2**	544.8
Total equity		**1,670.5**	1,340.3
Total liabilities and equity		**35,055.6**	30,229.0

The accompanying notes are an integral part of these consolidated financial statements.

The financial statements on pages 202 to 256 were approved and authorised for issue by the Board and were signed on its behalf on 27 February 2017.

Glen Moreno
Chairman

Jayne-Anne Gadhia CBE
Chief Executive

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December

Attributable to equity holders

	Share capital and share premium	Other equity instruments	Other reserves	Retained earnings	Total equity
	£ million	£ million	£ million	£ million	£ million
Balance at 1 January 2016	**654.6**	**156.5**	**(15.6)**	**544.8**	**1,340.3**
Comprehensive income					
Profit for the year	—	—	—	**140.1**	**140.1**
Other comprehensive income					
Net movement in revaluation reserve in respect of available-for-sale financial assets	—	—	**4.4**	—	**4.4**
Net movement in cash flow hedge reserve	—	—	**(16.2)**	—	**(16.2)**
Total other comprehensive expense	—	—	**(11.8)**	—	**(11.8)**
Total comprehensive (expense)/income for the year	—	—	**(11.8)**	**140.1**	**128.3**
Transactions with equity holders					
Dividends paid to ordinary shareholders	—	—	—	**(20.8)**	**(20.8)**
Distribution to Additional Tier 1 security holders	—	—	—	**(12.6)**	**(12.6)**
Group relief attributable to Additional Tier 1 securities	—	—	—	**2.5**	**2.5**
Purchase of own shares	—	—	—	**(7.3)**	**(7.3)**
Issue of Additional Tier 1 securities	—	**227.6**	—	—	**227.6**
Share based payments—charge for the year	—	—	—	**12.8**	**12.8**
Deferred tax on share based payments	—	—	—	**(0.3)**	**(0.3)**
Total transactions with equity holders	—	**227.6**	—	**(25.7)**	**201.9**
Balance at 31 December 2016	**654.6**	**384.1**	**(27.4)**	**659.2**	**1,670.5**

The accompanying notes are an integral part of these consolidated financial statements.

Further details of movements in the Group's share capital and reserves are provided in notes 28 to 31.

For the year ended 31 December

Attributable to equity holders (Continued)

	Share capital and share premium	Other equity instruments	Other reserves	Retained earnings	Total equity
	£ million	£ million	£ million	£ million	£ million
Balance at 1 January 2015	654.6	156.5	(1.8)	434.5	1,243.8
Comprehensive income					
Profit for the year	—	—	—	111.2	111.2
Other comprehensive income					
Net movement in revaluation reserve in respect of available-for-sale financial assets	—	—	(7.3)	—	(7.3)
Net movement in cash flow hedge reserve	—	—	(6.5)	—	(6.5)
Total other comprehensive expense	—	—	(13.8)	—	(13.8)
Total comprehensive (expense)/income for the year	—	—	(13.8)	111.2	97.4
Transactions with equity holders					
Dividends paid to ordinary shareholders	—	—	—	(6.2)	(6.2)
Distribution to Additional Tier 1 security holders	—	—	—	(12.6)	(12.6)
Tax attributable to Additional Tier 1 securities	—	—	—	2.6	2.6
Purchase of own shares	—	—	—	(5.0)	(5.0)
Share based payments—charge for the year	—	—	—	20.0	20.0
Deferred tax on share based payments	—	—	—	0.3	0.3
Total transactions with equity holders	—	—	—	(0.9)	(0.9)
Balance at 31 December 2015	654.6	156.5	(15.6)	544.8	1,340.3

The accompanying notes are an integral part of these consolidated financial statements.

Further details of movements in the Group's share capital and reserves are provided in notes 28 to 31.

CONSOLIDATED CASH FLOW STATEMENT

For the year ended 31 December

	Note	2016	2015
		£ million	**£ million**
Profit before taxation		**194.4**	138.0
Adjustments for:			
Change in operating assets	35(a)	**(5,387.3)**	(4,037.3)
Change in operating liabilities	35(b)	**3,957.3**	3,146.4
Non-cash and other items	35(c)	**(19.5)**	62.4
Tax paid		**(22.1)**	(5.0)
Net cash used in operating activities		**(1,277.2)**	(695.5)
Cash flows from investing activities			
Purchase of securities		**(670.0)**	(659.2)
Proceeds from sale and redemption of securities		**1,150.0**	900.5
Purchase in investment in intangible assets		**(31.6)**	(29.5)
Purchase of tangible fixed assets		**(8.6)**	(10.2)
Disposal of tangible fixed assets		**0.7**	—
Net cash provided by investing activities		**440.5**	201.6
Cash flows from financing activities			
Dividends paid to ordinary shareholders	11	**(20.8)**	(6.2)
Distributions to Additional Tier 1 security holders		**(12.6)**	(12.6)
Net proceeds from issue of debt securities		**1,278.9**	1,047.2
Repayments of debt securities in issue		**(718.3)**	(601.9)
Purchase of own shares		**(7.3)**	(5.0)
Issue of Additional Tier 1 securities (net of costs)		**227.6**	—
Net cash provided by financing activities		**747.5**	421.5
Change in cash and cash equivalents		**(89.2)**	(72.4)
Cash and cash equivalents at beginning of year		**1,461.4**	1,533.8
Cash and cash equivalents at end of year	35(d)	**1,372.2**	1,461.4

The accompanying notes are an integral part of these consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1: BASIS OF PREPARATION AND ACCOUNTING POLICIES

1.1 Reporting entity

Virgin Money Holdings (UK) plc (the Company) is a public limited company incorporated and registered in England and Wales. The registered office is Jubilee House, Gosforth, Newcastle-Upon-Tyne, NE3 4PL.

The Company was incorporated on 4 August 1995 as a private limited company with registered number 03087587. On 24 July 2014 the Company was re-registered as a public limited company.

The Company is the parent entity and the ultimate controlling party of the Virgin Money Group (the Group), which consists of the Company and its subsidiaries.

1.2 Basis of preparation

The Group consolidated financial statements, which should be read in conjunction with the Directors' Report, have been prepared on a going concern basis in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU, including interpretations issued by the IFRS Interpretations Committee, and with those parts of the Companies Act 2006 applicable to companies reporting under IFRS.

The Directors have reviewed the strategic plan which shows the financial position, cash flow, liquidity and capital forecasts for the Group. The Directors are confident that the Group will have sufficient resources to meet its liabilities as they fall due and to continue to operate for a period of at least 12 months from the date of approval of the financial statements. Accordingly the Directors believe that it remains appropriate to prepare the financial statements on a going concern basis.

1.3 Changes in accounting policy

New standards, amendments to standards and interpretations adopted

In 2016, the Group adopted a number of minor interpretations and amendments to standards, which were endorsed for adoption by the EU, and mandatory for annual reporting periods beginning on or after 1 January 2016. These included amendments published through the Annual Improvements to IFRSs 2010–2012 and 2012–2014 cycles, in addition to a number of stand-alone amendments.

The adoption of these interpretations and amendments to standards or interpretations had an insignificant impact on the Group and did not result in any change in accounting policies.

New accounting standards issued by the IASB that are relevant to the Group and effective in future periods are presented in note 38.

1.4 Presentation of information

Presentation of risk and capital management disclosures

Disclosures under IFRS 7 'Financial Instruments: Disclosure' concerning the nature and extent of risks relating to financial instruments and under IAS 1 'Presentation of financial statements' concerning objectives, policies and processes for managing capital have been included within the audited sections of the Risk Management Report. Where marked as 'audited' these are covered by the Independent Auditors' Report.

1.5 Basis of consolidation

The Group consists of the Company and its subsidiaries. The subsidiaries are listed in note 2 of the parent company financial statements. The consolidated financial statements comprise the financial statements of the Group.

Entities are regarded as subsidiaries where the Group has the power over an investee, exposure or rights to variable returns from its involvement with the investee and the ability to affect those returns. Inter-company transactions and balances are eliminated upon consolidation. Subsidiaries are consolidated from the date on which control is transferred to the Group and are deconsolidated from the date that power over an investee, exposure or rights to variable returns and the ability to affect these returns ceases. Accounting policies are applied consistently across the Group.

The Virgin Money Foundation, launched in August 2015, is managed and controlled by a Board of independent Trustees, such that the Group has no power over the Foundation or, exposure or ability to affect variable returns. The Foundation is therefore not consolidated in the financial statements of the Group.

Special Purpose Vehicles (SPV) are entities created to accomplish a narrow and well defined objective. For the Group this is the securitisation of mortgage assets. An SPV is consolidated if the Group has control over the SPV, through its exposure to variable returns from its involvement in the SPV and the ability to affect those returns through its power over the entity.

1.6 Basis of measurement

The financial statements have been prepared under the historical cost convention as modified by the revaluation of derivative financial instruments, available-for-sale and other assets held at fair value through profit or loss. A summary of the material accounting policies of the Group are included within note 1.9. Policies which are relevant to the financial statements as a whole are set out below.

The accounting policies have been applied consistently to all periods presented in these financial statements.

1.7 Client money

The Group's unit trust management and investment intermediary subsidiaries administer money on behalf of some clients in accordance with the Client Money Rules of the Financial Conduct Authority. Client money is not recognised in the balance sheet or in the notes to the financial statements as the Group is not the beneficial owner.

1.8 Foreign currency translation

The Group's financial statements are presented in Sterling, which is the functional currency of the Company, all of its subsidiaries and the SPVs included within the consolidated financial statements.

Foreign currency transactions are translated into functional currency using the exchange rates prevailing at the dates of the transactions. Monetary items denominated in foreign currencies are translated at the rate prevailing at the balance sheet date. Foreign exchange gains and losses resulting from the restatement and settlement of such transactions are recognised in the income statement, except when recognised in other comprehensive income if relating to a qualifying cash flow hedge or available-for-sale assets. Non-monetary items (which are assets or liabilities which do not attach to a right to receive or an obligation to pay currency) measured at historical cost and denominated in foreign currencies are translated at the exchange rate at the date of the transaction. Non-monetary items measured at fair value are translated at the exchange rate at the date of valuation. Where these are held at fair value through the income statement, exchange differences are reported as part of the fair value gain or loss.

1.9 Accounting policies

The accounting policies of the Group are set out below.

(a) Operating segments

The Group determines operating segments according to similar economic characteristics and the nature of its products and services in accordance with IFRS 8 'Operating Segments'. Management reviews the Group's internal reporting based around these segments in order to assess performance and allocate resources.

Segment performance is evaluated based on underlying profit or loss and is measured consistently with underlying profit or loss in the consolidated financial statements (income tax is unallocated). Segment results are regularly reviewed and reported to the Board of Directors to allocate resources to segments and to assess their performance.

Operating segments are reported in a manner consistent with the internal reporting provided to the Board. The Group Executive Committee (Management) has been determined to be the chief operating decision maker for the Group.

(b) Interest income and expense

Interest income and expense are recognised in the income statement for all instruments measured at amortised cost using the effective interest rate method.

This method calculates the amortised cost of a financial asset or liability, and allocates the interest income or expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts or payments through the expected life of the financial instrument or, where appropriate, a shorter period to the net carrying amount of the financial asset or liability. The Group estimates cash flows considering all contractual terms of the financial instrument (for example prepayment options) but does not consider future credit losses. The calculation includes all amounts received or paid by the Group that are an integral part of the overall return, direct incremental transaction costs related to the acquisition or issue of a financial instrument and all other premiums and discounts.

Once a financial asset or group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

Interest receivable or payable on derivatives, whether in economic or accounting hedges, is recorded on an accruals basis in interest receivable or payable. Interest on available-for-sale (AFS) debt securities is recorded in interest receivable using the effective interest rate method.

(c) Fees and commissions

Where they are not included in the effective interest rate calculation, fees and commissions are recognised on an accruals basis when the service has been received or provided. Loan commitment fees for loans that are likely to be drawn down are deferred (together with related incremental direct costs) and recognised as an adjustment to the effective interest rate on the loan.

Fee income from general insurance and life insurance policies is recognised in full on the effective date of commencement or renewal of the related policies to reflect underlying contracts with product providers.

(d) Other operating income

Other operating income comprises the fair value for services, net of value added tax, rebates and discounts. Other operating income is attributable to the sale and management of stocks and shares ISAs, pensions, authorised unit trusts and other financial services products.

Other operating income from sales of units in managed funds is recognised daily based on the average volume of funds under management.

Fees charged to register with Virgin Money Giving Limited are recognised from the date on which recovery is reasonably certain. The commission charged on donations and event fees is recognised from the date donations and event fees are transacted on the website. Both of these income streams contribute towards costs incurred by Virgin Money Giving Limited.

Other income includes commission on donations and other sundry income.

(e) Total operating expenses

Operating expenses are recognised on an accruals basis as services are provided. Included within the employee benefits expense are employee share based payments. The accounting policy in relation to share based payments is set out in policy (f).

Staff costs

The Group accounts for components of employee costs on the following bases:

- **Short-term employee benefits**

Short term employee benefits include salaries and social security costs and are recognised over the period in which the employees provide the services to which the payments relate.

Cash bonus awards are recognised to the extent that the Group has a present obligation to its employees that can be measured reliably and are recognised over the period of service that employees are required to work to qualify for the payment.

- **Other long-term employee benefits**

Other long-term employee benefits include deferred cash bonus awards. Deferred cash bonus awards are recognised at the present value of the obligation at the reporting date. These costs are recognised over the period of service that employees are required to work to qualify for the payment.

- **Retirement benefit obligations**

A defined contribution plan is a post-employment benefit plan into which the Group pays fixed contributions and has no legal or constructive obligation to pay further amounts. Contributions are recognised as staff expenses in profit or loss in the periods during which related employee services are fulfilled.

The Group operates defined contribution pension schemes for its Directors and employees. The assets of the schemes are held separately from those of the Group in independently administered funds.

Leases

If the lease agreement in which the Group is a lessee transfers the risks and rewards of the asset, the lease is recorded as a finance lease and the related asset is capitalised. At inception, the asset is recorded at the lower of the present value of the minimum lease payments or fair value and is depreciated over the estimated useful life. The lease obligations are recorded as borrowings.

If the lease does not transfer the risks and rewards of the asset, the lease is recorded as an operating lease.

Operating lease payments are charged to profit or loss on a straight line basis over the lease term unless a different systematic basis is more appropriate. Where an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor in compensation is charged to profit or loss in the period in which termination is made.

(f) Share based payments

The Group puts in place share schemes for employees to reward strong long-term business performance and to incentivise growth for the future.

The Group engages in equity settled share based payment transactions in respect of services received from certain of its employees.

For these transactions the grant date fair value of the award is recognised as an employee expense with a corresponding increase in equity over the period that the employees become unconditionally entitled to the awards.

The grant date fair value of the award is determined using valuation models which take into account the terms and conditions attached to the awards. Inputs into valuation models may include the exercise price, the risk-free interest rate, the expected volatility of the Company's share price and other various factors which relate to performance conditions attached to the awards.

The amount recognised as an expense is adjusted to reflect the actual number of awards for which the related service and non-market vesting conditions are expected to be met such that the amount ultimately recognised as an expense is based on the number of awards that do meet the related service and non-market performance conditions at the vesting date.

(g) Impairment losses

The Group assesses its financial assets or groups of financial assets for objective evidence of impairment at each balance sheet date. An impairment loss is recognised if a loss event (or events) has occurred after initial recognition, and on or before the balance sheet date, that has an impact on the estimated future cash flows of the financial assets or groups of financial assets that can be reliably measured. Losses incurred as a result of events occurring after the balance sheet date are not recognised in these financial statements.

- **Assets held at amortised cost**

The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant.

Objective evidence that a financial asset is impaired includes observable data that comes to the attention of the Group about the following loss events:

- there is evidence of the customer or issuer experiencing financial difficulty;
- there is a breach of contract, such as a default or delinquency in repayments;
- the customer is granted a concession that would otherwise not be considered;
- the borrower will enter bankruptcy or other financial reorganisation;
- the disappearance of an active market for that financial asset because of financial difficulties; and
- observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the portfolio, including:
  - there are adverse changes in the payment status of borrowers in the portfolio; and
  - economic conditions that correlate with defaults on the assets in the portfolio.

If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. In assessing collective impairment the Group uses statistical modelling of historic trends to assess the probability of a group of financial assets going into default and the subsequent loss incurred. Regular model monitoring is performed to ensure model assumptions remain appropriate.

Assets that are individually assessed and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss on loans and receivables has been incurred, the amount of the loss is measured as the difference between the asset carrying amount and the present value of the estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an impairment allowance and the amount of the loss is recognised in profit or loss.

When a loan or receivable is uncollectible, it is written off against the related provision for loan impairment. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off are recognised directly in the income statement. If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the customer's credit rating), the previously recognised impairment loss is reversed by adjusting the impairment allowance. The amount of the reversal is recognised in profit or loss.

A provision is also made in the case of accounts, which may not currently be in arrears, where losses may have been incurred but not yet recognised. An increased level of provision is held for accounts where an impairment trigger event has occurred which includes accounts benefiting from forbearance and those in arrears. Refer to the Risk Management Report for details of the forbearance policy.

- **Available-for-sale financial assets**

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset, or group of financial assets are impaired. The amount of the loss is measured as the difference between the asset's acquisition cost less principal repayments and amortisation and the current fair value. The amount of the impairment loss is recognised in profit or loss. This includes cumulative gains and losses previously recognised in other comprehensive income which are recycled from other comprehensive income to the income statement.

If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through profit or loss. Impairment losses recognised in profit or loss on equity instruments are not reversed through profit and loss.

(h) Taxation

Taxation comprises current tax and deferred tax. Current tax and deferred tax are recognised in profit or loss except to the extent that they relate to items recognised directly in equity or other comprehensive income.

Current tax is based on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years. The Group has adopted the Code of Practice on Taxation for Banks issued by HM Revenue and Customs.

Deferred tax is recognised in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

Deferred tax assets are recognised for unused tax losses, tax credits and deductible temporary differences, to the extent that it is probable that future taxable profits will be available against which they can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

(i) Earnings per share

Basic earnings per share is calculated by dividing the profit attributable to ordinary shareholders of the parent company by the weighted-average number of ordinary shares outstanding during the period excluding own shares held in employee benefit trusts or held for trading.

The diluted earnings per share is calculated by adjusting the profit or loss that is attributable to ordinary shareholders and the weighted-average number of ordinary shares outstanding for the effects of all dilutive potential ordinary shares, which comprise share options granted to employees.

For the calculation of diluted earnings per share the weighted-average number of ordinary shares in issue is adjusted to assume conversion of all dilutive potential ordinary shares, if any, that arise in respect of share options and rewards granted to employees. The number of shares that could have been acquired at the average annual share price of the Company's shares based on the monetary value of the subscription rights attached to outstanding share options and awards is determined. This is deducted from the number of shares issuable under such options and awards to leave a residual bonus amount of shares which are added to the weighted-average number of ordinary shares in issue, but no adjustment is made to the profit attributable to equity shareholders.

(j) Financial instruments

- **Financial assets**

Management determines the classification of its financial instruments at initial recognition.

Financial assets can be classified in the following categories:

- loans and receivables;
- available-for-sale;
- held to maturity; or
- financial assets at fair value through profit or loss.

Purchases and sales of financial assets at fair value through profit or loss, held to maturity and available-for-sale are recognised on the trade date, the date on which the Group commits to purchase or sell the asset.

- **Loans and receivables at amortised cost**

The Group's loans and advances to banks and customers and asset backed securities for which there is no active market are classified as loans and receivables. Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, whose recoverability is based solely on the credit risk of the customer and where the Group has no intention of trading the loan or receivable. Loans and receivables are initially recognised at fair value including direct and incremental transaction costs. Subsequent recognition is at amortised cost using the effective interest rate method, less any provision for impairment.

- **Available-for-sale financial assets**

Available-for-sale financial assets are non-derivative assets that are either designated as available-for-sale or are assets that do not meet the definition of loans and receivables and are not derivatives or assets held at fair value through profit or loss. These are principally, but not exclusively, investment securities intended to be held for an indefinite period of time which may be sold in response to a need for liquidity or changes in interest rates, exchange rates or equity prices. They are initially measured at fair value including direct and incremental transaction costs. Fair values are obtained from quoted market prices in active markets and, where these are not available, from valuation techniques including discounted cash flow models (refer to policy (m)). With the exception of certain unquoted equity instruments measured at cost less impairment because their fair value cannot be measured reliably, subsequent measurement is at fair value, with changes in fair value being recognised in other comprehensive income except for impairment losses and translation differences, which are recognised in profit or loss. Upon derecognition of the asset, or where there is objective evidence that the investment security is impaired, the cumulative gains and losses recognised in other comprehensive income are removed from other comprehensive income and recycled to profit or loss.

- **Held to maturity financial assets**

Held to maturity financial assets are non-derivative financial assets with fixed or determinable payments that the Group has the ability and intention to hold to maturity. They are initially measured at fair value including direct and incremental transaction costs. Subsequent measurement is at amortised cost using the effective interest rate method. No financial assets were classified as held to maturity during either the current or prior year.

- **Financial assets at fair value through profit or loss**

This category consists of derivative financial assets. Assets in this category are carried at fair value. The fair values of derivative instruments are calculated by discounted cash flow models using yield curves that are based on observable market data or are based on valuations obtained from counterparties. Gains and losses arising from the changes in the fair values are recognised in the income statement or other comprehensive income (refer policy (n)).

The fair values of quoted investments in active markets are based on current bid prices. If the market for a financial asset is not active (and for unlisted securities), the Group establishes fair value using valuation techniques. These include the use of recent arm's length transactions, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants.

- **Financial liabilities**

The Group measures all of its financial liabilities at amortised cost, other than derivatives and those instruments which have been designated as part of a hedging relationship (refer policy (n)). Borrowings, including deposits and debt securities in issue are recognised initially at fair value, being the issue proceeds net of premiums, discounts and transaction costs incurred. All borrowings are subsequently measured at amortised cost using the effective interest rate method. Amortised cost is adjusted for the amortisation of any premiums, discounts and transaction costs. The amortisation is recognised in interest expense and similar charges using the effective interest rate method. The Group does not hold any financial liabilities classified as held for trading.

- **Offsetting financial instruments**

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

- **Sale and repurchase agreements**

Securities sold subject to repurchase agreements (repos) are reclassified in the financial statements as assets pledged when the transferee has the right by contract or custom to sell or repledge the collateral. The counterparty liability is included in deposits from banks or customer deposits, as appropriate. Securities purchased under agreements to resell (reverse repos) are recorded as loans and advances to banks or customers as appropriate. The difference between sale and repurchase price is treated as interest and accrued over the life of the agreements using the effective interest rate method. Securities lent to counterparties are also retained in the financial statements.

- **Derecognition of financial assets and liabilities**

Derecognition is the point at which the Group removes an asset or liability from its balance sheet. The Group's policy is to derecognise financial assets only when the contractual right to the cash flows from the financial asset expires or when the Group transfers the financial assets to another party provided the transfer of the asset also transfers the right to receive the cash flows of the financial asset or where the Group has transferred substantially all the risks and rewards of ownership. Where the transfer does not result in the Group transferring the right to receive the cash flows of the financial assets, but it does result in the Group assuming a corresponding obligation to pay the cash flows to another recipient, the financial assets are also accordingly derecognised. The Group derecognises financial liabilities only when the obligation specified in the contract is discharged, converted to shares, cancelled or has expired or is transferred to a third party. There were no transactions in the year where the Group transferred financial assets that should have been derecognised in their entirety.

(k) Loans and advances to banks

The Group's loans and advances to banks are classified as loans and receivables.

(l) Loans and advances to customers

The Group's loans and advances to customers are classified as loans and receivables.

(m) Available-for-sale financial assets

The Group's debt securities and equity instruments are classified as available-for-sale assets. Debt securities are principally available-for-sale as they are intended to be held for an indefinite period of time but may be sold in response to a need for liquidity, changes in interest rates or exchange rates. Equity instruments are classified as available-for-sale because they do not meet the definition of loans and receivables, have no defined maturity dates and are not derivatives or assets held at fair value through profit or loss.

(n) Derivative financial instruments and hedge accounting

The Group is authorised to undertake the following types of derivative financial instrument transactions for non-trading purposes: cross currency swaps, interest rate swaps, equity swaps, interest rate caps, forward rate agreements, options, foreign exchange contracts and similar instruments.

The Group's derivative activities are entered into for the purpose of matching or eliminating risk from potential movements in interest rates, foreign exchange rates and equity exposures inherent in the Group's assets, liabilities and positions. All derivative transactions are for economic hedging purposes and it is decided at the outset which position the derivative will be hedging. Derivatives are reviewed regularly for their effectiveness as hedges and corrective action taken, if appropriate. Derivatives are measured initially at fair value and subsequently remeasured to fair value. Fair values are obtained from quoted market prices in active markets and, where these are not available, from valuation techniques including discounted cash flow models and option pricing models. Where derivatives are not designated as part of an accounting hedge relationship, changes in fair value are recorded in the income statement. Where derivatives are designated within accounting hedge relationships, the treatment of the changes in fair value depends on the nature of the hedging relationship as explained below.

Hedge accounting is used for derivatives designated in this way provided certain criteria are met. The Group documents at the inception of the accounting hedge relationship the link between the hedging instrument and the hedged item as well as its risk management objective and strategy for undertaking various hedge transactions. The Group also documents its assessment both at hedge inception and on an ongoing basis of whether the derivatives used in hedging transactions are highly effective in offsetting changes in the fair values or cash flows of hedged items. The Group designates certain derivatives as either:

- **Cash flow hedges**

A cash flow hedge is used to hedge exposures to variability in cash flows, such as variable rate financial assets and liabilities. The effective portion of changes in the derivative fair value is recognised in other comprehensive income, and recycled to the income statement in the periods when the hedged item will affect profit and loss. Interest rate derivatives designated as cash flow hedges primarily hedge the exposure to cash flow vulnerability from forecast loans and advances to customers. The fair value gain or loss relating to the ineffective portion is recognised immediately in profit or loss.

- **Fair value hedges**

A fair value hedge is used to hedge exposures to variability in the fair value of financial assets and liabilities, such as fixed rate loans. Changes in 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. If the hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of the hedged item is amortised to the income statement over the period to maturity.

The most frequently used fair value hedges are:

- hedging the interest rate risk of a portfolio of prepayable fixed rate assets with interest rate derivatives. This solution is used to establish a macro fair value hedge for derivatives hedging fixed rate mortgages;
- hedging the interest rate risk of a portfolio of fixed rate liabilities with interest rate derivatives. This solution is used to establish a macro fair value hedge for derivatives hedging fixed rate savings;
- hedging the interest rate risk of a portfolio of non-prepayable fixed rate assets with interest rate derivatives. This solution is used to establish a macro fair value hedge for fixed rate investments; and
- hedging the interest rate and foreign currency exchange risk of non-prepayable, foreign currency denominated fixed rate assets or liabilities on a one-for-one basis with fixed/ floating or floating/fixed cross currency interest rate swaps.

(o) Securitisation transactions

Certain Group companies have issued debt securities in order to finance specific loans and advances to customers. Both the debt securities in issue and the loans and advances to customers remain on the Group balance sheet within the appropriate balance sheet headings unless:

- a fully proportional share of all or of specifically identified cash flows have been transferred to the holders of the debt securities, in which case that proportion of the assets are derecognised;
- substantially all the risks and rewards associated with the assets have been transferred, in which case the assets are fully derecognised; and
- a significant proportion of the risks and rewards have been transferred, in which case the assets are recognised only to the extent of the Group's continuing involvement.

The Group has also entered into self-issuance of securitised debt which may be used as collateral for repurchase or similar transactions. Investments in self-issued debt and the equivalent deemed loan, together with the related income, expense and cash flows, are not recognised in the financial statements.

- **Debt securities in issue**

Issued securities are classified as financial liabilities where the contractual arrangements result in the Group having an obligation to deliver either cash or another financial asset to the security holder, or to exchange financial instruments under conditions that are potentially unfavourable to the Group. Issued securities are classified as equity where they meet the definition of equity and confer a residual interest in the Group's assets on the holder of the securities.

Financial liabilities are carried at amortised cost using the effective interest rate method. Equity instruments are initially recognised at net proceeds, after deducting transaction costs and any related income tax. Appropriations to holders of equity securities are deducted from equity, net of any related income tax, as they become irrevocably due to the holders of the securities.

Securitisation is a means used by the Group to fund an element of its mortgage portfolio. These securitised advances are subject to non-recourse finance arrangements. These advances have been transferred at their principal value to Special Purpose Vehicles (SPV) and have been funded through the issue of amortising mortgage backed securities to investors.

As discussed in note 1.5, the Group controls the securitisation SPVs and therefore consolidates the assets and liabilities of the securitisation SPVs, on a line by line basis.

(p) Funding for Lending Scheme

The Group participates in the Funding for Lending Scheme (FLS). The scheme allows the Group to receive Treasury bills in return for eligible collateral, including approved portfolios of loans and advances to customers.

Receipt of Treasury bills under the FLS does not involve the substantial transfer of the risks and rewards on the collateral, or the right to receive its related cash flows, hence the derecognition criteria outlined in policy (j) are not satisfied. Therefore the collateral assets will continue to be recognised in the financial statements and the Treasury bills are not separately recognised.

In the event that Treasury bills are utilised for repo transactions, the related collateral assets are categorised as pledged assets and the associated liability to the counterparty is recognised in the financial statements.

(q) Intangible assets and amortisation

Intangible assets purchased separately from a business combination are capitalised at their cost and amortised from the date from which they become available for use over their useful economic life which is generally 3 to 10 years. Intangible assets acquired as part of an acquisition are capitalised at their fair value where this can be measured reliably in accordance with IFRS 13 'Fair Value Measurement'.

Expenditure incurred in relation to scoping, planning and researching the build of an asset as part of a project is expensed as incurred.

Development expenditure incurred on a project is capitalised only if the following criteria are met:

- an asset is created that can be identified;
- it is probable that the asset created will generate future economic benefits; and
- the development cost of the asset can be measured reliably.

Following the initial recognition of development expenditure, the cost is amortised over the estimated useful lives of the assets created. Amortisation commences on the date that the asset is brought into use.

Internally generated intangible assets relate to computer software and core banking platforms.

- **Computer software**

Costs incurred in acquiring and developing computer software for internal use are capitalised as intangible assets where the software leads to the creation of an identifiable non-monetary asset and it is probable that the expected future economic benefits that are attributable to the asset will flow to the Group from its use for a period of over one year. The software is classified as an intangible asset where it is not an integral part of the related hardware and amortised over its estimated useful life on a straight line basis which is generally 3 to 10 years.

Costs associated with maintaining software are expensed as they are incurred.

- **Core banking platforms**

Core banking platforms primarily represent the construction of core operating platforms, which are internally generated. Core banking platforms are amortised on a straight line basis over 3 to 10 years.

- **Impairment of intangible assets**

Intangible assets are assessed for indications of impairment at each balance sheet date, or more frequently where required by events or changes in circumstances. If indications of impairment are found, these assets are subject to an impairment review. The impairment review compares the carrying value of the assets with their recoverable amounts, which are defined as the higher of the fair value less costs to sell and their value in use. Fair value less costs to sell is the amount at which the asset could be sold in a binding agreement in an arm's length transaction. Value in use is calculated as the discounted cash flows generated as a result of the asset's continued use including those generated by its ultimate disposal, discounted at a market rate of interest on a pre-tax basis.

Where impairments are indicated, the carrying values of intangible assets are written down by the amount of the impairment and the charge is recognised in the income statement in the period in which it occurs. A previously recognised impairment charge on an asset may be reversed in full or in part through the income statement where a change in circumstances leads to a change in the estimates used to determine its recoverable amount. The carrying value will only be increased to the value at which it would have been held had the impairment not been recognised.

(r) Tangible fixed assets and depreciation

Tangible fixed assets are stated at cost less accumulated depreciation and provision for impairment, as appropriate. Cost includes the original purchase price of the asset and the costs attributable to bringing the asset to its working condition for its intended use. Additions and subsequent expenditure are included in the asset's carrying value or are recognised as a separate asset only when they improve the expected future economic benefits to be derived from the asset. All other repairs and maintenance are charged to the income statement in the period in which they are incurred.

Depreciation is provided using the straight line method to allocate costs less residual values over estimated useful lives, as follows:

Freehold property	50–100 years
Leasehold property	Unexpired period of the lease
Plant and leasehold improvements	5–30 years
Computer equipment	3–5 years
Office equipment	3–10 years
Motor vehicles	4 years

The residual values and useful lives of assets are reviewed, and adjusted if appropriate, at each balance sheet date. Where the cost of freehold land can be identified separately from buildings, the land is not depreciated.

- **Impairment of tangible fixed assets**

Tangible fixed assets are assessed for indications of impairment at each balance sheet date, or more frequently where required by events or changes in circumstances. If indications of impairment are found, these assets are subject to an impairment review. The impairment review compares the carrying value of the assets with their recoverable amount, which are defined as the higher of the fair value less costs to sell and their value in use. Fair value less costs to sell is the amount at which the asset could be sold in a binding agreement in an arm's length transaction. Value in use is calculated as the discounted cash flows generated as a result of the asset's continued use including those generated by its ultimate disposal, discounted at a market rate of interest on a pre-tax basis.

Where impairments are indicated, the carrying values of fixed assets are written down by the amount of the impairment and the charge is recognised in the income statement in the period in which it occurs. A previously recognised impairment charge on an asset may be reversed in full or in part through the income statement where a change in circumstances leads to a change in the estimates used to determine its recoverable amount. The carrying value will only be increased to the value at which it would have been held had the impairment not been recognised.

(s) Other assets

Other assets include prepayments and other amounts the Group is due to receive from third parties in the normal course of business.

(t) Deposits from banks

Deposits by banks are initially measured at fair value, which is normally the proceeds received net of any directly attributable transaction costs incurred. Subsequent measurement is at amortised cost, using the effective interest rate method.

(u) Customer deposits

Customer deposits are initially measured at fair value, which is normally the proceeds received. Subsequent measurement is at amortised cost, using the effective interest rate method.

(v) Provisions

Provisions are recognised for present obligations arising from past events where it is more likely than not that an outflow of resources will be required to settle the obligations and they can be estimated reliably.

Provisions for levies are recognised when the conditions that trigger the payment of the levy are met.

(w) Other liabilities

Deferred income represents amounts received in advance of the Group providing services, and will be recognised as income in profit or loss when the services have been provided.

Other creditors represent amounts the Group is due to pay to third parties in the normal course of business. These include expense accruals, which have been incurred, but not yet billed.

Accrued expenses are amounts that the Group is due to pay to third parties in the normal course of business.

(x) Share capital and share premium

- **Share capital**

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:

- 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
- 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.

- **Share issue costs**

Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction, net of tax, from the proceeds.

- **Dividends and appropriations**

Dividends are recognised in equity in the period in which they are approved by the Company's shareholders or paid.

- **Share premium**

Share premium substantially represents the aggregate of all amounts that have ever been paid above par value to the Company when it has issued Ordinary and Deferred Shares. Certain expenses in relation to the issue of share capital can be offset against the share premium account. These expenses must be the incremental expenses arising on issue of the shares.

(y) Other equity instruments

Issued financial instruments are recognised as equity where there is no contractual obligation to deliver either cash or another financial asset. The proceeds are included in equity, net of transaction costs. Distributions and other returns to equity holders are treated as a deduction from equity.

(z) Other reserves

- **Revaluation reserve in respect of available-for-sale financial assets**

The revaluation reserve in respect of available-for-sale financial assets represents the unrealised change in the fair value of available-for-sale investments since initial recognition.

- **Cash flow hedge reserve**

For derivatives designated in a cash flow hedge, the effective portion of changes in fair value is recognised in the cash flow hedge reserve and recycled to profit or loss in the periods when the hedged item will affect profit or loss.

(aa) Contingent liabilities

Contingent liabilities are possible obligations whose existence depends upon the outcome of uncertain future events or are present obligations where the outflows of resources are uncertain or cannot be reliably measured. Contingent liabilities are not recognised in the financial statements but are disclosed unless they are remote.

(ab) Fair value of financial assets and liabilities

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 in the principal, or in its absence, the most advantageous market to which the Group has access at that date. The fair value of a liability reflects its non-performance risk (the risk the Group will not fulfil an obligation), including the Group's own credit risk.

For the majority of instruments, fair value is determined with reference to quoted prices in an active market. A market is regarded as active if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

Where quoted prices are not available, fair value is based upon cash flow models, which use wherever possible independently sourced observable market parameters such as interest rate yield curves, currency rates and option volatilities. The chosen valuation technique incorporates all the factors that market participants would take into account in pricing a transaction and is discounted at a risk free rate.

Refer to note 33 for a description of different levels within the fair value hierarchy. Levels are reviewed at each balance sheet date and this determines where transfers between levels are required.

The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price—i.e. the fair value of consideration given or received. The Group does not apply a credit valuation adjustment (CVA) or debit valuation adjustment (DVA) to reflect the credit risk of its derivative exposures as the Group's portfolio is fully collateralised.

If an asset or a liability measured at fair value has a bid price and an ask price, the Group measures assets and long positions at bid price and liabilities and short positions at an ask price.

1.10 Critical estimates and judgements

The preparation of financial statements in conformity with IFRS requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the reporting period. Although these estimates are based on management's best knowledge of the amount, actual results ultimately may differ from those estimates.

The areas involving a higher degree of judgement or complexity, or where assumptions and estimates are significant to the 2016 financial statements were as follows:

(a) Effective interest rates

IAS 39 requires interest earned from mortgages and credit cards to be measured under the effective interest rate method. The effective interest rate is the rate that exactly discounts estimated future cash flows through the expected life of the financial instrument to the net carrying value amount of the financial instrument. The accuracy of the effective interest rate can be affected when actual cash flows vary from the initial estimation of future cash flows. In that circumstance the carrying value of the financial instrument is adjusted to reflect the revisions to estimated cash flows with the adjustment made to profit and loss.

For secured lending management model future expected cash flows for each tranche of lending (by year of lending, product and LTV banding). In determining the future cash flows management must use judgement to estimate the average life of each tranche of lending. Management estimate expected repayment and redemption profiles of mortgage customers based on previous customer behaviour, this incorporates estimates of the proportion of borrowers expected to incur early redemption charges.

Management consider the estimated life to be the most significant estimate in the secured effective interest rate calculation. The accuracy of the estimated life would be affected by altered customer behaviour arising from unexpected market movements. For secured loans to the extent that the estimated life differs by +/– one month, the value of such loans on the balance sheet would be £4.5 million (2015: £3.6 million) higher or £4.6 million (2015: £3.7 million) lower respectively.

For unsecured lending management model future expected cash flows for each tranche of lending (by year of lending and product) over the customer life, up to a maximum of seven years from origination. In determining the future cash flows management must use judgement to estimate the life of the card relationship. Management estimate customer behaviour including card balance, transaction activity, repayment profiles and post-promotional retention rates based on previous customer experience.

Management consider the estimated life to be the most significant measure of performance in assessing the unsecured effective interest calculation. The accuracy of the effective interest rate would be affected by altered customer behaviour giving rise to actual cash flows that differ to expected cash flows. For unsecured loans to the extent that that estimated life differs by +/– one month, the value of such loans on the balance sheet would be £2.1 million (2015: £1.1 million) higher or £2.1 million (2015: £1.1 million) lower respectively.

(b) Impairment of loans and receivables

Individual impairment losses on secured loans and advances are calculated based on an individual valuation of the underlying asset. Collective impairment losses on loans and advances are calculated using a statistical model.

The key assumptions within the impairment models are monitored regularly to ensure the impairment allowance is entirely reflective of current portfolio experience. Key assumptions used within the models are based on various behavioural and arrears status segments, which vary by exposure type:

- The secured impairment model is based on measuring the probability of default; the probability of this default resulting in possession; and the subsequent loss incurred in the event of possession.
- The unsecured impairment model is based on measuring the probability of default; the probability of this default resulting in charge-off; and the subsequent loss incurred in the event of charge-off.

The accuracy of the impairment calculation would therefore be affected by unanticipated changes to the economic environment and assumptions which differ from actual outcomes. For mortgage loan receivables to the extent that:

- the loss given default differs by +/– 10%, for example if the loss given default is 10% then it is increased to 11%, the impairment allowance would be an estimated £0.3 million (2015: £0.3 million) higher or £0.3 million (2015: £0.3 million) lower respectively;
- the level of house prices differs by +/– 10%, for example a property value of £100,000 is increased to £110,000, the impairment allowance would be an estimated £1.3 million (2015: £1.3 million) lower or £2.6 million (2015: £3.0 million) higher respectively;
- the emergence period of 6 months differs by +/– 3 months, the impairment allowance would be an estimated £0.3 million (2015: £0.2 million) higher or £0.3 million (2015: £0.2 million) lower respectively.

For unsecured loans, to the extent that the loss given default differs by +/– 10%, the impairment allowance would be an estimated £3.9 million (2015: £2.9 million) higher or £3.9 million (2015: £2.9 million) lower respectively, and to the extent the emergence period of 6 months differs by +/– 3 months, the impairment allowance would be an estimated £5.9 million (2015: £3.8 million) higher or £5.9 million (2015: £3.8 million) lower respectively.

(c) Capitalisation and impairment of intangibles

Intangibles are initially recognised when they are separable or arise from contractual or other legal rights, the cost can be measured reliably and, in the case of intangible assets not acquired in a business combination, where it is probable that future economic benefits attributable to the assets will flow from their use. Management review and monitor the capitalisation of significant project development costs on a regular basis to ensure that they meet the recognition criteria for capitalisation of an intangible asset and to ensure the costs are directly attributable to the individual projects where an asset is under construction. A review of capitalisation of intangibles has been undertaken to ensure these conditions have been met.

A review of intangible assets which are not yet in use for indications of impairment is undertaken at each reporting date. If there are indicators of impairment, an estimate of the recoverable amount is made. The recoverable amount of the asset is the higher of its fair value less costs to sell and its value in use. Value in use is calculated by discounting the future cash flows (both costs to complete and benefits post completion) generated from the continuing use of the asset. If the carrying value of the asset is less than the greater of the value in use and the fair value less costs to sell, an impairment charge is recognised.

Through their assessment of intangible assets and review for impairment indicators Management have not identified any assets that have an impairment, therefore a £nil impairment charge has been recognised (2015: £nil).

(d) Deferred tax

Taxation involves estimation techniques to assess the liability in terms of possible outcomes. The assessment of the recoverability or otherwise of deferred tax assets is based mainly on a determination of whether the relevant entity will generate sufficient profits within 5 years to realise the deferred tax assets.

This is reviewed at each reporting date by the Directors with a detailed exercise conducted to establish the validity of profit forecasts and other relevant information including timescales over which the profits are expected to arise and the deferred tax assets will reverse. Deferred tax is determined using tax rates that have been enacted or substantially enacted by the balance sheet date and which are expected to apply when the related deferred tax assets are realised or the deferred tax liabilities are settled.

The judgement required in the assessment of whether to recognise deferred tax assets is set out in policy (h). Based on their assessment of future profitability and interpretation of the timing and level of reversal of existing taxable temporary differences, in line with relevant accounting standards, the Directors conclude that a net deferred tax asset of £23.0 million (2015: £38.0 million) should be recognised at the balance sheet date.

(e) Fair value of financial assets and liabilities

Management must use judgement and estimates calculating fair value where not all necessary inputs are observable or where factors specific to the Group's holdings need to be considered. The accuracy of the fair value calculations would therefore be affected by unexpected market movements, inaccuracies within the models used compared to actual outcomes and incorrect assumptions. For example, to the extent the interest yield curve differs by +/– 10 bps, the net impact on fair values of derivative financial instruments would be an estimated increase of £33.1 million (2015: £23.5 million) or decrease of £33.3 million (2015: £23.7 million) respectively.

NOTE 2: SEGMENTAL ANALYSIS

For Management reporting purposes, the Group is organised into the following business segments:

- Mortgages and savings;
- Credit cards;
- Financial services; and
- Central functions.

These business groupings reflect how the Group Executive Committee, in its capacity as the chief operating decision maker for the Group, assesses performance and makes decisions regarding the allocation of resources to the business on the basis of product and customers. Internal and external sources of revenue are allocated to the appropriate business segment.

Mortgages and savings

Mortgage products include residential and buy-to-let mortgages. Savings products include ISAs, easy access, fixed term accounts and current accounts.

Following a change in Management reporting of the financial performance and position of current accounts in 2016, these are now reported within this business segment. Previously these were reported within 'Current accounts, insurance and investments' (renamed 'Financial services').

Credit cards

Credit card products include balance transfer and retail credit cards.

Financial services

Financial services include financial products offered beyond the core banking products and include investments, international money transfers, travel money, pensions, life insurance, travel insurance, home insurance, motor insurance and pet insurance.

Central functions

Central functions provide shared support services to each of the Group's business lines and Virgin Money Giving Limited (VMG). These services include information technology and property along with central services such as Risk, Finance, Human Resources and Management. It is not the policy of the Group to allocate the cost of these shared services to each business line. All depreciation and amortisation is allocated to the central functions business line.

The Group does not manage Treasury as a profit centre, and so the interest expense incurred from its Group funding and liquidity operations has been allocated to the other business lines. Treasury is not engaged in trading activities. Central functions segment assets and liabilities includes fixed assets and treasury assets and liabilities.

Due to the nature of the Group's operations there are no inter-segmental transactions

	Mortgages and savings[1]	Credit cards	Financial services	Central functions	Underlying basis total
	£ million	£ million	£ million	£ million	£ million
Year ended 31 December 2016					
Net interest income	**383.0**	**136.0**	—	—	**519.0**
Other income	**2.0**	**17.7**	**37.5**	**10.7**	**67.9**
Total underlying income	**385**	**153.7**	**37.5**	**10.7**	**586.9**
Total costs	**(97.4)**	**(37.8)**	**(15.6)**	**(185.2)**	**(336.0)**
Impairment	**(2.8)**	**(34.8)**	—	—	**(37.6)**
Underlying profit/(loss) before tax	**284.8**	**81.1**	**21.9**	**(174.5)**	**213.3**
Segment assets	**29,743.9**	**2,453.0**	**3.2**	**2,855.5**	**35,055.6**
Segment liabilities	**28,214.9**	**3.9**	**2.6**	**5,163.7**	**33,385.1**

	Mortgages and savings	Credit cards	Financial services	Central functions	Underlying basis total
	£ million	£ million	£ million	£ million	£ million
Year ended 31 December 2015					
Net interest income	358.5	97.6	—	—	456.1
Other income	2.5	18.0	36.6	10.3	67.4
Total underlying income	361	115.6	36.6	10.3	523.5
Total costs	(92.7)	(37.1)	(16.7)	(186.0)	(332.5)
Impairment	(3.0)	(27.3)	—	—	(30.3)
Underlying profit/(loss) before tax	265.3	51.2	19.9	(175.7)	160.7
Segment assets	25,457.5	1,585.2	2.6	3,183.7	30,229.0
Segment liabilities	25,286.2	4.0	4.5[2]	3,594.0	28,888.7

(1) Current accounts are now included in the Mortgages and savings segment.

(2) Current account balances of £230.3 million are now shown in the Mortgages and savings segment.

Reconciliation of statutory results to underlying basis

The underlying basis is the basis on which financial information is presented to the chief operating decision maker which excludes certain items included in the statutory results, of which further information is provided on pages 54 and 55. The table below reconciles the statutory results to the underlying basis.

		Adjusted for				
	Statutory results	IPO Share based awards	Strategic items	Simplification costs	Fair value losses on financial instruments	Underlying basis
	£ million	£ million	£ million	£ million	£ million	£ million
Year ended 31st December 2016						
Net interest income	**522.4**	**—**	**(3.4)**	**—**	**—**	**519.0**
Other income	**59.0**	**—**	**—**	**—**	**8.9**	**67.9**
Total income	**581.4**	**—**	**(3.4)**	**—**	**8.9**	**586.9**
Total operating expenses	**(349.4)**	**2.0**	**5.8**	**5.6**	**—**	**(336.0)**
Profit before tax from operating activities	**232.0**	**2.0**	**2.4**	**5.6**	**8.9**	**250.9**
Impairment	**(37.6)**	**—**	**—**	**—**	**—**	**(37.6)**
Profit before tax	**194.4**	**2.0**	**2.4**	**5.6**	**8.9**	**213.3**

		Adjusted for				
	Statutory results	IPO Share based awards	Strategic items	Simplification costs	Fair value losses on financial instruments	Underlying basis
	£ million	£ million	£ million	£ million	£ million	£ million
Year ended 31st December 2016						
Net interest income	454.8	—	1.3	—	—	456.1
Other income	67.1	—	(0.1)	—	0.4	67.4
Total income	521.9	—	1.2	—	0.4	523.5
Total operating expenses	(353.6)	10.5	6.9	3.7	—	(332.5)
Profit before tax from operating activities	168.3	10.5	8.1	3.7	0.4	191
Impairment	(30.3)	—	—	—	—	(30.3)
Profit before tax	138.0	10.5	8.1	3.7	0.4	160.7

Geographical areas

The Group's operating activities are exclusively in the UK.

NOTE 3: NET INTEREST INCOME

	2016 £ million	2015 £ million
Interest and similar income:		
Loans and advances to customers	**933.1**	822.4
Loans and advances to banks	**2.3**	2.4
Interest receivable on loans and receivables	**935.4**	824.8
Available-for-sale financial assets	**8.9**	10.5
Cash and balances at central banks	**3.8**	4.0
Total interest and similar income	**948.1**	839.3
Interest and similar expense:		
Deposits from banks	**(7.6)**	(6.8)
Customer deposits	**(370.7)**	(342.7)
Debt securities in issue	**(40.6)**	(29.0)
Other	**(6.8)**	(6.0)
Total interest and similar expense	**(425.7)**	(384.5)
Net interest income	**522.4**	454.8

Interest accrued on individually impaired assets was £5.8 million (2015: £6.8 million).

NOTE 4: NET FEE AND COMMISSION INCOME

	2016 £ million	2015 £ million
Fee and commission income:		
On loans and advances to customers	**19.5**	21.0
Other fee and commission income	**9.3**	6.4
Total fee and commission income	**28.8**	27.4
Fee and commission expense:		
Other fee and commission expense	**(1.2)**	(1.2)
Net fee and commission income	**27.6**	26.2

NOTE 5: OTHER OPERATING INCOME

	2016 £ million	2015 £ million
Investment and protection income	**31.7**	31.5
Gains on sale of available-for-sale financial assets (refer note 16)	**6.8**	8.8
Other	**1.8**	1.0
Total other operating income	**40.3**	41.3

NOTE 6: OPERATING EXPENSES

	2016 £ million	2015 £ million
Staff costs:		
Wages and salaries	**156.8**	138.9
Social security costs	**14.6**	16.2
Other pension costs	**10.7**	10.6
Employee share option schemes	**12.8**	20.0
	194.9	185.7
Premises and equipment:		
Hire of equipment	**4.6**	4.6
Rent and rates	**14.3**	14.0
	18.9	18.6
Other expenses:		
Marketing costs	**21.0**	22.3
FSCS levy	**7.8**	12.5
Professional fees	**13.7**	10.7
Other	**72.1**	84.2
	114.6	129.7
Depreciation and amortisation:		
Depreciation of tangible fixed assets	**5.6**	8.4
Amortisation of intangible assets	**15.4**	11.2
	21.0	19.6
Total operating expenses	**349.4**	353.6

Average headcount

The monthly average number of persons (including Directors) employed by the Group during the year was as follows:

	2016	2015
Full time	**2,394**	2,359
Part time	**746**	699
Total	**3,140**	3,058

Retirement benefit obligations

The Group operates defined contribution pension schemes for its Directors and employees. The assets of the schemes are held separately from those of the Group in independently administered funds.

The Group made contributions of £10.7 million (2015: £10.6 million) during the year. There were no contributions overdue at the year end (2015: £nil).

Fees payable to the auditors

During the year the Group obtained the following services from the Group's auditors as detailed below:

	2016	2015
	£ million	£ million
Fees payable for the audit of the current year annual report and accounts	**0.2**	0.3
Fees payable for other services:		
Audit of the subsidiaries pursuant to legislation	**0.7**	0.6
Total audit fees	**0.9**	0.9
Audit-related assurance services	**0.2**	0.2
Total audit and audit related fees	**1.1**	1.1
Other non-audit fees:		
Other assurance services	**0.1**	0.2
Total other non-audit fees	**0.1**	0.2
Total fees payable to the auditors by the Group	**1.2**	1.3

All amounts are shown exclusive of VAT.

The following types of services are included in the categories listed above:

Audit and audit-related fees

This category includes fees in respect of the audit of the Group's annual financial statements and other services in connection with regulatory filings and services for assurance and related services that are reasonably related to the performance of the audit or review of the financial statements.

NOTE 7: SHARE BASED PAYMENTS

All share based payments charges relate to equity settled schemes. The scheme details are summarised below.

	Award plan	Eligible employees	Nature of award	Vesting conditions(1)	Issue dates(2)
(A)	Long-term incentive plan	Selected senior employees	Conditional share award	Continuing employment or leavers in certain circumstances and achievement of performance conditions	2015 & 2016
(B)	Deferred bonus share plan	Selected senior employees	Deferred bonus—conditional share award	Continuing employment or leavers in certain circumstances	2014, 2015 & 2016
(C)	Phantom share award	Selected senior employees	Deferred bonus—conditional share award	Continuing employment or leavers in certain circumstances	2012 & 2013
(D)	IPO incentive scheme	Selected senior employees	Conditional share award	Continuing employment or leavers in certain circumstances	2013
(E)	Recruitment award	Two senior employees	Conditional share award	Continuing employment or leavers in certain circumstances	2013
(F)	IPO share award	All employees excluding the Group's Executive Committee	Conditional share award	Continuing employment or leavers in certain circumstances	2014

(1) All awards have vesting conditions and therefore some may not vest.

(2) Issue dates show the year in which issues have been made under the relevant scheme. There could be further issuances in future years under the scheme.

The terms of the equity settled schemes the Group operated during the year are as follows:

(A) Long-term incentive plan (LTIP)

The LTIP introduced in 2014 is aimed at delivering shareholder value by linking the receipt of shares to performance measures that are based on delivering the Group's strategic objectives over a 3 year period. Awards are made within limits set by the rules of the plan.

During 2016, selected senior employees of the Group were granted up to a maximum of 1,572,717 Ordinary Shares under the LTIP scheme. This number includes awards granted to senior employees who joined the Company in 2016 in recognition of outstanding awards over shares in their previous employing company that lapsed on accepting employment with the Group. Awards granted under the LTIP have performance and service conditions, with vesting dates prescribed for each participant.

The weighted-average fair value of awards granted during 2016 was £3.64 based on market prices at the date of grant.

(B) Deferred bonus share plan

The deferred bonus share plan is an equity settled scheme that is operated in conjunction with the short-term incentive plan for Executive Directors and other senior managers of the Group.

Share awards for the deferred element of 2016 bonuses will be granted under this scheme in 2017.

During 2016, selected senior employees of the Group were granted up to a maximum of 1,695,266 Ordinary Shares under the scheme. This number includes awards granted to senior employees who joined the Company in 2016 in recognition of outstanding awards over shares in their previous employing company that lapsed on accepting employment with the Group. Awards granted under the scheme have service conditions, with vesting dates prescribed for each participant.

The weighted-average fair value of awards granted during 2016 was £3.64 based on market prices at the date of grant.

(C) Phantom share award

In 2012 a notional (phantom) share award for senior individuals was established. During 2014 an approved change to existing awards under this scheme resulted in a change in accounting treatment from a cash settled to an equity settled share based payment.

The fair value of the converted award was recalculated and is being recognised over the remaining vesting period within the income statement through to 2018. No awards were granted in 2016 (2015: none) under this scheme.

(D) IPO incentive scheme

The IPO incentive scheme was introduced in December 2013 for selected senior employees. Participants were entitled to receive shares in the event of a listing. The award was a pre-determined percentage of the listing value, which was then converted to a number of Ordinary Shares based on the listing price.

The final tranche of share awards made under this scheme vested in December 2016. No awards were granted in 2016 (2015: none) under this scheme.

(E) Recruitment award

Under the scheme the participants received shares in 2014, 2015 and 2016. The final tranche of share awards made under this scheme vested in March 2016. No awards were granted in 2016 (2015: none) under this scheme.

(F) IPO share award

On listing, the Group granted all employees below Executive level a one-off share award. A small number of senior employees received an award over Ordinary Shares of either 10% or 20% of salary. All other employees received an award over Ordinary Shares with a value of £1,000. The majority of awards vested on the first anniversary of the listing. Certain awards granted to senior employees were subject to different vesting schedules, and holding periods, to comply with the PRA Remuneration Code. No awards were granted in 2016 (2015: none) under this scheme.

Movement in share options and conditional shares

	Ordinary Shares						
	Former Chairman's interest in share options(1)	**Long-term incentive plan(2)**	**Deferred bonus share plan(2)**	**Phantom share award(2)**	**IPO incentive scheme(2)**	**Recruitment award(2)**	**IPO share award(2)**
Shares in existence at 1 January 2016	**625,328**	**1,399,453**	**1,157,800**	**3,061,820**	**332,334**	**175,810**	**139,041**
Granted in year	—	**1,572,717**	**1,695,266**	—	—	—	—
Exercised or vested in year	—	**(98,349)**	**(754,417)**	**(950,550)**	**(305,676)**	**(175,810)**	**(68,885)**
Forfeited in year	—	**(222,483)**	—	**(66,790)**	**(26,658)**	—	**(1,236)**
Outstanding 31 December 2016	**625,328**	**2,651,338**	**2,098,649**	**2,044,480**	—	—	**68,920**
Of which exercisable	**625,328**	—	—	—	—	—	—

	Ordinary Shares						
	Former Chairman's interest in share options(1)	**Long-term incentive plan(2)**	**Deferred bonus share plan(2)**	**Phantom share award(2)**	**IPO incentive scheme(2)**	**Recruitment award(2)**	**IPO share award(2)**
Shares in existence at 1 January 2015	625,328	—	14,918	3,120,900	664,658	327,760	1,773,880
Granted in year	—	1,727,770	2,032,683	—	—	—	—
Exercised or vested in year	—	(95,075)	(761,247)	—	(332,324)	(151,950)	(1,431,866)
Forfeited in year	—	(233,242)	(128,554)	(59,080)	—	—	(202,973)
Outstanding 31 December 2015	625,328	1,399,453	1,157,800	3,061,820	332,334	175,810	139,041
Of which exercisable	625,328	—	—	—	—	—	—

(1) This scheme was set up for the previous Chairman, Sir David Clementi. All share options granted under the scheme had vested prior to 1 January 2015. No share options have been exercised during 2016 or 2015. The weighted-average exercise price for options outstanding at 1 January 2016 and 31 December 2016 was £2.15. The options outstanding will expire 10 years from the date of listing if not exercised.

(2) Awards have vesting conditions.

NOTE 8: ALLOWANCE FOR IMPAIRMENT LOSSES ON LOANS AND RECEIVABLES

	2016			2015		
	On secured loans	**On unsecured loans**	**Total**	**On secured loans**	**On unsecured loans**	**Total**
	£ million	**£ million**	**£ million**	**£ million**	**£ million**	**£ million**
At 1 January	**8.7**	**31.2**	**39.9**	7.6	23.0	30.6
Advances written off	**(0.8)**	**(32.3)**	**(33.1)**	(1.9)	(26.0)	(27.9)
Gross charge to the income statement	**2.7**	**40.6**	**43.3**	3.0	34.2	37.2
As at 31 December	**10.6**	**39.5**	**50.1**	8.7	31.2	39.9

Of the total allowance in respect of loans and advances to customers, £49.4 million (2015: £38.8 million) was assessed on a collective basis.

During the year, sales of credit card receivables which had previously been written-off resulted in net recoveries of £5.7 million (2015: £6.9 million). The full amount of the proceeds have been recognised as a gain and the net charge to the income statement is summarised below.

	2016	2015
	£ million	**£ million**
Gross charge to the income statement	**43.3**	37.2
Debt sale recoveries	**(5.7)**	(6.9)
Net charge to the income statement	**37.6**	30.3

NOTE 9: TAXATION

(A) Analysis of the tax charge for the year

	2016 £ million	2015 £ million
UK corporation tax		
Current tax on profit for the year	**(40.3)**	(13.6)
Adjustments in respect of prior years	**0.4**	—
Current tax charge	**(39.9)**	(13.6)
Deferred tax (refer note [21])		
Origination and reversal of temporary differences	**(14.0)**	(15.0)
Adjustments in respect of prior years	**(0.2)**	(0.7)
Reduction in UK corporation tax rate	**(0.2)**	2.5
Deferred tax charge to the income statement	**(14.4)**	(13.2)
Tax charge	**(54.3)**	(26.8)

Analysis of tax charge recognised in Other Comprehensive Income:

	2016 £ million	2015 £ million
Current tax		
Available-for-sale financial assets	**—**	2.1
Cash flow hedge	**4.9**	—
Deferred tax		
Available-for-sale financial assets	**(1.7)**	(0.9)
Cash flow hedge	**1.4**	1.6
Total credit	**4.6**	2.8

(B) Factors affecting the tax charge for the year

A reconciliation of the charge that would result from applying the standard UK corporation tax rate to the profit before tax to the actual tax charge for the year is given below:

	2016 £ million	2015 £ million
Profit before tax	**194.4**	138.0
Tax charge at standard tax rate of 20% (2015: 20.25%)	**(38.9)**	(27.9)
Factors affecting charge:		
Disallowed items	**(1.8)**	(1.5)
Bank corporation tax surcharge	**(12.5)**	—
Non-taxable income	**—**	0.8
UK corporation tax rate change	**(0.2)**	2.5
Deferred tax charge in respect of share schemes	**(1.1)**	—
Adjustments in respect of prior years	**0.2**	(0.7)
Total tax charge	**(54.3)**	(26.8)

During the year the Group resolved an open HMRC enquiry relating to the tax treatment of certain funding transactions dating back to 2009. A payment of £2.1 million was made to HMRC in final and full settlement. This has resulted in a prior year credit of £0.2 million in the year to 31 December 2016.

The Finance (No. 2) Act 2015 was substantively enacted on 26 October 2015. This reduced the main rate of corporation tax to 19% with effect from 1 April 2017 and to 18% with effect from 1 April 2020. A further reduction in the main corporation tax rate to 17% from 1 April 2020 was announced in the 2016 Budget and substantively enacted in the Finance Act 2016.

The corporation tax surcharge for banks was introduced from 1 January 2016. The surcharge imposes an 8% charge on the banking profits of the Group (less a £25 million allowance against those profits).

NOTE 10: EARNINGS PER SHARE

	2016 £ million	2015 £ million
Profit attributable to equity shareholders—basic and diluted	**140.1**	111.2
Distributions to Additional Tier 1 security holders (net of group relief)	**(10.1)**	(10.0)
Profit attributable to equity holders for the purposes of basic and diluted EPS	**130.0**	101.2

	2016 Number of shares (million)	2015 Number of shares (million)
Weighted-average number of ordinary shares in issue—basic	**442.8**	441.0
Adjustment for share options and awards	**4.7**	4.7
Weighted-average number of ordinary shares in issue—diluted	**447.5**	445.7
Basic earnings per share (pence)	**29.4**	22.9
Diluted earnings per share (pence)	**29.1**	22.7

Basic earnings per share has been calculated after deducting 1.7 million (2015: 1.8 million) ordinary shares representing the Group's holdings of own shares in respect of employee share schemes.

Of the total number of employee share options and share awards at 31 December 2016 none were anti-dilutive (2015: nil).

NOTE 11: DIVIDENDS

The 2016 interim dividend of 1.6p per ordinary share, amounting to £7.1 million, was paid in September 2016 and a final dividend in respect of the year ended 31 December 2015 of 3.1 pence per Ordinary Share amounting to £13.7 million, was paid in May 2016. These dividends were deducted from retained profits in the current year.

The Directors have recommended for approval at the 2017 AGM the payment of a final dividend in respect of the year ended 31 December 2016 of 3.5p per ordinary share, amounting to £15.5 million. If approved, this final dividend will be paid on 10 May 2017 to shareholders on the register at close of business on 6 April 2017. The financial statements for the year ended 31 December 2016 do not reflect this final dividend, which will be accounted for in shareholders' equity as an appropriation of retained profits in the year ending 31 December 2017.

An interim dividend for 2015 of 1.4 pence per Ordinary Share amounting to £6.2 million, was paid in October 2015.

Under the trust deed of the Employee Benefit Trust (EBT), a standing waiver is in force in respect of any dividends declared on shares held by the EBT.

NOTE 12: ANALYSIS OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES BY MEASUREMENT BASIS

	Held at amortised cost	Loans and receivables	Available-for-sale securities	Derivatives not designated as hedging instruments	Derivatives designated as hedging instruments: Fair value hedges	Derivatives designated as hedging instruments: Cash flow hedges	Total
	£ million	£ million	£ million	£ million	£ million	£ million	£ million
As at 31 December 2016							
Financial assets							
Cash and balances at central banks	—	786.3	—	—	—	—	786.3
Derivative financial instruments	—	—	—	18.5	21.0	64.7	104.2
Loans and receivables:							
• Loans and advances to banks	—	635.6	—	—	—	—	635.6
• Loans and advances to customers	—	32,367.1	—	—	—	—	32,367.1
• Debt securities	—	0.7	—	—	—	—	0.7
Available-for-sale financial assets	—	—	858.8	—	—	—	858.8
Other assets	—	68.8	—	—	—	—	68.8
Total financial assets	—	33,858.5	858.8	18.5	21.0	64.7	34,821.5
Non financial assets							234.1
Total assets							35,055.6
Financial liabilities							
Deposits from banks	2,132.5	—	—	—	—	—	2,132.5
Customer deposits	28,106.3	—	—	—	—	—	28,106.3
Derivative financial instruments	—	—	—	22.9	206.8	—	229.7
Debt securities in issue	2,600.0	—	—	—	—	—	2,600.0
Other liabilities	189.5	—	—	—	—	—	189.5
Total financial liabilities	33,028.3	—	—	22.9	206.8	—	33,258.0
Non financial liabilities							127.1
Total liabilities							33,385.1
Equity							1,670.5
Total liabilities and equity							35,055.6

	Held at amortised cost	Loans and receivables	Available-for-sale securities	Derivatives not designated as hedging instruments	Derivatives designated as hedging instruments: Fair value hedges	Derivatives designated as hedging instruments: Cash flow hedges	Total
	£ million	£ million	£ million	£ million	£ million	£ million	£ million
As at 31 December 2015							
Financial assets							
Cash and balances at central banks	—	888.6	—	—	—	—	888.6
Derivative financial instruments	—	—	—	18.3	63.5	0.5	82.3
Loans and receivables:							
• Loans and advances to banks	—	614.5	—	—	—	—	614.5
• Loans and advances to customers	—	27,109.0	—	—	—	—	27,109.0
• Debt securities	—	1.1	—	—	—	—	1.1
Available-for-sale financial assets	—	—	1,296.9	—	—	—	1,296.9
Other assets	—	14.6	—	—	—	—	14.6
Total financial assets	—	28,627.8	1,296.9	18.3	63.5	0.5	30,007.0
Non financial assets							222.0
Total assets							30,229.0
Financial liabilities							
Deposits from banks	1,298.7	—	—	—	—	—	1,298.7
Customer deposits	25,144.9	—	—	—	—	—	25,144.9
Derivative financial instruments	—	—	—	15.4	139.6	1.0	156.0
Debt securities in issue	2,039.4	—	—	—	—	—	2,039.4
Other liabilities	155.1	—	—	—	—	—	155.1
Total financial liabilities	28,638.1	—	—	15.4	139.6	1.0	28,794.1
Non financial liabilities							94.6
Total liabilities							28,888.7
Equity							1,340.3
Total liabilities and equity							30,229.0

NOTE 13: DERIVATIVE FINANCIAL INSTRUMENTS

	As at 31 December 2016			As at 31 December 2015		
	Contract/ notional amount	Asset fair value	Liability fair value	Contract/ notional amount	Asset fair value	Liability fair value
	£ million	£ million	£ million	£ million	£ million	£ million
Derivatives in accounting hedge relationships						
Derivatives designated as fair value hedges:						
Interest rate derivatives	**21,584.8**	**21.0**	**(206.8)**	23,421.6	63.5	(139.6)
	21,584.8	**21.0**	**(206.8)**	23,421.6	63.5	(139.6)
Derivatives designated as cash flow hedges:						
Interest rate derivatives	**1,287.0**	**—**	**—**	369.7	0.5	(1.0)
Currency derivatives	**520.3**	**64.7**	**—**	—	—	—
Total derivative assets/(liabilities)—in accounting hedge relationships	**23,392.1**	**85.7**	**(206.8)**	23,791.3	64.0	(140.6)
Derivatives in economic hedging relationships but not in accounting hedge relationships						
Interest rate derivatives	**7,549.6**	**13.2**	**(14.8)**	3,651.4	16.8	(15.4)
Currency derivatives	**56.0**	**3.4**	**(3.8)**	—	—	—
Equity and other options	**149.5**	**1.9**	**(4.3)**	58.2	1.5	—
Total derivative assets/(liabilities)—in economic hedging relationship but not in accounting hedge relationships	**7,755.1**	**18.5**	**(22.9)**	3,709.6	18.3	(15.4)
Total recognised derivative assets/ (liabilities)	**31,147.2**	**104.2**	**(229.7)**	27,500.9	82.3	(156.0)

The principal amount of the contract does not represent the Group's real exposure to credit risk which is limited to the current cost of replacing contracts with a positive value to the Group should the counterparty default. To reduce credit risk the Group uses a variety of credit enhancement techniques such as netting and collateralisation, where security is provided against the exposure. Further details are provided in the Risk Management Report.

Hedged cash flows

For designated cash flow hedges the following table shows when the Group's hedged cash flows are expected to occur and when they will impact income:

	2016	2015
	£ million	£ million
Within one year	**(9.2)**	(5.5)
In one to five years	**(22.3)**	(9.8)
Total	**(31.5)**	(15.3)

Gains/(losses) from derivatives and hedge accounting

	2016	2015
	£ million	£ million
Loss from fair value hedge accounting(1):		
Derivatives designated as fair value hedges	**(69.9)**	53.7
Fair value movement attributable to hedged risk	**81.8**	(50.7)
	11.9	3.0
Loss from cash flow hedges	**(13.6)**	(5.1)
Fair value (losses)/gains from other derivatives(2)	**(7.2)**	1.7
Loss from derivatives and hedge accounting	**(8.9)**	(0.4)

(1) Gains or losses from fair value hedges can arise where there is an IAS 39 hedge accounting relationship in place and either:

- the fair value of the derivative was not exactly offset by the change in fair value attributable to the hedged risk; or
- the derivative was designated in or redesignated from the IAS 39 hedge accounting relationship and in the following months leads to amortisation of existing balance sheet positions.

(2) Other derivatives are those used for economic hedging but which are not in an IAS 39 hedge accounting relationship.

NOTE 14: LOANS AND ADVANCES TO BANKS

	2016	2015
	£ million	£ million
Balances within securitisation vehicles	**354.3**	384.3
Money market placements with banks	**33.0**	97.1
Other lending to banks	**248.3**	133.1
Total loans and advances to banks	**635.6**	614.5

NOTE 15: LOANS AND ADVANCES TO CUSTOMERS

	2016	2015
	£ million	£ million
Advances secured on residential property not subject to securitisation	**19,375.2**	17,389.9
Advances secured on residential property subject to securitisation	**4,907.8**	3,670.4
	24,283.0	21,060.3
Residential buy-to-let loans not subject to securitisation	**5,468.4**	4,401.9
Total loans and advances to customers secured on residential property	**29,751.4**	25,462.2
Unsecured receivables not subject to securitisation	**2,486.6**	1,610.0
Total loans and advances to customers before allowance for impairment losses	**32,238.0**	27,072.2
Allowance for impairment losses on loans and receivables (refer note [8])	**(50.1)**	(39.9)
Total loans and advances to customers excluding portfolio hedging	**32,187.9**	27,032.3
Fair value of portfolio hedging	**179.2**	76.7
Total loans and advances to customers	**32,367.1**	27,109.0

The fair value of portfolio hedging represents an accounting adjustment which offsets the fair value movement on derivatives designated in IAS 39 hedge accounting relationships with the mortgage portfolio. Such relationships are established to protect the Group from interest rate risk on fixed rate products. See the Risk Management Report for further details.

For collateral held in respect of the values included in the table above, refer to the Risk Management Report.

NOTE 16: AVAILABLE-FOR-SALE FINANCIAL ASSETS

	2016	2015
	£ million	£ million
At 1 January	**1,296.9**	1,539.6
Additions	**670.0**	659.2
Disposals (sales and redemptions)	**(1,111.1)**	(858.5)
Reclassification of equity investments(1)	**—**	1.3
Exchange differences	**0.1**	(0.7)
Changes due to amortisation and accrued interest	**(11.6)**	(9.6)
Net gains/(losses) on changes in fair value	**14.5**	(34.4)
At 31 December	**858.8**	1,296.9

(1) Represents investments in unquoted equity securities relating to the Group's participation in banking and credit card operations, previously recognised within other assets.

Gains on sale of available-for-sale securities amounted to £6.8 million (2015: £8.8 million).

Analysis of the composition of debt securities categorised as available-for-sale financial assets is set out in the Risk Management Report on page 162. All assets have been individually assessed for impairment and following this assessment no write down of assets was required.

NOTE 17: COLLATERAL PLEDGED AND RECEIVED

The Group receives and accepts collateral in the form of cash and marketable securities in respect of the following transactions:

- derivatives;
- sale and repurchase and reverse sale and repurchase agreements; and
- secured loans.

Collateral in respect of derivatives is subject to the standard industry terms of ISDA Credit Support Annex. This means that securities received or given as collateral can be pledged or sold during the term of the transaction but must be returned on maturity of the transaction. The terms also give each counterparty the right to terminate the related transactions upon the counterparty's failure to post collateral.

At 31 December 2016 cash collateral of £235.0 million had been pledged by the Group, comprising £181.1 million recognised within loans and advances to banks and £53.9 million within Other assets (2015: £94.6 million, comprising £94.3 million recognised within loans and advances to banks and £0.3 million within Other assets) and £14.0 million (2015: £23.8 million) has been received as cash collateral by the Group and recognised within deposits from banks.

At 31 December 2016 available-for-sale financial assets of £10.6 million (2015: £nil) are pledged as collateral in respect of derivative transactions.

At 31 December 2016 loans and advances of £2,302.3 million (2015: £755.0 million) are pledged as collateral in respect of secured loans and sale and repurchase agreements under terms that are usual and customary for such activities.

NOTE 18: SECURITISATION

Assets and liabilities of the SPVs included in these consolidated financial statements comprise:

	2016	2015
	£ million	£ million
Assets		
Derivative financial instruments	**64.5**	—
Loans and advances to customers	**4,907.8**	3,670.4
Loans and advances to banks	**354.3**	384.3
Other assets	**0.1**	0.3
Total assets	**5,326.7**	4,055.0
Liabilities		
Debt securities in issue	**2,294.2**	1,741.9
Deposits by banks	**0.4**	13.2
Derivative financial instruments	**0.1**	—
Other liabilities	**3.4**	3.1
Total liabilities	**2,298.1**	1,758.2

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

	2016	2015
	£ million	£ million
Carrying amount of transferred assets	**4,907.8**	3,670.4
Fair value of transferred assets	**4,982.7**	3,728.4
Carrying amount of associated liabilities	**2,294.2**	1,741.9
Fair value of associated liabilities	**2,300.1**	1,740.0

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

NOTE 19: INTANGIBLE ASSETS

	Core deposit intangible	Software	Core banking platform	Total
	£ million	£ million	£ million	£ million
Cost:				
At 1 January 2015	4.8	82.0	19.9	106.7
Additions	—	27.9	1.6	29.5
Disposals	—	(24.8)	—	(24.8)
At 31 December 2015	4.8	85.1	21.5	111.4
Additions	—	**31.6**	**—**	**31.6**
Disposals	—	**(2.1)**	**—**	**(2.1)**
At 31 December 2016	**4.8**	**114.6**	**21.5**	**140.9**
Accumulated amortisation:				
At 1 January 2015	3.7	56.9	—	60.6
Charge for the year	(0.3)	8.6	2.9	11.2
Disposals	—	(24.8)	—	(24.8)
At 31 December 2015	3.4	40.7	2.9	47.0
Charge for the year	**1.4**	**10.4**	**3.6**	**15.4**
Disposals	—	**(2.1)**	**—**	**(2.1)**
At 31 December 2016	**4.8**	**49.0**	**6.5**	**60.3**
Balance sheet amount at 31 December 2016	**—**	**65.6**	**15.0**	**80.6**
Balance sheet amount at 31 December 2015	1.4	44.4	18.6	64.4

NOTE 20: TANGIBLE FIXED ASSETS

	Land and buildings	Plant, equipment fixtures, fittings and vehicles	Total
	£ million	£ million	£ million
Cost:			
At 1 January 2015	61.2	41.6	102.8
Additions	2.1	8.1	10.2
Disposals	—	(10.2)	(10.2)
At 31 December 2015	63.3	39.5	102.8
Additions	**1.8**	**6.8**	**8.6**
Disposals	**(0.6)**	**(3.0)**	**(3.6)**
At 31 December 2016	**64.5**	**43.3**	**107.8**
Accumulated depreciation and impairment:			
At 1 January 2015	7.3	22.6	29.9
Depreciation charge for the year	2.2	6.2	8.4
Disposals	—	(10.1)	(10.1)
At 31 December 2015	9.5	18.7	28.2
Depreciation charge for the year	0.1	5.5	5.6
Disposals	**(0.5)**	**(2.9)**	**(3.4)**
At 31 December 2016	**9.1**	**21.3**	**30.4**
Balance sheet amount at 31 December 2016	**55.4**	**22.0**	**77.4**
Balance sheet amount at 31 December 2015	53.8	20.8	74.6

NOTE 21: DEFERRED TAX

	2016 £ million	2015 £ million
Deferred tax assets/(liabilities):		
Accelerated capital allowances	**12.9**	15.1
Revaluation reserve in respect of available-for-sale financial assets	**(2.6)**	—
Cash flow hedge reserve	**5.2**	3.8
Change in accounting basis on adoption of IFRS	**(4.0)**	(4.8)
Tax losses carried forward	**7.3**	18.0
Other temporary differences	**4.2**	4.3
Fair value adjustments on acquisition of Northern Rock	**—**	1.6
Total deferred tax assets	**23.0**	38.0

The Group has not recognised deferred tax assets in respect of gross unused tax losses of £31.2 million (2015: £31.2 million).

The movement in the net deferred tax balance is as follows:

	2016 £ million	2015 £ million
At 1 January	**38.0**	50.2
Income statement (charge)/credit (refer note 9):		
Accelerated capital allowances	**(2.2)**	8.0
Tax losses carried forward	**(10.7)**	(20.1)
Other temporary differences	**(1.5)**	(1.1)
	(14.4)	(13.2)
Amounts (charged)/credited to equity:		
Available-for-sale financial assets	**(1.7)**	(0.9)
Cash flow hedges	**1.4**	1.6
Adjustments relating to share based payments	**(0.3)**	0.3
	(0.6)	1.0
At 31 December	**23.0**	38.0

NOTE 22: OTHER ASSETS

	2016 £ million	2015 £ million
Trade debtors	**17.7**	9.7
Prepayments and accrued income	**27.9**	22.4
Other	**76.3**	27.5
Total other assets	**121.9**	59.6

Included within 'Other' assets are amounts receivable from clearing houses on centrally cleared derivative financial instruments of £50.7 million (2015: £0.2 million) recorded on a net basis.

NOTE 23: DEPOSITS FROM BANKS

	2016 £ million	2015 £ million
Liabilities in respect of securities sold under repurchase agreements	**850.0**	1,274.9
Secured loans	**1,268.0**	—
Other deposits from banks	**14.5**	23.8
Total deposits from banks	**2,132.5**	1,298.7

NOTE 24: CUSTOMER DEPOSITS

	2016	2015
	£ million	£ million
Savings and investment accounts	**27,762.7**	24,914.6
Personal current accounts	**343.6**	230.3
Total customer deposits	**28,106.3**	25,144.9

NOTE 25: DEBT SECURITIES IN ISSUE

	Secured	Unsecured	Total
	£ million	£ million	£ million
At 1 January 2015	**1,594.1**	—	1,594.1
Repayments	**(601.9)**	—	(601.9)
Issues	**750.0**	298.9	1,048.9
Other movements	**(0.3)**	(1.4)	(1.7)
At 31 December 2015	**1,741.9**	297.5	2,039.4
Repayments	**(798.1)**	—	**(798.1)**
Issues	**1,278.9**	—	**1,278.9**
Revaluations	**73.0**	—	**73.0**
Other movements	**(1.5)**	**8.3**	**6.8**
At 31 December 2016	**2,294.2**	**305.8**	**2,600.0**

Other movements comprise unamortised issue costs and hedge accounting adjustments.

On 16 April 2015, the Group issued 5 year Medium Term Notes with a nominal value of £300 million at a coupon of 2.25% per annum. The notes were issued as part of the Group's £3 billion Global Medium Term Note programme. On 8 June 2015, the Group raised £750 million from institutional investors through the issuance of Residential Mortgage Backed Securities in the Gosforth Funding 2015-1 transaction in Sterling.

On 25 January 2016, the Group raised £803 million from institutional investors through the issuance of Residential Mortgage Backed Securities in the Gosforth Funding 2016-1 transaction in Euro, US Dollars and Sterling. On 9 May 2016, the Group raised £474 million from institutional investors through the issuance of Residential Mortgage Backed Securities (RMBS) in the Gosforth Funding 2016-2 transaction in Euro and Sterling. For all RMBS funding raised in currencies other than Sterling, the Group enters into cross-currency derivatives which swap the foreign currency liabilities into Sterling.

NOTE 26: PROVISIONS

	FSCS	Other	Total
	£ million	£ million	£ million
At 1 January 2016	**6.6**	**1.8**	**8.4**
Provisions applied	**(6.7)**	**(1.1)**	**(7.8)**
Charge for the year	**7.8**	**0.1**	**7.9**
At 31 December 2016	**7.7**	**0.8**	**8.5**

The Financial Services Compensation Scheme (FSCS) is the UK's statutory compensation fund of last resort for customers of authorised financial services firms and pays compensation if a firm is unable to pay claims against it. The FSCS is funded by levies on the authorised financial services industry. Each deposit-taking institution contributes towards the FSCS levies in proportion to their share of total protected deposits on 31 December of the year preceding the scheme year, which runs from 1 April to 31 March. The FSCS can only raise a levy within its scheme year (which commences 1 April) and under IFRIC 21 'Levies' the Group recognises its FSCS provision in the scheme year itself.

Following the default of a number of deposit takers in 2008, the FSCS borrowed funds from HM Treasury to meet the compensation costs for customers of those firms. At 31 March 2016, the end of the latest FSCS scheme year for which it has published accounts, the principal balance outstanding on these loans was £15,655 million (31 March 2015: £15,798 million). Although it is anticipated that the substantial majority of this loan will be repaid from funds the FSCS receives from asset sales, surplus cash flow or other recoveries in relation to the assets of the firms that defaulted, any shortfall will be funded by deposit-taking participants of the FSCS. The amount of future levies payable by the Group depends on a number of factors including the amounts recovered by the FSCS from asset sales, the Group's participation in the deposit-taking market at 31 December, the level of protected deposits and the population of deposit taking participants.

NOTE 27: OTHER LIABILITIES

	2016	2016
	£ million	£ million
Trade creditors and accruals	**59.0**	55.5
Deferred income	**3.0**	5.0
Accrued interest	**127.2**	131.1
Other liabilities	**102.2**	43.4
Total other liabilities	**291.4**	235.0

Deferred income represents income advanced from partners that will be recognised in future periods.

Accrued interest primarily represents interest which has accrued on savings and investment accounts.

NOTE 28: SHARE CAPITAL AND SHARE PREMIUM

	2016	2015
	£ million	£ million
Share capital	**0.1**	0.1
Share premium	**654.5**	654.5
Total share capital and share premium	**654.6**	654.6

Issued and fully paid share capital

	2016 Number of shares	2016	2015 Number of shares	2015
		£		£
Ordinary Shares of £0.0001 each				
At 1 January	**443,711,458**	**44,371**	441,933,180	44,193
Issued during year	**1,230,550**	**123**	1,778,278	178
At 31 December	**444,942,008**	**44,494**	443,711,458	44,371
Deferred Shares of £0.001 each				
At 1 January and at 31 December	**10,052,161**	**10,052**	10,052,161	10,052

The following describes the rights attaching to each share class at 31 December 2016:

Ordinary Shares

The holders of Ordinary Shares are entitled to one vote per share at meetings of the Group. All Ordinary Shares in issue in the Company rank equally and carry the same voting rights and the same rights to receive dividends and other distributions declared or paid by the Company.

Deferred Shares

As set out in the Articles of Association adopted on listing (and pursuant to the provisions of the Companies Act 2006 in respect of shares held in own shares), the Deferred Shares have no voting or dividend rights and, on a return of capital on a winding up, have no valuable economic rights. No application has been made or is currently intended to be made for the Deferred Shares to be admitted to the Official List or to trade on the London Stock Exchange or any other investment exchange.

The Deferred Shares are held in treasury. This is to ensure that the aggregate nominal value of the Company's share capital will be not less than £50,000, which is the minimum level of nominal share capital required by the Companies Act 2006 for a company to be established as a public limited company.

NOTE 29: OTHER EQUITY INSTRUMENTS

	2016	2015
	£ million	£ million
At 1 January	**156.5**	156.5
Additional Tier 1 securities issued in the year (net of issue costs)	**227.6**	—
At 31 December	**384.1**	156.5

The Company issued Fixed Rate Resettable Additional Tier 1 (AT1) securities on the Luxembourg Stock Exchange of £230.0 million on 10 November 2016 and £160.0 million on 31 July 2014. The issues are treated as equity instruments in accordance with IAS 32 'Financial Instruments:

Presentation' with the proceeds included in equity, net of transaction costs of £5.9 million (2015: £3.5 million). Dividends and other returns to equity holders are treated as a deduction from equity.

The principal terms of the AT1 securities in issue are described below:

- the securities constitute direct, unsecured and subordinated obligations of the Company and rank pari passu with holders of other Tier 1 instruments and the holders of that class or classes of preference shares but rank junior to the claims of senior creditors;
- the securities bear a fixed rate of interest from the issue date of 8.750% and 7.875% from their issue dates up to their first reset dates on 10 November 2021 and 31 July 2019 respectively;
- interest on the securities will be due and payable only at the sole discretion of the Company, and the Company has sole and absolute discretion at all times and for any reason to cancel (in whole or in part) any interest payment that would otherwise be payable on any interest payment date;
- the securities are perpetual with no fixed redemption date and are repayable, at the option of the Company, all (but not part) on the first reset date or any reset date thereafter. In addition, the AT1 securities are redeemable, at the option of the Company, in whole for certain regulatory or tax reasons. Any optional redemption requires the prior consent of the PRA; and
- all AT1 securities will be converted into Ordinary Shares of the Company, at a pre-determined price, should the Common Equity Tier 1 ratio of the Group fall below 7.0% as specified in the terms.

NOTE 30: OTHER RESERVES

Other reserves comprise:

	2016	2015
	£ million	£ million
Revaluation reserve in respect of available-for-sale financial assets		
At 1 January	**(0.3)**	7.0
Net gains/(losses) from changes in fair value	**52.8**	(0.8)
Net gains on disposal transferred to net income	**(38.3)**	(33.6)
Amounts transferred to net income due to hedge accounting	**(8.4)**	25.9
Taxation	**(1.7)**	1.2
At 31 December	**4.1**	(0.3)

	2016	2015
	£ million	£ million
Cash flow hedge reserve		
At 1 January	**(15.3)**	(8.8)
Amounts recognised in equity	**(36.1)**	(13.2)
Amounts transferred to income statement	**13.6**	5.1
Taxation	**6.3**	1.6
At 31 December	**(31.5)**	(15.3)

NOTE 31: RETAINED EARNINGS

	2016	2015
	£ million	£ million
At 1 January	**544.8**	434.5
Profit for the year	**140.1**	111.2
Dividends paid to ordinary shareholders	**(20.8)**	(6.2)
Distributions to Additional Tier 1 security holders (net of tax)	**(10.1)**	(10.0)
Purchase of own shares	**(7.3)**	(5.0)
Share based payments (including deferred tax)	**12.5**	20.3
As at 31 December	**659.2**	544.8

Employee Benefit Trust (EBT)

Retained earnings are stated after deducting £6.9 million (2015: £2.9 million) representing 2,922,220 (2015: 1,815,387) own shares held in an EBT.

The Company established an EBT in 2011 in connection with the operation of the Company's share plans. The Company funded the EBT by means of a cash loan and is therefore considered to be the sponsoring entity. The EBT purchased shares in the Company using the cash loan which is accounted for as a purchase of own shares by the Company. The investment in own shares at 31 December 2016 is £6.9 million (2015: £2.9 million). The market value of the shares held in the EBT at 31 December 2016 was £8.8 million.

NOTE 32: CONTINGENT LIABILITIES AND COMMITMENTS

Contingent liabilities

The Board was not aware of any significant contingent liabilities as at 31 December 2016 (31 December 2015: none).

The Company is, from time to time and in the normal course of business, subject to a variety of legal or regulatory claims, actions or proceedings. When such circumstances arise, the Board considers the likelihood of a material outflow of economic resources and provides for its best estimate of costs where an outflow of economic resources is considered probable. While there can be no assurances, the Directors believe, based on information currently available to them, that the likelihood of material outflows from such matters is remote.

The Board does not expect the ultimate resolution of any other threatened or actual legal proceedings to have a significant adverse effect on the financial position of the Group.

Loan Commitments

Contractual amounts to which the Group is committed for extension of credit to customers.

	2016	2015
	£ million	£ million
Not later than 1 year	**4,854.3**	3,980.7
Later than one year and not later than 5 years	**88.2**	102.5
Later than 5 years	**346.6**	396.6
Total loan commitments	**5,289.1**	4,479.8

Operating lease commitments—land and buildings

Minimum future lease payments under non-cancellable operating leases:

	2016	2015
	£ million	£ million
Not later than 1 year	7.1	7.2
Later than one year and not later than 5 years	25.0	25.2
Later than 5 years	20.0	24.1
Total operating lease commitments—land and buildings	**52.1**	56.5

Operating lease commitments—other operating leases

Minimum future lease payments under non-cancellable operating leases:

	2016	2015
	£ million	£ million
Not later than 1 year	**4.6**	4.6
Later than one year and not later than 5 years	**4.6**	9.2
Later than 5 years	**—**	—
Total operating leases commitments—other operating leases	**9.2**	13.8

Capital commitments

Capital commitments for the acquisition of buildings and equipment:

	2016	2015
	£ million	£ million
Not later than 1 year	**1.0**	2.9
Later than one year and not later than 5 years	—	—
Later than 5 years	—	—
Total loan commitments	**1.0**	2.9

NOTE 33: FAIR VALUE OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

Fair value of financial assets and liabilities recognised at cost

The following table summarises the fair values of those financial assets and liabilities not presented on the Group's balance sheet at their fair value, by the level in the fair value hierarchy into which each fair value measurement is categorised. The accounting policy in note 1.9 (j) sets out the key principles for estimating the fair values of financial instruments.

	Level 1	Level 2	Level 3	Total fair value	Total carrying value
	£ million	£ million	£ million	£ million	£ million
At 31 December 2016					
Cash and balances at central banks	—	**786.3**	—	**786.3**	**786.3**
Loans and advances to banks	—	**635.6**	—	**635.6**	**635.6**
Loans and advances to customers	—	—	**32,514.0**	**32,514.0**	**32,367.1**
Debt securities classified as loans and receivables	**0.7**	—	—	**0.7**	**0.7**
Available-for-sale financial assets	—	—	**0.3**	**0.3**	**0.3**
Other assets	—	**68.8**	—	**68.8**	**68.8**
Total financial assets at fair value	**0.7**	**1,490.7**	**32,514.3**	**34,005.7**	**33,858.8**
Deposits from banks	—	**2,132.5**	—	**2,132.5**	**2,132.5**
Customer deposits	—	**28,222.7**	—	**28,222.7**	**28,106.3**
Debt securities in issue	**2,610.8**	—	—	**2,610.8**	**2,600.0**
Other liabilities	—	**189.5**	—	**189.5**	**189.5**
Total financial liabilities at fair value	**2,610.8**	**30,544.7**	—	**33,155.5**	**33,028.3**

	Level 1	Level 2	Level 3	Total fair value	Total carrying value
	£ million	£ million	£ million	£ million	£ million
At 31 December 2015					
Cash and balances at central banks	—	888.6	—	888.6	888.6
Loans and advances to banks	—	614.5	—	614.5	614.5
Loans and advances to customers	—	—	27,243.2	27,243.2	27,109.0
Debt securities classified as loans and receivables	1.2	—	—	1.2	1.1
Available-for-sale financial assets	—	—	1.3	1.3	1.3
Other assets	—	14.6	—	14.6	14.6
Total financial assets at fair value	1.2	1, 517.7	27,244.5	28,763.4	28,629.1
Deposits from banks	—	1,298.7	—	1,298.7	1,298.7
Customer deposits	—	25,162.5	—	25,162.5	25,144.9
Debt securities in issue	2,032.1	—	—	2,032.1	2,039.4
Other liabilities	—	155.1	—	155.1	155.1
Total financial liabilities at fair value	2032.1	26,616.3	—	28,648.4	28,638.1

Fair value hierarchy

The table above summarises the carrying value and fair value of assets and liabilities held on the balance sheet. There are three levels to the hierarchy as follows:

Level 1—Quoted prices (unadjusted) in active markets for identical assets and liabilities.

Level 2—Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, whether directly (i.e. as prices) or indirectly (i.e. derived from prices).

Level 3—Inputs for the asset or liability that are not based on observable market data (unobservable inputs).

Valuation methods for calculations of fair values of financial assets and liabilities recognised at cost are set out below:

Cash and balances at central banks

Fair value approximates to carrying value because cash and balances at central banks have minimal credit losses and are either short-term in nature or reprice frequently.

Loans and advances to banks

Fair value was estimated by using discounted cash flows applying either market rates where practicable or rates offered by other financial institutions for loans with similar characteristics. The fair value of floating rate placements, fixed rate placements with less than six months to maturity and overnight deposits is considered to approximate to their carrying amount.

Loans and advances to customers

The Group provides loans of varying rates and maturities to customers. The fair value of loans with variable interest rates is considered to approximate to carrying value as the interest rate can be moved in line with market conditions. For loans with fixed interest rates, fair value was estimated by discounting cash flows using market rates or rates normally offered by the Group. The change in interest rates since the majority of these loans were originated means that their fair value can vary significantly from their carrying value. However, as the Group's policy is to hedge fixed rate loans in respect of interest rate risk, this does not indicate that the Group has an exposure to this difference in value.

Loans and advances to customers are categorised as level 3 as unobservable pre-payment rates are applied.

Debt securities classified as loans and receivables

Fair values are based on quoted prices, where available, or by discounting cash flows using market rates.

Available-for-sale financial assets

These are unquoted equity securities held by the Group and relating to participation in banking and credit card operations (refer note 16). They are categorised as level 3 as the fair value of these securities cannot be reliably measured, due to the lack of equivalent instruments with observable prices.

Other assets and liabilities—trade debtors/creditors, accrued income and accrued interest

Fair value is deemed to approximate the carrying value.

Deposits from banks and customer deposits

Fair values of deposit liabilities repayable on demand or with variable interest rates are considered to approximate to carrying value. The fair value of fixed interest deposits with less than six months to maturity is their carrying amount. The fair value of all other deposit liabilities was estimated by discounting cash flows, using market rates or rates currently offered by the Group for deposits of similar remaining maturities.

Debt securities in issue

Fair values are based on quoted prices where available or by discounting cash flows using market rates.

Fair value of financial assets and liabilities recognised at fair value

The following table summarises the fair values of those financial assets and liabilities recognised at fair value, by the level in the fair value hierarchy into which each fair value measurement is categorised. The accounting policy in note 1.9(j) sets out the key principles for estimating the fair values of financial instruments.

2016	Level 1	Level 2	Level 3	Total
	£ million	£ million	£ million	£ million
Financial assets				
Derivative financial instruments	—	**104.2**	—	**104.2**
Available-for-sale financial assets	**850.9**	**—**	**7.6**	**858.5**
Financial liabilities				
Derivative financial instruments	—	**229.7**	—	**229.7**

2015	Level 1	Level 2	Level 3	Total
	£ million	£ million	£ million	£ million
Financial assets				
Derivative financial instruments	—	82.3	—	82.3
Available-for-sale financial assets	1,233.3	59.0	3.3	1,295.6
Financial liabilities				
Derivative financial instruments	—	156.0	—	156.0

Level 1 Valuations

The fair value of debt securities categorised as available-for-sale financial assets is derived from unadjusted quoted prices in an active market.

Level 2 Valuations

The fair values of derivative instruments are calculated by discounted cash flow models using yield curves that are based on observable market data or are based on valuations obtained from counterparties.

The fair value of level 2 available-for-sale securities were calculated using valuation techniques, including discounted cash flow models.

Level 3 Valuations

Level 3 available-for-sale financial assets represent the Group's best estimates of the value of certain equity investments in unlisted companies and of Visa Inc. preferred stock.

The level 3 valuation of £3.3 million at 31 December 2015 represented the Group's best estimate at that time of the value of its equity investment in Visa Europe Limited, with reference to the consideration expected to be received from the proposed acquisition of that company by Visa Inc.

The acquisition by Visa Inc. completed on 21 June 2016, resulting in disposal of the investment and receipt of Visa Inc. preferred stock and cash consideration and recognition of a gain on disposal of £5.3 million, included within Other Operating Income.

The Visa Inc. preferred stock value was determined by reference to the Visa Inc. common stock price at 31 December 2016, less a discount to reflect restrictions on transferability and the risk of future reduction in conversion to Visa Inc. common stock. The discount applied is the most significant unobservable input to the valuation.

The Company has determined of the fair value of the investments in the relevant unlisted entities by reference to third party valuations, taking into account pertinent information received on the individual investments to adjust those valuations, where considered appropriate.

NOTE 34: OFFSETTING OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

	Gross amounts of assets and liabilities	Amounts offset in the balance sheet(1)	Net amounts presented in the balance sheet	Related amounts where set off in the balance sheet not permitted(2)		Potential net amounts if offset of related amounts permitted
				Subject to master netting agreements	Collateral received/ pledged	
	£ million	£ million	£ million	£ million	£ million	£ million
As at 31 December 2016						
Financial assets						
Derivative financial instruments	**123.9**	**(19.7)**	**104.2**	**(25.4)**	**(78.8)**	**—**
Loans and advances to banks	**635.6**	**—**	**635.6**	**—**	**(168.1)**	**467.5**
Other assets	**72.0**	**(3.2)**	**68.8**	**—**	**—**	**68.8**
Financial liabilities						
Deposits from banks	**2,132.5**	—	**2132.5**	—	**(10.7)**	**2121.8**
Derivative financial instruments	**254.1**	**(24.4)**	**229.7**	**(25.4)**	**(168.1)**	**36.2**
Other liabilities	**188.0**	**1.5**	**189.5**	**—**	**—**	**189.5**

	Gross amounts of assets and liabilities	Amounts offset in the balance sheet(1)	Net amounts presented in the balance sheet	Related amounts where set off in the balance sheet not permitted(2)		Potential net amounts if offset of related amounts permitted
				Subject to master netting agreements	Collateral received/ pledged	
	£ million	£ million	£ million	£ million	£ million	£ million
As at 31 December 2015						
Financial assets						
Derivative financial instruments	82.6	(0.3)	82.3	(70.4)	(10.6)	1.3
Loans and advances to banks	614.5	—	614.5	—	(72.5)	542.0
Other assets	14.7	(0.1)	14.6	—	—	14.6
Financial liabilities						
Deposits from banks	1,298.7	—	1,298.7	—	(10.6)	1,288.1
Derivative financial instruments	156.4	(0.4)	156.0	(70.4)	(72.5)	13.1
Other liabilities	155.1	—	155.1	—	—	155.1

(1) The amounts set off in the balance sheet as shown above represent derivatives and variation margin cash collateral with central clearing houses which meet the criteria for offsetting under IAS 32.

(2) The Group enters into derivatives with various counterparties which are governed by industry standard master netting agreements. The Group holds and provides cash and securities collateral in respect of derivative transactions covered by these agreements. The right to set off balances under these master netting agreements or to set off cash and securities collateral only arises in the event of non-payment or default and, as a result, these arrangements do not qualify for offsetting under IAS 32.

The effects of over collateralisation have not been taken into account in the above table.

NOTE 35: CASH FLOW STATEMENTS

(a) Change in operating assets

	2016 £ million	2015 £ million
Change in loans and advances to customers	**(5,295.7)**	(4,046.2)
Change in derivative financial assets	**(21.9)**	18.9
Change in other operating assets	**(69.7)**	(10.0)
Change in operating assets	**(5,387.3)**	(4,037.3)

(b) Change in operating liabilities

	2016 £ million	2015 £ million
Change in customer deposits	**2,961.4**	2,779.2
Change in derivative financial liabilities	**73.7**	(72.2)
Change in other operating liabilities	**922.2**	439.4
Change in operating liabilities	**3,957.3**	3,146.4

(c) Non-cash and other items

	2016 £ million	2015 £ million
Depreciation and amortisation	**21.0**	19.6
Other non-cash items	**(40.5)**	42.8
Total non-cash and other items	**(19.5)**	62.4

(d) Analysis of cash and cash equivalents as shown in the balance sheet

	2016 £ million	2015 £ million
Cash and balances at central banks	**786.3**	888.6
Less: mandatory reserve deposits[1]	**(49.1)**	(41.7)
	737.2	846.9
Loans and advances to banks	**635.6**	614.5
Deposits from banks	**(2,132.5)**	(1,298.7)
Less: amounts not repayable on demand	**2,131.9**	1,298.7
	(0.6)	—
Total cash and cash equivalents	**1,372.2**	1,461.4

(1) Mandatory reserves with central banks are not available for use in day-to-day operations.

NOTE 36: RELATED PARTY TRANSACTIONS

Key Management Personnel

Key Management Personnel refer to the Executive Team of the Group, Non-Executive Directors and Directors of subsidiary companies.

	2016 £ million	2015 £ million
Compensation		
Salaries and other short-term benefits	**7.4**	8.2
Share based payments (Refer note 7)	**7.6**	12.3
Post-employment benefits	**0.8**	0.9
Total compensation	**15.8**	21.4

Aggregate contributions in respect of Key Management Personnel to defined contribution pension schemes £0.8 million (2015: £0.9 million).

	2016	2015
	£ million	£ million
Deposits		
At 1 January	**2.2**	1.1
Placed	**1.5**	1.8
Withdrawn	**(2.3)**	(0.7)
Deposits outstanding at 31 December	**1.4**	2.2

Deposits placed by Key Management Personnel attracted interest rates of up to 3.0% (2015: 2.8%). At 31 December 2016, the Group did not provide any guarantees in respect of Key Management Personnel (2015: none).

At 31 December 2016, transactions, arrangements and agreements entered into by the Group's banking subsidiaries with Key Management Personnel included amounts outstanding in respect of loans and credit card transactions of £0.9 million with 7 Key Management Personnel (2015: £0.3 million with 5 Key Management Personnel).

Subsidiaries

Transactions and balances with subsidiaries have been eliminated on consolidation. A full list of the company's subsidiaries and SPVs included within the consolidation is provided in note 2 to the parent company financial statements.

The Virgin Money Foundation, launched in August 2015, is managed and controlled by a Board of independent Trustees, such that the Group has no power over the Foundation or, exposure or ability to affect variable returns. The Foundation is therefore not consolidated in the financial statements of the Group.

Other transactions

	2016	2015
	£ million	£ million
Transaction value at year end:		
Trademark licence fees to Virgin Enterprises Limited	**5.9**	5.1
Virgin Atlantic Airways Limited	**0.2**	—
Dividend payment to Virgin Group Holdings Limited	**7.3**	2.2
Other costs to Virgin Management Group Companies	**1.2**	0.4

	2016	2015
	£ million	£ million
Balance outstanding at year end:		
Trademark licence fees to Virgin Enterprises Limited	**—**	(0.4)
Other costs to Virgin Management Group Companies	**(0.1)**	(0.1)

Trademark licence fees to Virgin Enterprises Limited

Licence fees are payable to Virgin Enterprises Limited for the use of the Virgin Money brand trademark.

Virgin Atlantic Airways Limited

The Group incurs credit card commissions and air mile charges to Virgin Atlantic Airways Limited (VAA) in respect of an agreement between the two parties.

Dividend payment to Virgin Group Holdings Limited

The Group made dividend payments totalling £7.3 million to Virgin Group Holdings Limited in the year, comprising a £4.8 million payment in May 2016 and a £2.5 million payment in September 2016, which represented that company's proportionate share of the total final 2015 dividend and the total interim 2016 dividend respectively. In the prior year, a dividend payment of £2.2 million was made to Virgin Group

Holdings Limited in October 2015 which represented that Company's proportionate share of the total interim 2015 dividend. Refer to note 11.

Other costs to Virgin Management Group Companies

These costs include transactions with other companies in the Virgin Group.

NOTE 37: EVENTS AFTER BALANCE SHEET DATE

There have been no significant events between 31 December 2016 and the date of approval of the financial statements which would require a change or additional disclosure in the financial statements.

NOTE 38: FUTURE ACCOUNTING DEVELOPMENTS

A number of new accounting standards and amendments to accounting standards have been issued by the IASB, however are not yet effective and have not been early adopted by the Group. Those which may be relevant to the Group are set out below.

Pronouncement	Nature of change	IASB effective date
IFRS 9 'Financial Instruments'	IFRS 9 'Financial Instruments' replaces IAS 39 'Financial Instruments: Recognition and Measurement'. IFRS 9 is split over 3 core areas of change. **Classification and Measurement** IFRS 9 requires financial assets to be classified into one of three measurement categories, fair value through profit or loss, fair value through other comprehensive income and amortised cost. Classification is based on the objectives of the entity's business model for managing its financial assets and the contractual cash flow characteristics of the instruments, while it retains most of the existing requirements for financial liabilities. The Group has undertaken an assessment to determine the potential impact of changes in classification and measurement of financial assets and liabilities. The adoption of IFRS 9 is unlikely to result in a significant change to the current asset and liability measurement bases, however, the final impact will be dependent on the facts and circumstances that exist on 1 January 2018. **Impairment** IFRS 9 replaces the existing 'incurred loss' impairment approach with an expected credit loss approach, resulting in earlier recognition of credit losses. The IFRS 9 impairment model has three stages. Entities are required to recognise a 12 month expected loss allowance on initial recognition (stage 1) and a lifetime expected loss allowance when there has been a significant increase in credit risk (stage 2). Stage 3 requires objective evidence that an asset is credit-impaired, which is similar to the guidance on incurred losses in IAS 39. Loan commitments and financial guarantees not measured at fair value through profit or loss are also in scope for impairment. The assessment of whether a significant increase in credit risk has occurred is a key aspect of the IFRS 9 methodology. It involves quantitative and qualitative measures and therefore requires considerable management judgement. In addition IFRS 9 also requires the use of more forward-looking information including reasonable and supportable forecasts of future economic conditions. The need to consider multiple economic scenarios and how they could impact the loss	1 January 2018 (EU endorsed on 22 November 2016)

allowance is a subjective feature of the IFRS 9 impairment model. The Group's final methodology for significant increase in credit risk and multiple economic scenarios are still under development.

These changes may result in a material increase in the Group's balance sheet provisions for credit losses and may therefore negatively impact the Group's regulatory capital position, although the regulatory capital transitional arrangements are still in consultation and the impact may be spread over a period of time. The extent of any increase in provisions will depend upon, amongst other things, the composition of the Group's lending portfolios and forecast economic conditions at the date of implementation. The requirement to transfer assets between stages and to incorporate forward-looking data into the expected credit loss calculation, including multiple economic scenarios, is likely to result in impairment charges being more volatile when compared to the current IAS 39 impairment model.

Hedge Accounting

The hedge accounting requirements of IFRS 9 are more closely aligned with risk management practices and follow a more principle-based approach than IAS 39. However, there is an option to maintain the existing IAS 39 hedge accounting rules until the IASB completes its project on macro hedging. The Group currently expects to continue applying IAS 39 hedge accounting in accordance with this accounting policy choice.

Accounting Transition

IFRS 9 is effective for annual periods beginning on or after 1 January 2018 with no requirement to restate prior periods. If comparative periods are not restated, at the date of initial application, any difference between the carrying amount of financial assets and the change in loss allowance shall be recognised in opening retained earnings.

IFRS 9 implementation programme

The Group has an established IFRS 9 programme to ensure a high quality implementation in compliance with the standard and regulatory guidance. The programme involves multiple functions from across the Group with steering committees providing oversight. The key responsibilities of the programme include defining IFRS 9 methodology and accounting policy, development of expected loss models, identifying data and system requirements and establishing an appropriate operating model and governance framework.

The Group is building new expected credit loss models using three key input parameters for the computation of expected loss: probability of default, loss given default and exposure at default. The initial build phase of the programme is complete and the Group is currently testing and refining the models in line with the Group's delivery plans. The Group will continue to refine the expected credit loss approach under IFRS 9 and provide an update on the progress made at each reporting period until implementation.

Pronouncement	Nature of change	IASB effective date
IFRS 15 'Revenue from Contracts with Customers'	IFRS 15 replaces IAS 18 'Revenue' and IAS 11 'Construction contracts' as a comprehensive standard to address current inconsistencies in accounting practice for revenue recognition. Financial instruments and other contractual rights or obligations within the scope of IFRS 9 are excluded from the scope of this standard. The Group has reviewed the requirements of the new standard and it is not expected to have a significant impact, as a substantial proportion of the Group's income is generated from financial instruments.	1 January 2018 (EU endorsed on 22 September 2016)
IFRS 16 'Leases'	This standard replaces IAS 17 'Leases' and will result in most leases for lessees being brought on to the Balance Sheet under a single lease model, removing the distinction between finance and operating leases. It requires a lessee to recognise a 'right-of-use' asset and a lease liability. Lessor accounting remains largely unchanged. The Group is currently assessing the impact of the new standard.	1 January 2019 (has not been EU endorsed)

NOTE 39: COUNTRY BY COUNTRY REPORTING

The Capital Requirements (Country by Country Reporting) Regulations came into effect on 1 January 2014 and place certain reporting obligations on financial institutions within CRD IV.

The activities of the Group are described in the Strategic Report.

All companies consolidated within the Group's financial statements are UK registered entities.

	UK
Number of employees (average FTE)	2,893
Turnover (total income)	£581.4m
Pre-tax profit	£194.4m
Corporation tax paid	£ 22.1m
Public subsidies received	£ 0.0m

The Group received no public subsidies during the year.

FULL ANALYSIS OF RISK CLASSES

Credit risk

Definition

Credit risk is defined as the risk that a borrower or counterparty fails to pay the interest or the capital due on a loan or other financial instrument (both on and off- balance sheet).

Risk appetite

The Group has appetite for high-quality credit exposures including affordable retail lending and liquid wholesale investments.

Exposures

The principal credit risks arise from loans and advances to customers, debt securities and derivatives. The credit risk exposures of the Group are set out on page 143. Credit risk exposures are categorised as retail (secured and unsecured) and wholesale.

In terms of loans and advances, credit risk arises both from amounts lent and commitments to extend credit to a customer. This applies to the secured and unsecured portfolios.

Loans and advances expose the Group to customer re- mortgage risk, for example, in the interest only retail mortgage portfolio. Re-mortgage risk is the possibility that an outstanding exposure cannot be repaid at its contractual maturity date. Interest only mortgage management strategies are detailed on page 159.

Growth in buy-to-let lending has been undertaken in a controlled manner, with Board oversight against risk appetite. The buy-to-let lending policy is targeted towards retail customers rather than professional landlords, with specific restrictions in place on total exposures by loan amount and number of properties.

The Group's unsecured portfolio has grown in line with expectation and within strict underwriting criteria.

Credit risk in the wholesale portfolio arises from debt securities, derivatives and foreign exchange activities. The Group's wholesale credit risk exposure is reflected on page 161.

Measurement

The Group uses statistical models, supported by both internal and external data, to measure retail credit risk exposures.

The models reflect three components: (i) the 'probability of default' (PD) by the borrowers on their contractual obligations, (ii) current exposures to the borrowers and their likely future development, from which the Group derives the 'exposure at default', and (iii) the likely loss ratio on the defaulted obligations (the 'loss given default'). These parameters are used in order to derive an expected loss.

Portfolios are assessed by using segmentation for measurement and reporting purposes. Details of the classifications used for asset quality can be found on page 144.

The Group uses Advanced Internal Ratings Based (AIRB) models in measuring the credit risk of secured loans and advances to customers. All retail unsecured and wholesale exposures are measured under the Standardised Approach for regulatory capital.

The Group's credit portfolios are subject to regular stress testing, with stress scenario assessments run at various levels of the organisation from Group-led to individual portfolio exercises. Further information on the stress testing process, methodology and governance can be found on page 135.

Page 147 provides details of the Group's approach to the impairment of financial assets. Refer to note 1 to the financial statements.

Mitigation

The Group uses a range of approaches to mitigate credit risk.

Credit policy

The Risk function uses risk appetite to set the credit policy for each type of credit risk. These policies are supported by lending manuals which define the responsibilities of underwriters and provide a rule set for credit decisions. The risk appetite, target market and risk acceptance criteria are reviewed at least annually. Risk oversight teams monitor early warning indicators, credit performance trends, and key risk indicators, and review and challenge exceptions to planned outcomes. They test the adequacy of the credit risk infrastructure and governance processes throughout the Group. Counterparty exposures are regularly reviewed and appropriate interventions are made where necessary. Risk Assurance perform independent risk-based reviews, and provide an assessment of the effectiveness of internal controls and risk management practices. Oversight and review is also undertaken by Internal Audit.

Controls over AIRB rating systems

The Group has an established Independent Model Validation team that sets common minimum standards. The standards are designed to ensure risk models and associated AIRB rating systems are developed consistently, and are of sufficient quality to support business decisions and meet regulatory requirements[1].

Credit underwriting

The Group uses a variety of lending criteria when assessing applications for secured and unsecured lending. The general approval process uses credit acceptance scorecards and involves a review of an applicant's previous credit history using information held by credit reference agencies.

The Group assesses the affordability of the borrower under stressed scenarios including increased interest rates. In addition, the Group has in place limits on permitted indebtedness.

The Group rejects any application for a product where a customer is registered as bankrupt or insolvent, or has a County Court Judgement registered at a credit reference agency used by the Group. In addition, the Group's approach to underwriting applications takes into account the total unsecured debt held by a customer and their affordability.

For residential mortgages, the Group's policy is to accept only standard applications with a loan-to-value (LTV) of less than 95%. All originations in the year to 31 December 2016 which were between 90% and 95% LTV were only permitted under the Help to Buy loan guarantee scheme. The Group has maximum % LTV limits which depend upon the loan size. Residential mortgage limits are:

Loan size from	To	Maximum LTV
£1	£500,000	95% (purchase) 90% (re-mortgage)
£500,001	£1,000,000	80%

Buy-to-let is limited to a maximum of 75% LTV and residential interest only is limited to a maximum of 70% LTV, regardless of loan size.

The Group's approach to underwriting applications for unsecured products takes into account the total unsecured debt held by a customer and their affordability.

The Group uses statistically based decisioning techniques (primarily credit scoring models) for its retail portfolios.

Collateral for secured retail and wholesale exposures

The sole collateral type for secured loans and advances to customers is residential real estate. Property offered as collateral must be of acceptable construction and located in England, Wales, Scotland or Northern Ireland. Title to the property must be good, marketable and free from onerous restrictions and conditions. The Group requires first legal charge over the property offered as collateral and does not accept charges over part of the collateral. The Group does not lend where the collateral is land only.

Collateral held as security for financial assets other than loans and advances is determined by the nature of the instrument. Debt securities, treasury and other bills are generally unsecured, with the exception of asset-backed securities and similar instruments such as covered bonds, which are secured by portfolios of financial assets.

1 The Risk function reviews model effectiveness, while new models and model changes are referred to the appropriate model governance committee for approval.

Collateral is generally not held against loans and advances to financial institutions, except where a collateral agreement has been entered into under a master netting agreement.

In addition, derivative transactions with wholesale counterparties are collateralised under a Credit Support Annex in conjunction with the ISDA Master Agreement to further mitigate credit risk. The Group will receive additional collateral from certain counterparties in the event their external credit rating falls below contractually set triggers as agreed in the Credit Support Annex.

It is the Group's policy that, at the time of borrowing, collateral should always be realistically valued by an appropriately qualified source, independent of both the credit decision process and the customer. Collateral valuation is reviewed on a regular basis.

Monitoring

The Group produces regular portfolio monitoring reports for review by senior management. The Risk function in turn produces a review of credit risk throughout the Group, including reports on significant credit exposures, which are presented to the Risk Management Committee and the Board Risk Committee.

The performance of all rating models is monitored on a regular basis to ensure that:

- appropriate risk differentiation capability is provided;
- generated ratings remain as accurate and robust as practical; and
- appropriate risk estimates are assigned to grades and pools of accounts.

In the event that the monitoring identifies material exceptions or deviations from expected outcomes, these are escalated for resolution.

Debt management for customers in financial difficulty

The Group's aim in offering forbearance and other assistance to retail customers in financial distress is to benefit both the customer and the Group by discharging the Group's regulatory and social responsibilities to support customers and act in their best long-term interests. This allows customer facilities to be brought back into a sustainable position which, for residential mortgages, may also mean keeping customers in their homes. The Group offers a range of tools and assistance to support customers who are encountering financial difficulties. Cases are managed on an individual basis, with the circumstances of each customer considered separately and the action taken judged as being affordable and sustainable for the customer.

Customers are assisted through the Debt Management Function where tailored repayment programmes can be agreed. Customers are actively supported and referred to free money advice agencies where they have multiple credit facilities, including those at other lenders, which require restructuring.

One component of the management approach is to contact customers showing signs of financial difficulty to discuss their circumstances and offer solutions to prevent their accounts falling into arrears.

Specific tools are available to assist customers which vary by product and the customer's status. Further details can be found on page 159.

Income and expenditure assessments are undertaken for all customers entering into a long-term repayment plan. This ensures that customers are provided with a sustainable and affordable solution that allows them a realistic opportunity to repay their debt in the short to medium term. In addition, the Group will advise customers to contact debt management companies such as Citizens Advice Bureau, Stepchange and Payplan. These companies do not charge any fees and will offer advice to customers as well as work with creditors to agree affordable repayment plans. Understanding what has changed and establishing the customers' current and future financial situation is imperative to ensuring that the right level of support is offered and that customers receive the appropriate solution to help them manage their debt when in financial difficulty.

Forbearance and provisioning

The Group's approach is to ensure that provisioning models, supported by management judgement, appropriately reflect the incurred loss risk of exposures. The Group uses behavioural scoring to assess customers' credit risk and the models take a range of potential indicators of customer financial distress into account.

The performance of provision models is monitored and challenged on an ongoing basis in line with the Retail Credit Provisioning Policy. Regular detailed analysis of modelled provision outputs is undertaken to demonstrate that the risk of forbearance or other similar activities is recognised, that the outcome period adequately captures the risk and that the underlying risk is appropriately reflected.

Further details on forbearance can be found on page 159.

Credit risk portfolio as at 31 December 2016

Overview

The tables below show the total credit risk exposures for the Group's retail and wholesale portfolios.

	Secured		Unsecured		Wholesale		
2016 (audited)	**Residential mortgage loans**	**Residential buy-to-let mortgage loans**	**Credit cards**	**Overdrafts**	**Treasury assets**	**Derivative exposures**	**Total**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Total gross loans and advances to customers	24,283.0	5,468.4	2,486.5	0.1	—	—	32,238.0
Loans and advances to banks	—	—	—	—	635.6	—	635.6
Cash and balances at central banks	—	—	—	—	786.3	—	786.3
Debt securities classified as loans and receivables	—	—	—	—	0.7	—	0.7
Available-for-sale financial assets	—	—	—	—	858.8	—	858.8
Gross positive fair value of derivative assets	—	—	—	—	—	104.2	104.2
Total	**24,283.0**	**5,468.4**	**2,486.5**	**0.1**	**2,281.4**	**104.2**	**34,623.6**

	Secured		Unsecured		Wholesale		
2015 (audited)	**Residential mortgage loans**	**Residential buy-to-let mortgage loans**	**Credit cards**	**Overdrafts**	**Treasury assets**	**Derivative exposures**	**Total**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Total gross loans and advances to customers	21,060.3	4,401.9	1,609.8	0.2	—	—	27,072.2
Loans and advances to banks	—	—	—	—	614.5		614.5
Cash and balances at central banks	—	—	—	—	888.6	—	888.6
Debt securities classified as loans and receivables	—	—	—	—	1.1	—	1.1
Available-for-sale financial assets	—	—	—	—	1,296.9	—	1,296.9
Gross positive fair value of derivative assets	—	—	—	—	—	82.3	82.3
Total	**21,060.3**	**4,401.9**	**1,609.8**	**0.2**	**2,801.1**	**82.3**	**29,955.6**

Credit quality of assets

Loans and receivables

The Group defines three classifications of credit quality (low risk, medium risk and higher risk) for all credit exposures. These are based on the following criteria.

Secured credit exposures are segmented according to the credit quality classification and a point-in-time PD. The point- in-time PD is an internal parameter used within the Group's AIRB capital models which aims to estimate the probability of default over the next 12 months based on account characteristics and customer behavioural data. Default occurs where the borrower has missed six months of mortgage repayments or the borrower is deemed to be unlikely to repay their loan. Exposures are categorised as:

- higher risk where assets are past due or have a point in time PD greater than 2%;
- medium risk where assets are not past due and have a PD greater than 0.8% and less than or equal to 2%; and
- low risk where assets are not past due and have a PD less than or equal to 0.8%.

Unsecured exposures are categorised as:

- higher risk where assets are past due;
- medium risk where assets are currently not past due and benefiting from a forbearance solution; and
- low risk where assets are neither past due nor in forbearance.

Wholesale credit exposures are assessed by reference to credit rating. The Group's wholesale exposures are investment grade and therefore classified as low risk.

No wholesale credit exposures were past due or impaired as at 31 December 2016 and 31 December 2015.

Further asset quality categorisation is disclosed on page 147, which reflects the impairment status of assets.

Maximum credit exposure

The maximum credit risk exposure of the Group in the event of other parties failing to perform their obligations is detailed below. No account is taken of any collateral held, other credit enhancements or provisions for impairment.

The maximum credit risk exposure for off-balance sheet items relates to applications that have been approved and have not yet been drawn by the customer and undrawn loan commitments. These commitments represent agreements to lend in the future and may be decreased or removed by the Group, subject to product notice requirements.

2016 (audited)	Low risk	Medium risk	Higher risk	Total exposures	Low risk	Medium risk	Higher risk
	£m	£m	£m	£m	%	%	%
On-balance sheet							
Wholesale							
Cash and balances at central banks	786.3	—	—	786.3	100.0	—	—
Debt securities classified as loans and receivables	0.7	—	—	0.7	100.0	—	—
Available-for-sale financial assets	858.8	—	—	858.8	100.0	—	—
Loan and advances to banks	635.6	—	—	635.6	100.0	—	—
Derivative financial instruments	104.2	—	—	104.2	100.0	—	—
Retail							
Gross loans and advances to customers—secured	26,822.3	1,871.6	1,057.5	29,751.4	90.1	6.3	3.6
Gross loans and advances to customers—unsecured	2,451.3	2.9	32.4	2,486.6	98.6	0.1	1.3
Total on-balance sheet	**31,659.2**	**1,874.5**	**1,089.9**	**34,623.6**	**91.5**	**5.4**	**3.1**
Off-balance sheet							
Loan commitments (pipeline and undrawn commitments)	5,289.1	—	—	5,289.1	100.0	—	—

2015 (audited)	Low risk	Medium risk	Higher risk	Total exposure	Low risk	Medium risk	Higher risk
	£m	£m	£m	£m	%	%	%
On-balance sheet							
Wholesale							
Cash and balances at central banks	888.6	—	—	888.6	100.0	—	—
Debt securities classified as loans and receivables	1.1	—	—	1.1	100.0	—	—
Available-for-sale financial assets	1,296.9	—	—	1,296.9	100.0	—	—
Loan and advances to banks	614.5	—	—	614.5	100.0	—	—
Derivative financial instruments	82.3	—	—	82.3	100.0	—	—
Retail							
Gross loans and advances to customers—secured	22,916.7	1,652.7	892.8	25,462.2	90.0	6.5	3.5
Gross loans and advances to customers—unsecured	1,579.7	2.9	27.4	1,610.0	98.1	0.2	1.7
Total on-balance sheet	**27,379.8**	**1,655.6**	**920.2**	**29,955.6**	**91.4**	**5.5**	**3.1**
Off-balance sheet							
Loan commitments (pipeline and undrawn commitments)	4,479.8	—	—	4,479.8	100.0	—	—

(audited)	2016	2015
	£m	£m
Advances secured on residential property not subject to securitisation	19,375.2	17,389.9
Advances secured on residential property subject to securitisation	4,907.8	3,670.4
Total advances secured on residential property	**24,283.0**	**21,060.3**
Residential buy-to-let loans not subject to securitisation	5,468.4	4,401.9
Total loans and advances to customers secured on residential property	**29,751.4**	**25,462.2**
Impairment allowance-secured	(10.6)	(8.7)
Loans and advances-secured	29,740.8	25,453.5
Credit cards	2,486.5	1,609.8
Overdrafts	0.1	0.2
Unsecured receivables not subject to securitisation	**2,486.6**	**1,610.0**
Impairment allowance—unsecured	(39.5)	(31.2)
Loans and advances—unsecured	2,447.1	1,578.8
Total loans and advances to customers excluding portfolio hedging	**32,187.9**	**27,032.3**

The mortgage portfolio has grown by 16.8% (£4.3 billion) during 2016. Buy-to-let loans grew by 24.2% (£1.1 billion) to £5.5 billion, accounting for 18.4% of total secured loans (2015: 17.3%). This increase is in line with growth in the private rental sector, with the proportion of buy-to-let mortgage lending in line with the market. In particular, the market experienced an increase in buy-to-let lending during the first three months of 2016, ahead of the stamp duty changes which came into effect on 1 April 2016. Growth in buy-to-let lending has been undertaken in a controlled manner, with the intention of keeping the portfolio mix broadly in line with the market average position.

The credit card portfolio has grown by 54.5% (£876.7 million) during 2016, in line with the target of £3 billion of receivables by the end of 2017. This growth has not been at the expense of credit quality, as shown by the reduction in the proportion of impaired balances to total book of 0.4% in the year.

Credit risk categorisation	Description
Neither past due nor impaired	Loans that are not in arrears and which do not meet the impaired asset definition. This segment can include assets subject to forbearance solutions.
Neither past due nor impaired and in forbearance	Loans that are categorised as neither past due nor impaired, and are currently subject to one of the defined forbearance solutions.
Past due and not impaired	Loans that are in arrears or where there is objective evidence of impairment and the asset does not meet the definition of impaired assets,

Credit risk categorisation	Description
	as the expected recoverable amount exceeds the carrying amount. This category is not applicable for unsecured lending.
Arrears	For secured lending, where the customer's payment shortfall exceeds 1% of the current monthly contractual payment amount. For unsecured lending, customers are classified as in arrears at one day past due.
Impaired assets	Loans that are in arrears or where there is objective evidence of impairment, including changes in customer behaviour or circumstances, and where the carrying amount of the loan exceeds the expected recoverable amount. Unsecured lending assets are treated as impaired at one day past due. All fraud and operational risk loans are categorised as impaired irrespective of the expected recoverable amount.

The credit quality of retail assets is detailed in the tables below.

2016 (audited)	Secured				Unsecured				Total	
	Residential mortgage loans		Residential buy-to-let mortgage loans		Credit cards		Overdrafts			
	£m	%	£m	%	£m	%	£m	%	£m	%
Neither past due nor impaired	24,047.8	99.1	5,441.8	99.5	2,454.1	98.7	0.1	100.0	31,943.8	99.1
—of which in receipt of forbearance(1)	*231.5*	*1.0*	*25.7*	*0.5*	*2.9*	*0.1*	—	—	*260.1*	*0.8*
Past due and not impaired	151.3	0.6	17.6	0.3	—	—	—	—	168.9	0.5
Impaired	83.9	0.3	9.0	0.2	32.4	1.3	—	—	125.3	0.4
Total	**24,283.0**	**100.0**	**5,468.4**	**100.0**	**2,486.5**	**100.0**	**0.1**	**100.0**	**32,238.0**	**100.0**

(1) This category reflects accounts which are neither past due nor impaired and subject to forbearance solutions. Accounts in this category are also included in the neither past due nor impaired categorisation. Full forbearance disclosures can be found on page 160.

2015 (audited)	Secured				Unsecured				Total	
	Residential mortgage loans		Residential buy-to-let mortgage loans		Credit cards		Overdrafts			
	£m	%	£m	%	£m	%	£m	%	£m	%
Neither past due nor impaired	20,837.5	98.9	4,379.9	99.5	1,582.4	98.3	0.2	100.0	26,800.0	99.0
—of which in receipt of forbearance(1)	*238.6*	*1.1*	*8.8*	*0.2*	*2.9*	*0.2*	—	—	*250.3*	*0.9*
Past due and not impaired	145.2	0.7	15.0	0.3	—	—	—	—	160.2	0.6
Impaired	77.6	0.4	7.0	0.2	27.4	1.7	—	—	112.0	0.4
Total	**21,060.3**	**100.0**	**4,401.9**	**100.0**	**1,609.8**	**100.0**	**0.2**	**100.0**	**27,072.2**	**100.0**

(1) This category reflects accounts which are neither past due nor impaired and subject to forbearance solutions. Accounts in this category are also included in the neither past due nor impaired categorisation. Full forbearance disclosures can be found on page 160.

The criteria the Group uses to determine that there is objective evidence of impairment are disclosed on page 147. All loans, where specific circumstances indicate that a loss is likely to be incurred (for example, mortgage accounts which have entered possession or loans where fraud has been confirmed), are individually assessed for impairment by reviewing expected future cash flows including those that could arise from the realisation of security.

Loans and advances which are neither past due nor impaired

Loans which are neither past due nor impaired have improved marginally by 0.1% in the year to 31 December 2016. This has been driven primarily by a reduction in secured and unsecured arrears rates. Additionally, new lending during the period, although having a diluting effect, has shown strong arrears performance.

The segmentation for 'low', 'medium' and 'higher' risk categories for the unsecured portfolio can be found on page 145. The tables below show the details of the credit quality for neither past due nor impaired loans.

2016 (audited)	Residential mortgage loans		Residential buy-to-let mortgage loans		Total	
	£m	%	£m	%	£m	%
PD by internal ratings						
Low risk	21,565.5	89.7	5,256.8	96.6	26,822.3	90.9
Medium risk	1,699.5	7.1	172.1	3.2	1,871.6	6.3
Higher risk	782.8	3.2	12.9	0.2	795.7	2.8
Total neither past due nor impaired	**24,047.8**	**100.0**	**5,441.8**	**100.0**	**29,489.6**	**100.0**

2015 (audited)	Residential mortgage loans		Residential buy-to-let mortgage loans		Total	
	£m	%	£m	%	£m	%
PD by internal ratings						
Low risk	18,681.1	89.6	4,235.6	96.7	22,916.7	90.8
Medium risk	1,519.0	7.3	133.7	3.1	1,652.7	6.6
Higher risk	637.4	3.1	10.6	0.2	648.0	2.6
Total neither past due nor impaired	**20,837.5**	**100.0**	**4,379.9**	**100.0**	**25,217.4**	**100.0**

Loans and advances which are past due and not impaired

The balance of mortgages which are past due and not impaired totalled £168.9 million at 31 December 2016, representing a 5.4% (£8.7 million) increase from 31 December 2015. Past due and not impaired balances as a proportion of the overall book have remained stable, constituting 0.6% of secured loans (2015: 0.6%). All unsecured assets which are past due are treated as impaired.

2016 (audited)	Residential mortgage loans		Residential buy-to-let mortgage loans		Total	
	£m	%	£m	%	£m	%
Up to one month	57.1	37.8	4.3	24.4	61.4	36.4
One to three months	63.9	42.2	10.8	61.4	74.7	44.2
Three to six months	21.4	14.1	2.1	11.9	23.5	13.9
Over six months	8.9	5.9	0.4	2.3	9.3	5.5
Total past due and not impaired	**151.3**	**100.0**	**17.6**	**100.0**	**168.9**	**100.0**

2015 (audited)	Residential mortgage loans		Residential buy-to-let mortgage loans		Total	
	£m	%	£m	%	£m	%
Up to one month	44.4	30.6	4.3	28.7	48.7	30.4
One to three months	63.5	43.7	8.3	55.3	71.8	44.8
Three to six months	24.1	16.6	1.3	8.7	25.4	15.9
Over six months	13.2	9.1	1.1	7.3	14.3	8.9
Total past due and not impaired	**145.2**	**100.0**	**15.0**	**100.0**	**160.2**	**100.0**

Impaired assets

The tables below show the movement of impaired loan balances during 2016 and 2015.

	Secured		Unsecured		Wholesale		
2016 (audited)	Residential mortgage loans	Residential buy-to-let mortgage loans	Credit cards	Overdrafts	Treasury assets	Derivative exposures	Total
	£m	£m	£m	£m	£m	£m	£m
As at 1 January 2016	77.6	7.0	27.4	—	—	—	112.0
Classified as impaired during the year	132.3	20.4	85.0	—	—	—	237.7
Transferred from impaired to unimpaired	(112.9)	(17.7)	(38.3)	—	—	—	(168.9)
Amounts written off	(0.6)	(0.2)	(32.3)	—	—	—	(33.1)
Repayments	(12.5)	(0.5)	(9.4)	—	—	—	(22.4)
As at 31 December 2016	**83.9**	**9.0**	**32.4**	**—**	**—**	**—**	**125.3**

2015 (audited)	Secured: Residential mortgage loans	Secured: Residential buy-to-let mortgage loans	Unsecured: Credit cards	Unsecured: Overdrafts	Wholesale: Treasury assets	Wholesale: Derivative exposures	Total
	£m	£m	£m	£m	£m	£m	£m
As at 1 January 2015	68.9	7.6	27.4	—	—	—	103.9
Classified as impaired during the year	174.9	22.2	81.9	—	—	—	279.0
Transferred from impaired to unimpaired	(151.2)	(21.6)	(42.7)	—	—	—	(215.5)
Amounts written off	(1.7)	(0.2)	(26.0)	—	—	—	(27.9)
Repayments	(13.3)	(1.0)	(13.2)	—	—	—	(27.5)
As at 31 December 2015	**77.6**	**7.0**	**27.4**	**—**	**—**	**—**	**112.0**

Total impaired assets increased by £13.3 million in the year to 31 December 2016. This increase reflects growth in the book, despite improved arrears performance. Further details can be found on page 154.

An analysis of impaired assets by overdue term and assets where the borrower's property is in possession is provided in the tables below.

2016 (audited)	Residential mortgage loans		Residential buy-to-let mortgage loans		Credit cards		Overdrafts		Total	
	£m	%	£m	%	£m	%	£m	%	£m	%
Up to one month	55.7	66.4	6.2	69.0	13.1	40.5	—	—	75.0	59.8
One to three months	19.9	23.7	2.2	24.4	9.3	28.7	—	—	31.4	25.1
Three to six months	4.1	4.9	0.3	3.3	9.7	29.9	—	—	14.1	11.3
Over six months	3.9	4.6	0.2	2.2	0.3	0.9	—	—	4.4	3.5
Possession	0.3	0.4	0.1	1.1	—	—	—	—	0.4	0.3
Total impaired assets	**83.9**	**100.0**	**9.0**	**100.0**	**32.4**	**100.0**	**—**	**—**	**125.3**	**100.0**

2015 (audited)	Residential mortgage loans		Residential buy-to-let mortgage loans		Credit cards		Overdrafts		Total	
	£m	%	£m	%	£m	%	£m	%	£m	%
Up to one month	50.6	65.1	4.5	64.3	11.8	43.1	—	—	66.9	59.7
One to three months	13.7	17.7	1.4	20.0	7.6	27.7	—	—	22.7	20.3
Three to six months	5.2	6.7	0.3	4.3	7.7	28.1	—	—	13.2	11.8
Over six months	7.2	9.3	0.7	10.0	0.3	1.1	—	—	8.2	7.3
Possession	0.9	1.2	0.1	1.4	—	—	—	—	1.0	0.9
Total impaired assets	**77.6**	**100.0**	**7.0**	**100.0**	**27.4**	**100.0**	**—**	**—**	**112.0**	**100.0**

The tables below show impaired assets and impairment provisions.

2016 (audited)	Gross balances	Impaired balances	Impaired balances as a % of gross balances	Impairment provisions	Impairment provisions as a % of Impaired balances
	£m	£m	%	£m	%
Residential mortgage loans	24,283.0	83.9	0.3	9.4	11.2
Residential buy-to-let mortgage loans	5,468.4	9.0	0.2	1.2	13.3
Total secured	**29,751.4**	**92.9**	**0.3**	**10.6**	**11.4**
Credit cards	2,486.5	32.4	1.3	39.4	121.6
Overdrafts	0.1	—	—	0.1	—
Total unsecured	**2,486.6**	**32.4**	**1.3**	**39.5**	**121.9**
Wholesale treasury assets	2,281.4	—	—	—	—
Wholesale derivative exposures	104.2	—	—	—	—
Total wholesale	**2,385.6**	**—**	**—**	**—**	**—**
Total	**34,623.6**	**125.3**	**0.4**	**50.1**	**40.0**

2015 (audited)	Gross balances	Impaired balances	Impaired balances as a % of gross balances	Impairment provisions	Impairment provisions as a % of Impaired balances
	£m	£m	%	£m	%
Residential mortgage loans	21,060.3	77.6	0.4	7.7	9.9
Residential buy-to-let mortgage loans	4,401.9	7.0	0.2	1.0	14.3
Total secured	**25,462.2**	**84.6**	**0.3**	**8.7**	**10.3**
Credit cards	1,609.8	27.4	1.7	31.1	113.5
Overdrafts	0.2	—	—	0.1	—
Total unsecured	**1,610.0**	**27.4**	**1.7**	**31.2**	**113.9**
Wholesale treasury assets	2,801.1	—	—	—	—
Wholesale derivative exposures	82.3	—	—	—	—
Total wholesale	**2,883.4**	**—**	**—**	**—**	**—**
Total	**29,955.6**	**112.0**	**0.4**	**39.9**	**35.6**

Secured impaired balances increased by 9.8% during the year to 31 December 2016 and remained stable as a proportion of gross balances. Impairment provisions on the secured book have increased by £1.9 million; representing 0.04% and 0.03% as a proportion of gross balances as at 31 December 2016 and 31 December 2015 respectively. This increase reflects book growth and the use of management judgement to maintain appropriate coverage in the current uncertain economic environment.

Unsecured impaired assets have increased by £5.0 million during the year, reducing as a proportion of gross balances from 1.7% to 1.3% at 31 December 2015 and 31 December 2016 respectively. This reflects improved arrears performance and the diluting effect of new lending which is yet to mature. Impairment provisions have increased by £8.3 million during the period and have reduced as a percentage of gross balances from 1.9% at 31 December 2015 to 1.6% at 31 December 2016. The impairment provisions as a proportion of impaired balances have increased however, from 113.9% to 121.9% at 31 December 2015 and 31 December 2016 respectively. Impairment provisions have remained consistent on older tranches of debt while increasing on newer tranches to take into account the maturing of the book.

The table below shows the movement of impairment provisions during the year.

	Secured		Unsecured		Wholesale		
(audited)	On advances secured on residential property	On advances secured on residential buy-to-let property	Credit cards	Overdrafts	Treasury assets	Derivative exposures	Total
	£m	£m	£m	£m	£m	£m	£m
As at 1 January 2015	**6.2**	**1.4**	**22.9**	**0.1**	**—**	**—**	**30.6**
Advances written off	(1.7)	(0.2)	(26.0)	—	—	—	(27.9)
Gross charge to the income statements	3.2	(0.2)	34.2	—	—	—	37.2
As at 1 January 2016	**7.7**	**1.0**	**31.1**	**0.1**	**—**	**—**	**39.9**
Advances written off	(0.6)	(0.2)	(32.3)	—	—	—	(33.1)
Gross charge to the income statement	2.3	0.4	40.6	—	—	—	43.3
As at 31 December 2016	**9.4**	**1.2**	**39.4**	**0.1**	**—**	**—**	**50.1**

The net impairment charge to the income statement in 2016 was £37.6 million (2015: £30.3 million) with the gross charge of £43.3 million (2015: £37.2 million), and advances written off of £33.1 million (2015: £27.9 million), representing the movement between opening and closing provision balances as shown above. The difference between the gross and net charge represents sales of credit card receivables which had previously been written off resulting in net recoveries of £5.7 million (2015:£6.9 million). Refer to note 8 in the financial statements for more details.

Collateral held as security for loans and receivables to customers

A general description of collateral held as security in respect of financial instruments is provided on page 141. The Group holds collateral against loans and receivables in the mortgage portfolio. Quantitative and, where appropriate, qualitative information is provided in respect of this collateral on page 156.

The Group holds collateral in respect of loans and advances to customers as set out on page 141. The Group does not hold collateral against debt securities, comprising asset-backed securities and corporate and other debt securities, which are classified as loans and receivables.

The tables below show retail secured loan-to-value (LTV) %.

2016 (audited)	**Residential mortgage loans**		**Residential buy-to-let mortgage loans**		**Total**	
	£m	**%**	**£m**	**%**	**£m**	**%**
<50%	9,476.6	39.1	1,922.8	35.2	11,399.4	38.3
50%–60%	4,958.1	20.4	1,454.8	26.6	6,412.9	21.6
60%–70%	3,918.9	16.1	1,271.8	23.3	5,190.7	17.4
70%–80%	3,162.8	13.0	796.4	14.6	3,959.2	13.3
80%–90%	2,307.7	9.5	19.0	0.3	2,326.7	7.8
90%–100%	445.1	1.8	2.2	—	447.3	1.5
>100%	13.8	0.1	1.4	—	15.2	0.1
Total	**24,283.0**	**100.0**	**5,468.4**	**100.0**	**29,751.4**	**100.0**
Average LTV(1) of stock—indexed		55.6%		54.8%		55.4%
Average LTV of new business		69.8%		60.5%		68.0%

(1) The average LTV of stock and new business is balance weighted.

2015 (audited)	**Residential mortgage loans**		**Residential buy-to-let mortgage loans**		**Total**	
	£m	**%**	**£m**	**%**	**£m**	**%**
<50%	8,125.8	38.6	1,443.5	32.8	9,569.3	37.6
50%–60%	4,680.7	22.2	1,202.9	27.3	5,883.6	23.1
60%–70%	4,026.2	19.1	1,069.7	24.3	5,095.9	20.0
70%–80%	2,247.7	10.7	680.5	15.5	2,928.2	11.5
80%–90%	1,720.1	8.2	3.4	0.1	1,723.5	6.8
90%–100%	250.4	1.2	1.4	—	251.8	1.0
>100%	9.4	—	0.5	—	9.9	—
Total	**21,060.3**	**100.0**	**4,401.9**	**100.0**	**25,462.2**	**100.0**
Average LTV(1) of stock—indexed		54.9%		55.4%		55.0%
Average LTV of new business		69.8%		62.7%		68.0%

(1) The average LTV of stock and new business is balance weighted.

The average indexed LTVs of the overall mortgage portfolio have increased by 0.4% as at 31 December 2016. This reflects the overall book growth, with an increased proportion of residential new lending. The value of loans with a LTV greater than 100% increased from £9.9 million as at 31 December 2015 to £15.2 million as at 31 December 2016. This increase is due to a small number of cases in Northern Ireland which experienced a 7.1% decrease in the indexed value for properties during the period.

The average LTV for new business has remained at 68.0% as at 31 December 2016, despite a reduction in the proportion of buy- to-let new business. Buy-to-let mortgages have lower LTV's due to the 75% cap enforced at origination, therefore, this reduction is not sufficiently material to change the overall new business LTV.

Collateral held in relation to secured loans is capped at the amount outstanding on an individual loan basis. The percentages in the tables below represent the value of collateral, capped at loan amount, divided by the total loan amount in each category.

2016(1) (audited)	Residential mortgage loans		Residential buy-to-let mortgage loans		Total	
	£m	%	£m	%	£m	%
Neither past due nor impaired	24,046.6	100.0	5,441.7	100.0	29,488.3	100.0
—of which in receipt of forbearance	*231.5*	*100.0*	*25.7*	*100.0*	*257.2*	*100.0*
Past due and not impaired	151.3	100.0	17.6	100.0	168.9	100.0
Impaired	83.7	99.8	9.0	100.0	92.7	99.8
—of which in possession	*0.3*	*100.0*	*0.1*	*100.0*	*0.4*	*100.0*
Total	**24,281.6**	**100.0**	**5,468.3**	**100.0**	**29,749.9**	**100.0**

(1) Some segments may appear fully collateralised due to immaterial balances in negative equity. Due to rounding these do not change the overall collateralised percentage shown.

2015(1) (audited)	Residential mortgage loans		Residential buy-to-let mortgage loans		Total	
	£m	%	£m	%	£m	%
Neither past due nor impaired	20,836.9	100.0	4,379.8	100.0	25,216.7	100.0
—of which in receipt of forbearance	*238.6*	*100.0*	*8.8*	*100.0*	*247.4*	*100.0*
Past due and not impaired	145.2	100.0	15.0	100.0	160.2	100.0
Impaired	77.3	99.6	7.0	100.0	84.3	99.6
—of which in possession	*0.9*	*100.0*	*0.1*	*100.0*	*1.0*	*100.0*
Total	**21,059.4**	**100.0**	**4,401.8**	**100.0**	**25,461.2**	**100.0**

(1) Some segments may appear fully collateralised due to immaterial balances in negative equity. Due to rounding these do not change the overall collateralised percentage shown.

The tables below show the excess between the mortgage balance and collateral held, on secured balances with a LTV of greater than 100%.

For these loans, the exposure was £1.5 million greater than the collateral held as at 31 December 2016. This has increased from £1.0 million as at 31 December 2015 reflecting a small number of cases in Northern Ireland where negative house price movements were observed during the year. The recoverable amount used for impairment provision purposes reflects this level of collateral.

2016 (audited)	Residential mortgage loans	Residential buy-to-let mortgage loans	Total
	£m	£m	£m
Neither past due nor impaired	1.2	0.1	1.3
—of which in receipt of forbearance	—	—	—
Past due and not impaired	—	—	—
Impaired	0.2	—	0.2
—of which in possession	0.1	—	0.1
Total	**1.4**	**0.1**	**1.5**

2015 (audited)	Residential mortgage loans	Residential buy-to-let mortgage loans	Total
	£m	£m	£m
Neither past due nor impaired	0.6	0.1	0.7
—of which in receipt of forbearance	—	—	—
Past due and not impaired	—	—	—
Impaired	0.3	—	0.3
—of which in possession	—	—	—
Total	**0.9**	**0.1**	**1.0**

Repossessions

The Group works with customers who have difficulty paying their mortgages, and will only repossess a property when all other possibilities have been exhausted. Where accounts have been repossessed, the Group will obtain the best price that might reasonably be paid, taking into account factors such as property and market conditions.

The Group uses external asset management specialists to realise the value as soon as practicable to settle indebtedness. Any surplus funds are returned to the borrower or are otherwise dealt with in accordance with appropriate insolvency regulations.

The Group had six repossessed properties as at 31 December 2016, compared to twelve as at 31 December 2015.

Interest only mortgages

The Group provides interest only mortgages to customers, whereby payments made by the customer comprise interest for the term of the mortgage, with the customer responsible for repaying the principal outstanding at the end of the loan term. The Group's interest only exposure for customers on both interest only and part-and-part for the year to 31 December 2016 has reduced, accounting for 29.9% of total secured balances, compared to 33.1% at 31 December 2015.

The tables below provide details of balances which are on an interest only basis, analysed by maturity. This includes the interest only balances for loans on a part-and-part repayment basis.

2016 (audited)	**Residential mortgage loans**	**Residential buy-to-let mortgage loans**	**Total**
	£m	**£m**	**£m**
Term expired (still open)	30.1	1.9	32.0
Due within 2 years	167.5	16.4	183.9
Due after 2 years and before 5 years	405.2	77.8	483.0
Due after 5 years and before 10 years	1,012.9	591.8	1,604.7
Due after more than 10 years	2,726.0	3,852.6	6,578.6
Total	**4,341.7**	**4,540.5**	**8,882.2**
—of which are impaired	8.6	47.8	56.4
% of total secured loans and advances to customers	**17.9**	**83.0**	**29.9**
Average LTV (%)	**42.1**	**55.8**	**49.6**

2015 (audited)	**Residential mortgage loans**	**Residential buy-to-let mortgage loans**	**Total**
	£m	**£m**	**£m**
Term expired (still open)	19.1	0.7	19.8
Due within 2 years	172.4	15.7	188.1
Due after 2 years and before 5 years	411.6	57.6	469.2
Due after 5 years and before 10 years	1,017.7	488.1	1,505.8
Due after more than 10 years	3,173.2	3,068.6	6,241.8
Total	**4,794.0**	**3,630.7**	**8,424.7**
—of which are impaired	6.7	41.6	48.3
% of total secured loans and advances to customers	**22.8**	**82.5**	**33.1**
Average LTV (%)	**44.9**	**56.4**	**50.3**

The Group has been following a process whereby contact is made with customers who have an interest only mortgage scheduled to mature within the next ten years. These customers are contacted throughout their mortgage term to confirm if their strategy to repay the mortgage loan in full at the end of the agreed term remains on track. If not, the Group will discuss a range of options with them which may include a review of the product to ensure it remains the best product for their needs, or a forbearance treatment if required.

Interest only balances due to mature in the next two years represent 2.1% of total interest only balances, totalling £183.9 million at 31 December 2016. Treatment strategies exist to help customers who may not be able to repay the full amount of principal balance at maturity. Of residential interest only mortgages which have missed the payment of principal at the end of term, £32.0 million remain at 31 December 2016 (2015: £19.8 million).

All expired term balances are categorised as impaired loans, regardless of loss expectation. The provisioning methodology for expired term mortgage loans reflects the latest performance on these accounts. Approximately

0.1% of the secured portfolio relates to expired term loan balances. The average balance of expired term loans which are more than six months past their maturity date is around £60,000 with an average LTV of 24%.

The Group offers interest only loans to applicants who have credible means to repay the mortgage loan at maturity other than sale of main residence. The flow of new interest only residential business has remained low during 2016, representing 2.5% of residential completions. As a result, the proportion of residential interest only mortgages (excluding part-and-part) in the portfolio continues to reduce, moving from 19.1% to 15.0% during 2016.

The Group regularly reviews the effectiveness of the interest only policy and contact strategies to ensure the delivery of fair customer outcomes.

Forbearance

The Group operates a number of treatments to assist borrowers who are experiencing financial distress. In defining these treatments, the Group distinguishes between the following categories for secured assets:

- payment arrangements: a temporary arrangement for customers in financial distress where arrears accrue at the contractual payment, for example, short-term arrangements to pay less than the contractual payment;
- transfers to interest only: an account change to assist customers through periods of financial difficulty where arrears do not accrue at the original contractual payment. Any arrears existing at the commencement of the arrangement are retained;
- term extensions: a permanent account change for customers in financial distress where the overall term of the mortgage is extended, resulting in a lower contractual monthly payment; and
- discretionary payment holidays: a temporary account change to assist customers through periods of financial difficulty where arrears do not accrue at the original contractual payment.

The value of forbearance stock totalled £278.8 million at 31 December 2016, representing a 3.2% (£8.6 million) increase since 31 December 2015. This increase is reflective of book growth, as forbearance as a percentage of total loans and advance has reduced for both secured and unsecured lending.

2016 (audited)	Neither past due nor impaired		Past due not impaired		Impaired		Total	
	£m	%	£m	%	£m	%	£m	%
Secured								
Payment arrangement	0.1	—	0.6	9.7	—	—	0.7	0.3
Transfer to interest only	20.9	8.1	1.8	29.0	0.6	22.2	23.3	8.8
Term extension	177.0	68.9	2.3	37.1	1.4	51.9	180.7	67.8
Payment holiday	59.2	23.0	1.5	24.2	0.7	25.9	61.4	23.1
Total secured forbearance	**257.2**	**100.0**	**6.2**	**100.0**	**2.7**	**100.0**	**266.1**	**100.0**
Unsecured								
Accounts where the customer has been approved on a repayment plan	2.9	100.0	—	—	9.8	100.0	12.7	100.0
Total forbearance	**260.1**	**100.0**	**6.2**	**100.0**	**12.5**	**100.0**	**278.8**	**100.0**

2015 (audited)	Neither past due nor impaired		Past due not impaired		Impaired		Total	
	£m	%	£m	%	£m	%	£m	%
Secured								
Payment arrangement	3.0	1.2	0.3	3.2	0.3	12.5	3.6	1.4
Transfer to interest only	17.5	7.1	3.3	34.0	0.8	33.3	21.6	8.3
Term extension	171.9	69.5	5.3	54.6	0.7	29.2	177.9	68.6
Payment holiday	55.0	22.2	0.8	8.2	0.6	25.0	56.4	21.7
Total secured forbearance	**247.4**	**100.0**	**9.7**	**100.0**	**2.4**	**100.0**	**259.5**	**100.0**
Unsecured								
Accounts where the customer has been approved on a repayment plan	2.9	100.0	—	—	7.8	100.0	10.7	100.0
Total forbearance	**250.3**	**100.0**	**9.7**	**100.0**	**10.2**	**100.0**	**270.2**	**100.0**

£266.1 million of retail secured loans and advances were subject to forbearance as at 31 December 2016 (31 December 2015: £259.5 million). Loans which are forborne are grouped with other assets portraying similar risk characteristics and assessed collectively for impairment, for example, all customers with a payment arrangement are grouped together and assessed on a collective basis. The loans are not considered to be impaired unless they meet the Group's definition of an impaired asset.

Retail unsecured loans and advances subject to forbearance totalled £12.7 million (31 December 2015: £10.7 million). Credit risk provisioning for the retail unsecured portfolio is undertaken on a collective basis, except for fraud cases, which are provided for in full, on an individual basis. The approach used is based on PD's for various behavioural and arrears status segments, measuring the likelihood of default and the probability of charge-off given default.

Wholesale credit risk

	2016	2015
(audited)	**£m**	**£m**
Loans and advances to banks excluding Bank of England	635.6	614.5
Bank of England	786.3	888.6
Debt securities classified as loans and receivables	0.7	1.1
Debt securities classified as available-for-sale financial assets	850.9	1,292.3
Gross positive fair value of derivative contracts	104.2	82.3
Total	**2,377.7**	**2,878.8**

The Group's wholesale credit risk exposures reduced by £501.1 million during 2016 due to a reduction of debt securities held and cash deposited at the BoE. Full disclosure of the Group's liquid asset portfolio can be found on page 183.

At 31 December 2016 the single largest exposure to any single counterparty, which is not a sovereign or a supranational, was £115.9 million (2015: £130.8 million). This exposure was to a large UK bank. The table below shows the credit ratings of loans and advances to banks excluding the BoE.

	2016	2015
(audited)	**£m**	**£m**
AA+	56.8	16.8
AA–	115.9	130.8
A+	208.4	205.5
A	187.4	174.3
A–	35.2	42.1
BBB+	31.9	45.0
Total	**635.6**	**614.5**

The table below shows debt securities classified as loans and receivables and debt securities classified as available-for-sale financial assets.

	2016		2015	
	Debt securities classified as loans and receivables	Debt securities classified as available-for-sale financial assets	Debt securities classified as loans and receivables	Debt securities classified as available-for-sale financial assets
(audited)	**£m**	**£m**	**£m**	**£m**
UK sovereign exposures	—	317.3	—	409.5
Non-domestic sovereign exposures	—	—	—	—
Supranational	—	129.3	—	203.7
Residential mortgage-backed securities	0.7	52.2	1.1	59.4
Covered bonds	—	327.1	—	535.3
Debt securities issued by banks	—	25.0	—	84.4
Total	**0.7**	**850.9**	**1.1**	**1,292.3**

The table below shows the credit rating of debt securities classified as loans and receivables and debt securities classified as available-for-sale financial assets.

(audited)	2016 £m	2015 £m
AAA	508.6	798.4
AA+	—	434.9
AA	317.3	—
AA–	25.0	30.0
A+	—	29.0
A	0.7	1.1
Total	**851.6**	**1,293.4**

The credit rating of the debt securities remains high, with 97% rated AA or higher compared to 95% at 31 December 2015. The movement of exposures from AA+ to AA is due to the downgrading of the UK's credit rating, following the outcome of the EU referendum.

Derivative financial instruments

The Group reduces exposure to credit risk through central clearing for eligible derivatives and daily posting of cash collateral on such transactions, as detailed in note 34 to the financial statements. For over-the-counter (OTC) transactions, exposure is reduced by the use of master netting agreements and by obtaining collateral in the form of cash or highly liquid securities. In respect of the Group's maximum credit risk relating to derivative assets of £104.2 million (2015: £82.3 million), collateral of £86.4 million (2015: £10.6 million) was held.

The Group measures exposure in OTC derivatives using the gross positive fair value of contracts outstanding with a counterparty, increased by potential future rises in fair value and reduced by gross negative fair value of contracts and collateral received.

While exposures are managed on a net basis, they are represented on the balance sheet on a gross basis unless the IAS 32 offsettings rules are met. Contracts with positive fair value are disclosed as assets in the balance sheet under 'derivative financial instruments'; those with negative fair value are disclosed as stated on the liabilities side under the same title.

Cash collateral received is shown as deposits from banks, with cash collateral posted shown as loans and advances to banks. The notes to the financial statements provide further information on collateral. The table below details OTC derivative exposures.

(audited)	2016 £m	2015 £m
Gross positive fair value of derivative contracts	**104.2**	82.3
Netting with gross negative fair value of derivative contracts[(1)]	**(25.4)**	(70.4)
Potential future incremental exposure	**61.2**	49.9
Collateral received	**(86.4)**	(10.6)
Net OTC derivative exposures	**53.6**	51.2

(1) The use of netting allows positions on all bilateral transactions with any given counterparty to be offset.

The table below provides a summary of net OTC liabilities.

(audited)	2016 £m	2015 £m
Gross negative fair value of derivative contracts	**(222.3)**	(151.0)
Netting with gross positive fair value of derivative contracts[(1)]	**25.4**	70.4
Collateral pledged (loans and advances to banks)[(2)]	**168.1**	72.5
Net OTC derivative liability	**(28.8)**	(8.1)

(1) The use of netting allows positions on all bilateral transactions with any given counterparty to be offset.

(2) The December 2015 collateral pledged has been restated to exclude the impact of over-collateralisation.

The only netting agreements in place are in relation to derivative financial instruments and repurchase transactions. In respect of repurchase transactions, only the haircut between the asset pledged and deposit received is classed as an exposure given the balance sheet maintains the exposure to the underlying obligor.

The table below provides credit quality analysis of the gross OTC derivative exposures by credit rating of the counterparties.

(audited)	31 December 2016		31 December 2015	
	£m	**%**	**£m**	**%**
AA–	**5.6**	**5.4**	22.1	26.9
A+	**0.6**	**0.6**	6.8	8.3
A	**84.5**	**81.1**	42.0	51.0
A–	**12.7**	**12.2**	6.4	7.7
BBB+	**0.8**	**0.7**	5.0	6.1
Total	**104.2**	**100.0**	82.3	100.0

Market risk

Definition

Market risk is defined as the risk that the value of, or net income arising from, assets and liabilities changes as a result of interest rate or exchange rate movements. Market risk for the Group arises only as a natural consequence of carrying out and supporting core business activities. The Group does not trade or make markets. As a result, interest rate risk is the only material market risk for the Group.

Risk appetite

The Group has limited risk appetite for exposures to IRRBB, in terms of both potential changes to economic value, and changes to expected net interest income or earnings.

Exposures

The Group's banking activities expose it to the risk of adverse movements in interest rates and exchange rates.

Interest rate mismatch risk in the Group's portfolio and in the Group's capital and funding activities arises from the different re-pricing characteristics of the Group's assets, liabilities and off-balance sheet positions. Interest rate risk arises predominantly from the mismatch between interest rate sensitive assets and liabilities, the variation in volume of business written in response to changes in interest rate, optionality in customers' ability to complete or redeem their products, the investment term of capital and reserves, and the need to stabilise earnings in order to minimise income volatility.

Basis risk arises from possible changes in spreads, between different reference rates, for example, where assets and liabilities reprice at the same time and the scale of rate movement differs. The primary rates that the Group is exposed to are the Bank Base Rate and LIBOR. If the spread between these rates moves adversely, the Group may experience a reduction in income on unhedged exposures.

Pipeline risk arises where new business volumes are higher or lower than forecast, requiring the business to unwind or execute additional hedging at rates which may differ to what was expected.

Product option/optionality risk arises as customer balances amortise more quickly or slowly than anticipated due to economic conditions or customers' response to changes in economic conditions.

Foreign currency risk arises as a result of having assets, liabilities and derivative items denominated in currencies other than Sterling as a result of banking activities. This includes maintaining liquid assets and wholesale funding. The Group has minimal appetite for foreign currency risk.

Measurement

The Group uses stress scenarios to quantify the impact to economic value and earnings arising from a shift to interest rates. These include interest rate re-pricing gaps, earnings sensitivity analysis and open foreign exchange positions.

During April 2016, the Basel Committee on Banking Supervision (BCBS) published standards relating to the management of IRRBB. The Group maintains IRRBB management practices in line with regulatory expectations.

Interest rate risk exposure is measured as follows:

- Capital at Risk (CaR) is considered for assets and liabilities in all interest rate risk re-pricing periods. This is expressed as the present value of the negative impact of a sensitivity test on the Group's capital position.
- Earnings at Risk (EaR) is considered for assets and liabilities on the forecast balance sheet over a 12 month period, measuring the adverse change to net interest income from a movement in interest rates.

IRRBB is measured considering both positive and negative instantaneous shocks to interest rates. The measurement is enhanced with non-parallel stress scenarios (basis risk) and behavioural volume stresses (pipeline and optionality risk). Both EaR and CaR are controlled by a defined risk appetite limit and supporting metrics.

The disclosures on the following page show CaR and EaR measurements based on a 2% parallel stress for interest rate mismatch risk, subject to a contractual rate floor at 0%, with complementary stress scenarios in other risk categories. The use of this standardised parallel stress is intended to provide comparability in reporting, consistent with the objectives of the regulatory bodies. The magnitude of stress used within the Group's internal risk appetite differs from the standardised regulatory stress, based on observed rate movements and internally defined exposure holding periods.

The Group has an integrated Asset and Liability Management system which allows it to measure and manage interest rate re-pricing profiles (including behavioural assumptions), perform stress testing and produce forecasts.

Mitigation

As defined within the scope of the Group's IRRBB Policy, the Interest Rate Risk Transfer Pricing framework is used for all hedgeable interest rate risk arising from commercial product lines. Treasury is responsible for managing risk and does this through natural offsets of matching assets and liabilities where possible.

Appropriate hedging activity of residual exposures is undertaken, subject to the authorisation and mandate of the Asset and Liability Committee, within the Board-approved risk appetite. Certain residual interest rate risks may remain due to differences in basis and profile mismatches arising from customer behaviour. The impact of this is detailed in the table on page 167.

The TFS could increase the Group's basis mismatch exposure as funding is linked to the BBR. In the absence of the TFS, the Group would use more retail and market-based wholesale funding. While the TFS offers cost-effective funding, it brings additional concentration in relation to basis risk. The Group mitigates basis risk through product strategy; creating natural offsets where possible. When required, the Group uses basis derivatives to maintain the residual exposure within risk appetite.

Monitoring

The Board Risk Committee regularly reviews market risk exposure as part of the wider risk management framework.

Capital at Risk

The forecast interest rate environment reduced during 2016, following the UK's vote to leave the EU and the BoE's 25 basis point reduction to Bank Base Rate. The lower rate environment reduced the severity of the negative rate shock assuming contractual rates do not go below 0%. CaR as at 31 December 2016, decreased to £14.1 million from £20.1 million at 31 December 2015 in a negative rate shock scenario. CaR at December 2016 under a positive rate shock scenario is comparable with December 2015 across all sources of IRRBB risk.

	2016		2015	
	Positive rate shock	Negative rate shock(1)	Positive rate shock	Negative rate shock(1)
	£m	£m	£m	£m
Interest rate mismatch risk	**(1.6)**	**(0.7)**	(3.8)	3.1
Pipeline risk	**5.7**	**7.1**	8.9	4.7
Optionality risk	**30.1**	**7.7**	27.1	12.3
Total interest rate risk—Capital at Risk	**34.2**	**14.1**	32.2	20.1

(1) Market rate (BBR, LIBOR and swaps) stresses are subject to a contractual rate floor of 0%.

Earnings at Risk

EaR has increased year-on-year by £7.8 million in a positive rate shock scenario and by £16.1 million in a negative rate shock scenario due to changes made in the way the Group measures the exposure to basis risk. The scenarios used have been updated to better capture basis risk in the current low rate environment. The Group's underlying IRRBB risk exposure, after removing the impact of changes to basis risk stress scenarios, is materially unchanged.

(unaudited)	2016 Positive rate shock	2016 Negative rate shock(1)	2015 Positive rate shock	2015 Negative rate shock(1)
	£m	£m	£m	£m
Interest rate mismatch risk	**1.7**	**1.4**	4.0	2.9
Basis risk	**10.4**	**17.6**	(0.2)	0.1
Pipeline risk	**3.0**	**2.3**	3.8	1.7
Optionality risk	**8.6**	**0.3**	8.3	0.8
Total interest rate risk—Earnings at Risk	**23.7**	**21.6**	15.9	5.5

(1) Market rate (BBR, LIBOR and swaps) stresses are subject to a contractual rate floor of 0%.

The volume of balance sheet items denominated in foreign currencies has increased since 31 December 2015 due to the issuance of debt securities in US Dollars and Euros as part of the Gosforth Residential Mortgage Backed Securities (RMBS) programmes.

The Group raised £803.0 million during January 2016 and a further issuance in May 2016 raised £474.2 million. Exposures to adverse changes in exchange rates have been reduced by using cross-currency swaps, resulting in a minimal net exposure. The table below shows assets and liabilities in foreign currency at sterling carrying values.

(audited)	2016 US$ in £m	2016 € in £m	2015 US$ in £m	2015 € in £m
Assets				
Loans and advances to banks	**0.7**	**0.9**	—	—
Available-for-sale financial assets	**1.5**	**—**	—	3.3
Other assets	**0.1**	**0.5**	0.1	0.1
Total assets	**2.3**	**1.4**	0.1	3.4
Liabilities				
Debt securities in issue	**175.7**	**412.4**	—	—
Other liabilities	**0.4**	**0.5**	0.1	0.1
Total liabilities	**176.1**	**412.9**	0.1	0.1
Notional value of derivatives affecting currency exposures	**(174.1)**	**(412.4)**	—	—
Net position	**0.3**	**0.9**	**—**	3.3

Interest rate re-pricing of assets and liabilities

The following tables provide an analysis of the contractual re-pricing periods of assets and liabilities on the balance sheet. Mismatches in the re-pricing timing of assets, liabilities, and off-balance sheet positions create interest rate risk quantified in CaR and EaR.

2016[1] (audited)	Within 3 months	After 3 months and within 6 months	After 6 months and within 1 year	After 1 year and within 5 years	After 5 years	Non-interest bearing instruments	Total
	£m	£m	£m	£m	£m	£m	£m
Assets							
Cash and balances at central banks	**732.0**	—	—	—	—	**54.3**	**786.3**
Loans and receivables:							
Loans and advances to banks	**630.1**	—	—	—	—	**5.5**	**635.6**
Loans and advances to customers	**8,074.2**	**1,871.1**	**3,425.2**	**18,365.1**	**298.5**	**333.0**	**32,367.1**
Debt securities	**0.7**	—	—	—	—	—	**0.7**
Available-for-sale financial assets	**212.9**	—	—	**154.5**	**426.0**	**65.4**	**858.8**
Other assets	**54.0**	—	—	—	—	**353.1**	**407.1**
Total assets	**9,703.9**	**1,871.1**	**3,425.2**	**18,519.6**	**724.5**	**811.3**	**35,055.6**
Liabilities							
Deposits from banks	**2,132.5**	—	—	—	—	—	**2,132.5**
Customer deposits	**18,027.5**	**1,157.1**	**4,081.4**	**4,810.2**	—	**30.1**	**28,106.3**
Debt securities in issue	**2,299.9**	—	—	**300.0**	—	**0.1**	**2,600.0**
Other liabilities	—	—	—	—	—	**546.3**	**546.3**
Equity	—	—	—	**390.0**	—	**1,280.5**	**1,670.5**
Total liabilities and equity	**22,459.9**	**1,157.1**	**4,081.4**	**5,500.2**	—	**1,857.0**	**35,055.6**
Notional values of derivatives affecting interest rate sensitivity	**10,864.0**	**(548.2)**	**1,388.0**	**(10,395.4)**	**(1,240.7)**	**(67.7)**	—
Total interest rate sensitivity gap	**(1,892.0)**	**165.8**	**731.8**	**2,624.0**	**(516.2)**	**(1,113.4)**	—
Cumulative interest rate sensitivity gap	**(1,892.0)**	**(1,726.2)**	**(994.4)**	**1,629.6**	**1,113.4**	—	—

(1) Items are allocated to time bands in the table above by reference to the earlier of the next contractual interest rate re-pricing date and the residual maturity date.

2015[1] (audited)	Within 3 months	After 3 months and within 6 months	After 6 months and within 1 year	After 1 year and within 5 years	After 5 years	Non-interest bearing instruments	Total
	£m	£m	£m	£m	£m	£m	£m
Assets							
Cash and balances at central banks	835.5	—	—	—	—	53.1	888.6
Loans and receivables:							
Loans and advances to banks	610.0	—	—	—	—	4.5	614.5
Loans and advances to customers	7,201.3	1,710.6	3,132.4	14,407.5	516.9	140.3	27,109.0
Debt securities	1.2	—	—	—	—	(0.1)	1.1
Available-for-sale financial assets	373.2	4.7	59.0	177.9	612.7	69.4	1,296.9
Other assets	—	—	—	—	—	318.9	318.9
Total assets	**9,021.2**	**1,715.3**	**3,191.4**	**14,585.4**	**1,129.6**	**586.1**	**30,229.0**
Liabilities							
Deposits from banks	1,298.7	—	—	—	—	—	1,298.7
Customer deposits	14,679.4	1,661.6	3,443.6	5,348.6	—	11.7	25,144.9
Debt securities in issue	1,745.9	—	—	300.0	—	(6.5)	2,039.4
Other liabilities	—	—	—	—	—	405.7	405.7
Equity	—	—	—	160.0	—	1,180.3	1,340.3
Total liabilities and equity	**17,724.0**	**1,661.6**	**3,443.6**	**5,808.6**	**—**	**1,591.2**	**30,229.0**
Notional values of derivatives affective interest rate sensitivity	7,698.6	199.8	591.2	(7,103.3)	(1,386.3)	—	—
Total interest rate sensitivity gap	**(1,004.2)**	**253.5**	**339.0**	**1,673.5**	**(256.7)**	**(1,005.1)**	**—**
Cumulative interest rate sensitivity gap	(1,004.2)	(750.7)	(411.7)	1,261.8	1,005.1	—	—

The interest rate re-pricing tables shown above reflect the re-pricing of assets and liabilities without adjustments to the re- pricing profile that reflect future pricing assumptions or taking into account expected future business that the Group hedges ahead of becoming contractually bound. The Group manages interest rate risk taking these factors into account. Therefore, the increased gap profile shown above does not directly translate to the CaR and EaR term mismatch quantification.

OPERATIONAL RISK

Definition

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. It also includes legal risk.

Risk appetite

The Group's operational risk appetite is designed to safeguard the interests of customers, internal and external stakeholders, and shareholders.

Exposures

The principal operational risks to the Group are:

- IT systems and resilience risk arising from failure to develop,
- deliver and maintain effective IT solutions;
- information security risk arising from information leakage, loss or theft;
- external fraud arising from an act of deception or omission;
- cyber risk arising from malicious attacks on the Group via technology, networks and systems;
- service disruption;

- failure of a third party corporate partner or strategic supplier; and
- normal business operational risk including transaction processing, information capture and implementation of change.

Measurement

A variety of measures is used such as scoring of potential risks, considering impact and likelihood, assessing the effectiveness of controls, monitoring of events and losses by size, functional area and internal risk categories. The Group maintains a formal approach to operational risk event escalation. Material events are identified, captured and escalated. The root causes of events are determined and action plans put in place to ensure an optimum level of control. This ensures the Group keeps customers and the business safe, reduces costs, and improves efficiency.

Mitigation

The Group's control environment is regularly reviewed and reporting on material risks is discussed monthly by senior management. Risks are managed through a range of strategies such as mitigation, transfer (including insurance), and acceptance. Contingency plans are maintained for a range of potential scenarios with regular disaster recovery exercises.

Mitigating actions for the principal risks include:

- investment in IT to ensure continued availability, security and resilience of infrastructure;
- investment in information security capability to protect customers and the Group;
- investment in the protection of customer information, including access to key systems and the security, durability and accessibility of critical records;
- a risk-based approach to mitigate the financial crime risks the Group faces, reflecting the current and emerging financial crime risks within the market. The Group has developed a comprehensive financial crime operating model. The Group's fraud awareness programme is a key component of the financial crime control environment; and
- operational resilience measures and recovery planning to ensure an appropriate and consistent approach to the management of continuity risks, including potential interruptions from a range of internal and external incidents or threats.

Monitoring

Monitoring and reporting of operational risk is undertaken at Board and Executive Committees. A combination of systems, monthly reports, oversight and challenge from the Risk function, Internal Audit and assurance teams ensures that key risks are regularly presented and debated by Executive Management.

Key operational risks are appropriately insured, where possible. The insurance programme is monitored and reviewed regularly, with recommendations made to Executive management prior to each renewal.

CONDUCT RISK AND COMPLIANCE

Definition

Conduct risk and compliance is defined as the risk that the Group's operating model, culture or actions result in unfair outcomes for customers, and the risk of regulatory sanction, material financial loss or reputational damage if the Group fails to design and implement operational processes, systems and controls and maintain compliance with all applicable regulatory requirements.

Risk appetite

The Group has no appetite for failure to remediate regulatory breaches and no tolerance for failing to deliver fair customer outcomes, whether through product design, sales or after sales processes.

Exposures

Conduct risk could affect all aspects of the Group's operations, all types of customers and the Group's stakeholders. The Group faces limited conduct risk in relation to products and services, sales processes and complaint handling.

A series of change programmes drives new legislation and regulation into day-to-day operational and business practices across the Group.

The Group is unburdened with legacy conduct risk issues such as PPI, investments or derivatives mis-selling, LIBOR manipulation and distressed asset portfolios.

Measurement

Risk assessments are regularly reviewed and include assessments of control and material regulatory rule breaches, complaints and whistleblowing.

Mitigation

The Group takes a range of mitigating actions with respect to conduct risk and compliance. They include:

- policies, processes and standards which provide a framework for the business to operate in accordance with the relevant laws and regulations;
- putting the customer at the heart of business planning and strategy;
- using a risk assessment framework that ensures product design and sales processes offer customers value for money, meet the needs of the target market, and deliver fair outcomes to customers, including vulnerable customers;
- focusing on recruitment and training and how the Group manages colleagues' performance in relation to fair customer outcomes;
- regulatory horizon scanning; and
- using oversight and assurance themed reviews to assess compliance with rules, regulations and policies.

Monitoring

A robust assurance and quality monitoring regime is in place to test the performance of customer critical activities. Customer metrics are proactively used when reviewing business performance and feedback loops have been established to learn from issues identified.

The Risk function reports on conduct risk and compliance exposure. The report forms the basis of challenge to the business at the monthly Operational Risk, Conduct Risk and Compliance Committee.

CONCENTRATION RISK[2]

Definition

Concentration risk is defined as the exposure of the Group to credit concentrations in relation to retail and wholesale portfolios, products and counterparty levels.

Risk appetite

The Group has limited appetite for concentrated exposures by country, region, loan size and type.

Exposures

The principal source of concentration risk is from loans and advances to customers in relation to geography, loan size and loan type concentrations in the mortgage portfolio.

In addition, concentration risk arises from cash, debt securities and derivatives in relation to individual counterparty and country of exposure.

The Group has no significant concentrations of risk in the credit card portfolio.

Measurement

Credit concentration risk is measured through the application of limits relating to each concentration category.

2 All risk class components of financial risk are outlined on page 139. Concentration risk is the most significant component of financial risk and therefore has been disclosed in detail

Mitigation

Credit risk management includes portfolio controls on product lines and risk segments to reflect risk appetite and individual limit guidelines. Credit policy is aligned to the Group's risk appetite and restricts exposure to more vulnerable sectors and segments.

Monitoring

Monthly reporting on concentration risk exposures is made to the Board.

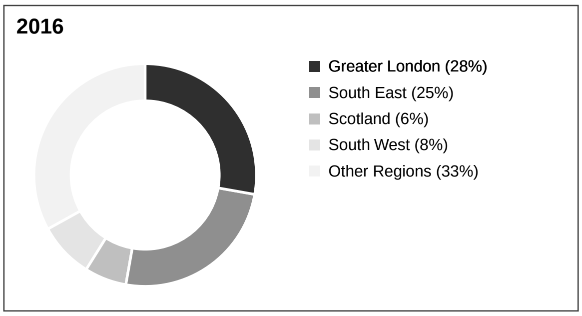
Secured credit

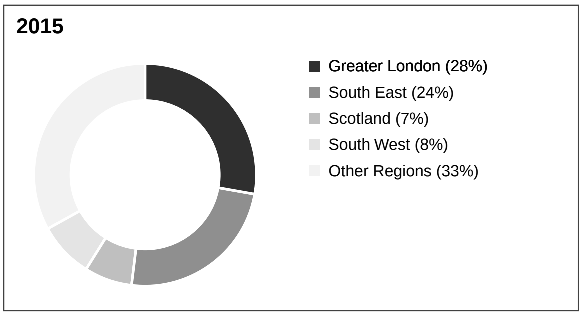
The Group's large exposures are reported in accordance with regulatory reporting requirements. There has been significant focus on house price inflation since the end of 2013 with London and the South East experiencing higher levels of house price growth than the rest of the UK. Whilst demand for London property may be influenced by the international market, concerns over an asset bubble forming in these two regions are based on the rate of growth relative to other regions, a potential divergence in supply and demand for property, and customer affordability being stretched. The Group's policy restricts LTV for higher value loans, resulting in the lower average new lending LTVs observed in London (58%) and the South East (65%) compared to other regions (72%).

The Group made changes to its lending policy in March 2016 in response to this risk through an income multiple cap.

The table below shows the geographical concentration of the mortgage portfolio.

(audited)	**2016**		**2015**	
	£m	**%**	**£m**	**%**
East Anglia	**726.0**	**2.6**	605.9	2.5
East Midlands	**1,556.4**	**5.2**	1,287.8	5.1
North	**1,025.3**	**3.4**	957.0	3.8
Yorkshire & Humberside	**1,640.3**	**5.5**	1,413.0	5.5
North West	**2,209.3**	**7.4**	1,890.7	7.4
West Midlands	**1,560.9**	**5.2**	1,302.3	5.1
South West	**2,320.6**	**7.8**	1,936.2	7.6
South East	**7,365.7**	**24.8**	6,139.4	24.1
Greater London	**8,365.9**	**28.1**	7,230.0	28.4
Wales	**673.9**	**2.3**	597.4	2.3
Scotland	**1,828.0**	**6.1**	1,685.5	6.6
Northern Ireland	**478.3**	**1.6**	416.5	1.6
Other	**0.8**	**—**	0.5	—
Total	**29,751.4**	**100.0**	25,462.2	100.0



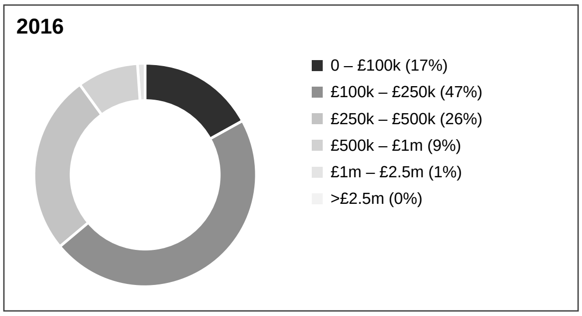


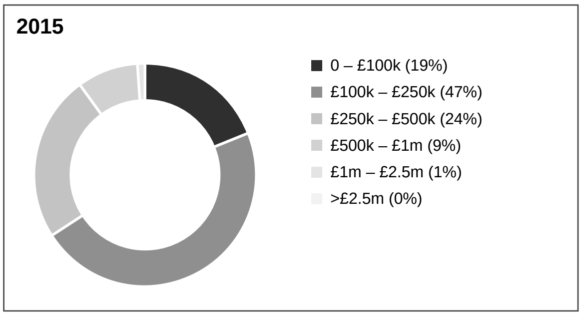
The geographical split of the portfolio remains broadly stable.

The table below shows retail secured credit concentrations by loan size.

(audited)	2016		2015	
	£m	%	£m	%
0–£100k	**5,169.9**	**17.4**	4,941.5	19.4
£100k–£250k	**13,989.5**	**47.1**	11,878.2	46.6
£250k–£500k	**7,835.2**	**26.3**	6,078.0	23.9
£500k–£1m	**2,536.2**	**8.5**	2,334.3	9.2
£1m–£2.5m	**207.4**	**0.7**	211.3	0.8
>£2.5m	**13.2**	**0.0**	18.9	0.1
Total	**29,751.4**	**100.0**	25,462.2	100.0

As at 31 December 2016, 0.7% (2015: 0.9%) of mortgage balances consisted of loans in excess of £1 million.





The value of loans with balances of up to £250,000 increased by £2,339.7 million during 2016. This represents 55% of the total secured loans portfolio growth of £4,289.2 million.

The table below shows retail secured credit average LTV by loan size.

2016 (audited)	Residential mortgage loans %	Residential buy-to-let mortgage loans %	Total
0–£100k	**42.6**	**58.2**	**48.4**
£100k–£250k	**58.9**	**55.2**	**58.2**
£250k–£500k	**57.9**	**49.0**	**57.1**
£500k–£1m	**51.0**	**42.7**	**50.3**
£1m–£2.5m	**43.7**	**34.9**	**42.2**
>£2.5m	**35.8**	**—**	**35.8**
Total	**55.6**	**54.8**	**55.4**

2016 (audited)	Residential mortgage loans %	Residential buy-to-let mortgage loans %	Total
0–£100k	42.9	57.9	47.9
£100k–£250k	58.9	56.5	58.5
£250k–£500k	56.5	49.5	55.9
£500k–£1m	51.6	43.9	51.0
£1m–£2.5m	46.5	35.9	44.9
>£2.5m	43.8	—	43.8
Total	**54.9**	**55.4**	**55.0**

The Group's policy broadly restricts LTV for higher value loans. The average LTV for each loan band demonstrates that, excluding loans under £100,000, higher value loans have lower LTVs. The average indexed LTV across the loan size bands has increased reflecting portfolio growth, with an increased proportion of residential new lending.

Loan type

The residential mortgage loan portfolio comprises three principal loan repayment types:

- capital repayment loans amortise monthly through customer repayments which comprise an interest payment and contribution to the principal loan balance;
- part-and-part loans provide customers with the flexibility to choose to pay a proportion of the loan on a capital repayment basis and a proportion on interest only, with the interest only element repaid from an acceptable repayment vehicle; and
- interest only loans allow borrowers to pay only the interest on the loan each month, with the capital to be repaid in full at the end of the loan period from an acceptable repayment vehicle.

For residential mortgage customers, the Group continues to apply strict affordability criteria and restricts applicant LTV. For buy-to-let customers, interest only mortgages continue to be the predominant repayment method, with the majority of customers looking to the sale of the mortgaged property as the ultimate loan repayment vehicle. These loans are also subject to stringent lending standards.

The tables below show retail secured credit concentrations by loan type.

2016 (audited)	Residential mortgage loans		Residential buy-to-let mortgage loans		Total	
	£m	%	£m	%	£m	%
Capital repayment	**19,521.7**	**80.4**	**913.0**	**16.7**	**20,434.7**	**68.7**
Part-and-part	**1,115.6**	**4.6**	**37.3**	**0.7**	**1,152.9**	**3.9**
Interest only	**3,645.7**	**15.0**	**4,518.1**	**82.6**	**8,163.8**	**27.4**
Total	**24,283.0**	**100.0**	**5,468.4**	**100.0**	**29,751.4**	**100.0**

2015 (audited)	Residential mortgage loans		Residential buy-to-let mortgage loans		Total	
	£m	%	£m	%	£m	%
Capital repayment	15,800.7	75.0	761.0	17.3	16,561.7	65.0
Part-and-part	1,235.4	5.9	26.5	0.6	1,261.9	5.0
Interest only	4,024.2	19.1	3,614.4	82.1	7,638.6	30.0
Total	**21,060.3**	**100.0**	**4,401.9**	**100.0**	**25,462.2**	**100.0**

Wholesale

Concentration risk is managed for both individual counterparties and for country of exposure. The Group does not set a limit on exposures to the BoE and the UK Sovereign. The table below shows exposures by country.

(audited)	2016	2015
	£m	%
Australia	**19.3**	63.2
Canada	**169.0**	108.9
France	**105.3**	67.7
UK	**1,747.5**	2,234.9
Germany	**—**	10.9
Netherlands	**102.7**	73.8
Norway	**—**	24.0
Sweden	**—**	20.0
USA	**104.6**	71.7
Supranational	**129.3**	203.7
Total	**2,377.7**	2,878.8

The Group's wholesale credit risk exposure outside the UK remains well-diversified.

FUNDING AND LIQUIDITY RISK

Definition

Funding risk is defined as the inability to raise and maintain sufficient funding in quality and quantity to support the delivery of the business plan. Sound funding risk management reduces the likelihood of liquidity risks occurring through minimising refinancing concentration.

Liquidity risk is defined as the inability to accommodate liability maturities and withdrawals, fund asset growth and otherwise meet contractual obligations to make payments as they fall due.

Risk appetite

The Group funds before it lends. The Group operates an investment strategy for treasury assets which prioritises liquidity and ensures that the Group holds a liquid asset buffer in excess of internal analysis.

Exposures

Liquidity exposure represents the amount of potential stressed outflows in any future period less expected inflows.

The Group's primary liquidity risk exposure arises through the redemption of retail deposits where customers are permitted to withdraw funds with limited or no notice. Additional exposures exist in relation to pipeline mortgage business, undrawn card balances and wholesale funding.

The Group is exposed to refinancing risk at the point of contractual maturity. The risk arises from both wholesale and retail funding sources.

Measurement

A series of measures is used across the Group to monitor both short and long-term liquidity requirements including ratios, cash outflow triggers, wholesale and retail funding maturity profile, early warning indicators and stress test survival periods. Liquidity risk appetite covers a range of metrics considered key to maintaining a strong liquidity and funding position. Strict criteria and limits are in place to ensure highly liquid marketable securities are available as part of the portfolio of liquid assets.

The measurement framework has two other important components:

- the volume and quality of the Group's liquid asset portfolio is defined through a series of stress tests across a range of time horizons and stress conditions. The Group ensures a liquidity surplus is held during normal market conditions above liquidity stress outflow requirements. Stress cash outflow assumptions have been established for individual liquidity risk drivers across idiosyncratic and market wide stresses.

  Internal and regulatory liquidity requirements are quantified on a daily basis, with holdings assessed against a full suite of liquidity stresses weekly.

  As at 31 December 2016, the results of stress testing of liquidity outflows were £3,688.1 million (2015: £3,069.1 million) based on the Group's internal 90 day liquidity stress scenario. The primary driver for the increased liquidity outflows is growth in deposit redemption risk arising from customer deposits which permit access. Risk drivers of this liquidity stress outflow are detailed, in the following table. As the Group is predominantly retail funded, the largest potential source of liquidity stress is the unexpected outflow of retail customer deposits.

  The key risk driver assumptions applied to the scenarios are:

Liquidity risk driver	Modelling assumption
Retail funding	Severe unexpected withdrawal of retail deposits arising from redemption or refinancing risk. No additional deposit inflows are assumed.
Wholesale funding	Limited opportunity to refinance wholesale contractual maturities. Full outflow of secured and unsecured funding during the refinancing period, with no reinvestment of funding.
Off-balance sheet	Cash outflows during the period of stress as a result of off-balance sheet commitments such as mortgage pipeline, undrawn credit card facilities and collateral commitments.

Franchise viability risk	Lending outflows over and above those relating to contractual obligations, as the Group undertakes actions in order to preserve ongoing franchise viability.
Marketable asset risk	Assets held for liquidity purposes experience deterioration in market availability.

The scenarios and the assumptions are reviewed to ensure that they continue to be relevant to the nature of the business. The Group's liquidity risk appetite is calibrated against a number of stressed metrics. The funding plan is also stressed against a range of macro-economic scenarios; and

- the Group maintains a Contingency Funding Plan which is designed to provide an early warning indicator for liquidity concerns and a list of potential actions to address a liquidity shortfall. As a result, mitigating actions can be taken to avoid a more serious situation developing.

Mitigation

The most material component of the Group's funding and liquidity position is the customer deposit base, which is supplemented by wholesale funding providing a source of stable funding for balance sheet growth. Exposures to the UK Sovereign are described on page 183. The concentration of exposure to other counterparties is not considered significant for the Group. Where concentrations do exist for example, refinancing at maturity, these are managed within the appropriate internal risk appetite, to control the size of the exposure. Refinancing exposures are planned in advance of maturity with liquidity held to mitigate the potential exposure. Longer term funding is used to manage the Group's strategic liquidity profile in line with limits.

The Group operates a Funds Transfer Pricing (FTP) mechanism which supports customer pricing and the overall Group balance sheet strategy.

FTP makes use of behavioural maturity profiles, taking account of expected customer loan prepayments and the stability of customer deposits. Such behavioural maturity assumptions are subject to formal governance and reviewed periodically.

The ability to deploy assets quickly, either through the repo market or through outright sale, is also an important source of liquidity for the Group. In addition to central bank reserves, the Group holds sizeable balances of high-quality marketable debt securities which can be sold to provide, or used to secure, additional cash inflows should the need arise from either market counterparties or central bank facilities (BoE).

Monitoring

Liquidity is actively monitored by the Group. Reporting is conducted through the Asset and Liability Committee and the Board Risk Committee. In a stress situation the level of monitoring and reporting is increased commensurate with the nature of the stress event.

Daily monitoring and control processes are in place to address internal and regulatory liquidity requirements. The Group monitors a range of market and internal early warning indicators on a daily basis for early signs of liquidity risk in the market or specific to the Group. These are a mixture of quantitative and qualitative measures including daily variation of customer balances, cash outflows, changes in primary liquidity portfolio, credit default swap spreads and changing funding costs.

Funding and liquidity management in 2016

During 2016 the Group has maintained a strong funding and liquidity position in excess of risk appetite and the regulatory short-term liquidity stress metric, the Liquidity Coverage Ratio (LCR). As at 31 December 2016, the Group had a LCR of 153.7% based on the PRA's guidance for calculation. The Net Stable Funding Ratio (NSFR) is due to become a minimum standard from January 2018. The Group expects to meet the minimum requirements once fully implemented into liquidity regulation.

Wholesale funding is used to support balance sheet growth, lengthen the contractual tenor of funding and diversify sources of funding. During January and May 2016, the Group raised wholesale funding in two separate issuances from the well-established Gosforth RMBS programme and through additional drawings from the FLS facility. The RMBS issuance further diversified the Group's investor base and sources of wholesale funding, through issuing in non-sterling denominations. The Group has made use of the TFS during the final quarter of the year, drawing £1,268.0 million of funding. The scheme provides the Group with a cost effective source of funding.

Group funding sources

The Group is funded predominantly through customer deposits. Throughout 2016, the Group maintained a strong presence in the retail savings market, increasing total customer deposits by £3.0 billion, representing 81.5% of the Group's funding. The primary driver of retail funding growth was the Defined Access product, which offers a higher rate of interest than other instant access products, whilst retaining depositors' access to funds on demand. The balance of these defined access products increased by £3,580.2 million since December 2015 to £6,993.4 million at 31 December 2016.

The Group's loan-to-deposit ratio increased to 114.5% as at 31 December 2016 (31 December 2015: 107.5%), as a result of participation in the TFS. The Group expects the overall loan-to-deposit ratio to increase beyond this for the period in which the scheme is used. The following table shows the Group's funding position.

(audited)	2016	2015
	£m	£m
Loans and advances to customers	**32,367.1**	27,109.0
Loans and advances to banks	**635.6**	614.5
Debt securities classified as loans and receivables	**0.7**	1.1
Available-for-sale financial assets (encumbered)	**10.6**	—
Cash and balances at central banks (encumbered)	**168.1**	160.5
Funded assets	**33,182.1**	27,885.1
Other assets	**407.1**	318.9
Total assets (excluding liquid assets)	**33,589.2**	28,204.0
On balance sheet primary liquidity assets		
Cash and balances at central banks—primary	**618.2**	728.1
Available-for-sale financial assets (unencumbered)	**848.2**	1,296.9
Total assets	**35,055.6**	30,229.0
Less: Other liabilities	**(560.8)**	(429.5)
Funding requirement	**34,494.8**	29,799.5
Funded by		
Customer deposits	**28,106.3**	25,144.9
Wholesale funding	**4,718.0**	3,314.3
Total equity	**1,670.5**	1,340.3
Total funding	**34,494.8**	29,799.5

The table below shows the sources of wholesale funding.

(audited)	2016	2015
	£m	£m
Debt securities in issue	**2,600.0**	2,039.4
Liabilities in respect of securities sold under repurchase agreements	**850.0**	1,274.9
Secured loans	**1,268.0**	—
Total on-balance sheet sources of funds	**4,718.0**	3,314.3
Treasury bills raised through FLS	**2,683.7**	2,960.0
Total	**7,401.7**	6,274.3

The tables below show residual maturity of the wholesale funding book.

2016 (audited)	Within 3 months	3–12 months	1–5 years	After 5 years	Total
	£m	£m	£m	£m	£m
Debt securities in issue	**—**	**—**	**305.8**	**2,294.2**	**2,600.0**
Liabilities in respect of securities sold under repurchase agreements	**500.0**	**75.0**	**275.0**	**—**	**850.0**
Secured loans	**—**	**—**	**1,268.0**	**—**	**1,268.0**
Total on-balance sheet sources of funds	**500.0**	**75.0**	**1,848.8**	**2,294.2**	**4,718.0**
Treasury bills raised through FLS	**—**	**649.2**	**2,034.5**	**—**	**2,683.7**
Total	**500.0**	**724.2**	**3,883.3**	**2,294.2**	**7,401.7**

2015 (audited)	Within 3 months	3–12 months	1–5 years	After 5 years	Total
	£m	£m	£m	£m	£m
Debt securities in issue	—	—	297.5	1,741.9	2,039.4
Liabilities in respect of securities sold under repurchase agreements	749.9	525.0	—	—	1,274.9
Total on-balance sheet sources of funds	749.9	525.0	297.5	1,741.9	3,314.3
Treasury bills raised through FLS	—	510.0	2,450.0	—	2,960.0
Total	**749.9**	**1,035.0**	**2,747.5**	**1,741.9**	**6,274.3**

The increase in average tenor of wholesale funding during 2016 is driven by the drawings from the TFS and additional RMBS issuances, which are categorised as '1-5 years' and 'After 5 years' maturities.

The Group manages the average tenor of wholesale funding within a defined Board risk appetite based on cash flow maturity as shown on page 185.

Encumbered assets

The Group's assets can be used to support funding collateral requirements for central bank operations or third party re-purchase transactions. Assets that have been set aside for such purposes are classified as 'encumbered and pledged assets' and cannot be used for other purposes. The following tables show asset encumbrance.

	Encumbered assets		Unencumbered assets		
2016 (audited)	Pledged as collateral(2)	Other(3)	Available as collateral(4)	Other(5)	Total
	£m	£m	£m	£m	£m
Cash and balances at central banks	**—**	**168.1**	**—**	**618.2**	**786.3**
Debt securities classified as loans and receivables	**—**	**—**	**0.7**	**—**	**0.7**
Available-for-sale financial assets	**10.6**	**—**	**840.3**	**7.9**	**858.8**
Derivative financial assets	**—**	**—**	**—**	**104.2**	**104.2**
Loans and advances to banks	**181.1**	**354.4**	**—**	**100.1**	**635.6**
Loans and advances to customers	**9,425.6**	**—**	**2,932.9**	**20,008.6**	**32,367.1**
Other assets	**53.9**	**—**	**—**	**249.0**	**302.9**
Total assets	**9,671.2**	**522.5**	**3,773.9**	**21,088.0**	**35,055.6**
Treasury bills raised through FLS held off balance sheet(6)	**—**	**—**	**2,683.7**	**—**	**2,683.7**
Total assets plus off-balance sheet Treasury bills raised through FLS	**9,671.2**	**522.5**	**6,457.6**	**21,088.0**	**37,739.3**

2015 (audited)	Encumbered assets		Unencumbered assets		
	Pledged as collateral(2)	Other(3)	Available as collateral(4)	Other(5)	Total
	£m	£m	£m	£m	£m
Cash and balances at central banks	—	160.5	—	728.1	888.6
Debt securities classified as loans and receivables	—	—	1.1	—	1.1
Available-for-sale financial assets	—	—	1,292.3	4.6	1,296.9
Derivative financial assets	—	—	—	82.3	82.3
Loans and advances to banks	94.3	384.3	—	135.9	614.5
Loans and advances to customers	7,524.1	—	3,153.5	16,431.4	27,109.0
Other assets	0.3	—	—	236.3	236.6
Total assets	**7,618.7**	**544.8**	**4,446.9**	**17,618.6**	**30,229.0**
Treasury bills raised through FLS held off balance sheet(6)	786.0	—	2,174.0	—	2,960.0
Total assets plus off-balance sheet Treasury bills raised through FLS	**8,404.7**	**544.8**	**6,620.9**	**17,618.6**	**33,189.0**

(1) The 2015 table has been restated to reclassify certain encumbered assets between the 'Pledged as collateral and 'Other' categories to better reflect the underlying nature of the Group's collateral arrangements. This restatement has not impacted the Group's total encumbrance ratio as at 31 December 2015.

(2) Encumbered loans and advances to customers of £9,425.6 million (2015: £7,524.1 million) consists of securitised mortgages and other loan pools positioned with the Bank of England that have been pledged as collateral for funding and liquidity transactions. At 31 December 2016, £2,302.3 million (2015: £755.0 million) of loan pools have been pledged as collateral in respect of secured loans and repo agreements (refer note 17 to the financial statements).

(3) Other encumbered assets are assets that cannot be used for secured funding due to legal or other reasons. These comprise the mandatory reserve and the minimum requirement for the BACS payment system of £168.1 million (2015: £160.5 million) and cash reserves supporting secured funding structures of £354.4 million (2015: £384.3 million).

(4) Unencumbered asserts which are classified as 'Available for collateral' are readily available to secure funding or to meet collateral requirements. Loans and advances to customers are classified as 'Available for collateral' only if they are already in such a form that they can be used immediately to raise funding.

(5) Other unencumbered assets are assets which are not subject to any restrictions and are not readily available for use.

(6) These amounts represent Treasury Bills received by the Group through FLS, which are not recognised on the balance sheet. The Group is permitted to re-pledge these securities to generate on-balance sheet financial assets, such as cash, or to fund lending. These items are classified as encumbered where the Group has used them in repurchase transactions or unencumbered where it has not.

The Group's total level of asset encumbrance remained at 27.0% at 31 December 2016. Encumbered assets increased by £1,244.2 million year-on-year, in line with balance growth, due to wholesale funding to support increased lending. Encumbrance of assets predominantly arises from the use of the BoE funding and liquidity facilities and from the Gosforth RMBS programme. The Group manages the volume of available unencumbered collateral to meet requirements arising from current and future secured funding transactions. Available collateral provides a source of contingent funding for use in stress conditions, as identified within the Contingency Funding Plan.

The Group maintains a portfolio of liquid assets in accordance with risk appetite. Liquid assets are held predominantly in high-quality unencumbered securities issued by the UK Government or supranationals and deposits with central banks. The portfolio mix is aligned to the liquidity coverage requirement defined in European liquidity regulatory standards. Other liquidity resources represent additional unencumbered liquid assets held over and above high-quality liquid assets. These are intended to covermore extreme stress events and provide flexibility for liquidity management. The table opposite shows the composition of the liquidity portfolio.

	2016	2016 Average	2015	2015 Average
	£m	£m	£m	£m
Level 1				
Cash and balances at central banks	**737.2**	**819.6**	846.3	796.4
UK Government securities	**306.7**	**339.3**	409.5	392.6
Other HQLA level 1 eligible	**—**	**33.8**	25.4	15.8
Supranational securities	**129.3**	**222.0**	203.7	294.6
Treasury bills raised through FLS	**2,683.7**	**2,528.2**	2,174.0	2,150.6
Covered bonds (Level 1 eligible)	**304.9**	**434.4**	498.2	248.2
Total level 1	**4,161.8**	**4,377.3**	4,157.1	3,898.2
Level 2a				
Covered bonds (Level 2a eligible)	**22.2**	**22.4**	22.1	133.5
Total level 2a	**22.2**	**22.4**	22.1	133.5
Level 2b				
Eligible RMBS	**38.6**	**49.1**	59.4	44.7
Total level 2b	**38.6**	**49.1**	59.4	44.7
High quality liquid assets (Level 1 + 2a + 2b)	**4,222.6**	**4,448.8**	4,238.6	4,076.4
Other liquidity resources				
Covered bonds	**—**	**1.2**	15.0	2.3
Non-eligible RMBS	**13.6**	**11.6**	—	3.0
Certificates of deposit	**—**	**44.5**	59.0	4.5
Floating rate notes	**25.0**	**9.6**	—	—
Fixed rate bonds	**—**	**—**	—	17.0
Money market loans	**26.0**	**38.8**	54.0	30.9
Total other liquidity resources	**64.6**	**105.7**	128.0	57.7
Self-issued RMBS	**1,306.4**	**550.8**	326.7	197.6
Total liquidity	**5,593.6**	**5,105.3**	4,693.3	4,331.7

The Group holds sufficient liquidity to meet all internal and regulatory liquidity requirements.

The tables overleaf analyse assets and liabilities of the Group into relevant maturity groupings based on the remaining contractual period at the balance sheet date. The Group's assets and liabilities may be repaid or otherwise mature earlier or later than implied by their contractual terms, and readers are therefore advised to use caution when using this data to evaluate the Group's liquidity position.

In particular, amounts in respect of customer deposits are usually contractually payable on demand or at short notice. In practice, these deposits are not usually withdrawn on their contractual maturity. Amounts in respect of RMBS in issue have a maximum contractual maturity consistent with underlying mortgage assets (in excess of five years); the cashflow profile below reflects that securitisation documents will require repayment of the securities in line with repayments of the underlying mortgages, which may be in advance of the legal maturity date.

2016 (audited)	Within 3 months	3–12 months	1–5 years	After 5 years	Total
	£m	£m	£m	£m	£m
Assets					
Cash and balances at central banks	**737.2**	**—**	**—**	**49.1**	**786.3**
Derivative financial instruments	**1.4**	**1.5**	**99.8**	**1.5**	**104.2**
Loans and receivables:					
Loans and advances to banks	**635.6**	**—**	**—**	**—**	**635.6**
Loans and advances to customers	**2,700.3**	**720.1**	**3,910.6**	**25,036.1**	**32,367.1**
Debt securities	**—**	**—**	**—**	**0.7**	**0.7**
Available-for-sale financial assets	**—**	**25.0**	**283.2**	**550.6**	**858.8**
Other assets	**99.2**	**25.3**	**10.8**	**167.6**	**302.9**
Total assets	**4,173.7**	**771.9**	**4,304.4**	**25,805.6**	**35,055.6**
Liabilities					
Deposits from banks	**514.5**	**75.0**	**1,543.0**	**—**	**2,132.5**
Customer deposits	**24,540.2**	**1,883.6**	**1,682.5**	**—**	**28,106.3**
Derivative financial instruments	**8.2**	**8.6**	**185.6**	**27.3**	**229.7**
Debt securities in issue	**—**	**—**	**305.8**	**2,294.2**	**2,600.0**
Other liabilities	**240.7**	**67.0**	**5.0**	**3.9**	**316.6**
Total liabilities	**25,303.6**	**2,034.2**	**3,721.9**	**2,325.4**	**33,385.1**
Net liquidity (gap) / surplus	**(21,129.9)**	**(1,262.3)**	**582.5**	**23,480.2**	**1,670.5**

2015 (audited)	Within 3 months	3–12 months	1–5 years	After 5 years	Total
	£m	£m	£m	£m	£m
Assets					
Cash and balances at central banks	846.9	—	—	41.7	888.6
Derivative financial instruments	16.1	13.3	47.4	5.5	82.3
Loans and receivables:					
Loans and advances to banks	614.5	—	—	—	614.5
Loans and advances to customers	1,778.0	572.5	3,334.6	21,423.9	27,109.0
Debt securities	—	—	—	1.1	1.1
Available-for-sale financial assets	47.5	4.7	424.4	820.3	1,296.9
Other assets	47.5	20.2	14.8	154.1	236.6
Total assets	**3,350.5**	**610.7**	**3,821.2**	**22,446.6**	**30,229.0**
Liabilities					
Deposits from banks	773.7	525.0	—	—	1,298.7
Customer deposits	20,776.5	2,630.2	1,738.2	—	25,144.9
Derivative financial instruments	5.9	12.1	103.2	34.8	156.0
Debt securities in issue	—	—	297.5	1,741.9	2,039.4
Other liabilities	158.8	46.9	39.5	4.5	249.7
Total liabilities	**21,714.9**	**3,214.2**	**2,178.4**	**1,781.2**	**28,888.7**
Net liquidity (gap) / surplus	(18,364.4)	(2,603.5)	1,642.8	20,665.4	1,340.3

Cashflow profile

The tables below allocate the Group's non-derivative cash outflows into relevant maturity groupings based on the remaining period between the balance sheet date and the contractual maturity date. The amounts disclosed are the contractual undiscounted cash flows. These differ from balance sheet values due to the effects of discounting on certain balance sheet items and due to the inclusion of contractual future interest flows.

2016 (audited)	Within 3 months	3–6 months	6–12 months	1–5 years	Over 5 years	Total
	£m	£m	£m	£m	£m	£m
Deposits from banks	**514.1**	**76.7**	**3.1**	**1,556.8**	—	**2,150.7**
Customer deposits	**24,638.0**	**703.8**	**1,393.7**	**1,835.9**	**—**	**28,571.4**
Debt securities in issue	**158.7**	**154.4**	**304.1**	**2,056.5**	**—**	**2,673.7**
Total	**25,310.8**	**934.9**	**1,700.9**	**5,449.2**	**—**	**33,395.8**

2015 (audited)	Within 3 months	3–6 months	6–12 months	1–5 years	Over 5 years	Total
	£m	£m	£m	£m	£m	£m
Deposits from banks	775.8	526.3	—	—	—	1,302.1
Customer deposits	21,228.6	895.0	1,604.4	1,962.0	—	25,690.0
Debt securities in issue	152.3	236.7	208.3	1,550.4	—	2,147.7
Total	**22,156.7**	**1,658.0**	**1,812.7**	**3,512.4**	**—**	**29,139.8**

Growth in customer deposits has primarily been achieved through the Defined Access product, providing on-demand access to depositors, shown in the 'Within 3 months' column. As a result, the Group's contractual cashflow profile of customer deposits has shortened. The reduced retail funding tenor has been partially offset by a lengthening of the wholesale funding profile.

The following tables allocate the undiscounted derivative cash outflows into relevant maturity groupings based on the remaining period between the balance sheet date and the contractual maturity date. Cash flows for the floating legs of derivative transactions are calculated based on market indications of future interest rates. As a result, totals in these tables are not intended to be identical to tables on OTC derivatives or the notes to the financial statements by definition.

2016 (audited)	Within 3 months	3–6 months	6–12 months	1–5 years	Over 5 years	Total
	£m	£m	£m	£m	£m	£m
Settled on a net basis						
Derivatives in economic and not accounting hedges	**(1.8)**	**(0.5)**	**(4.5)**	**(12.2)**	**(0.3)**	**(19.3)**
Derivatives in accounting hedge relationships	**(26.1)**	**(21.2)**	**(37.6)**	**(110.0)**	**(6.2)**	**(201.1)**
Total	**(27.9)**	**(21.7)**	**(42.1)**	**(122.2)**	**(6.5)**	**(220.4)**
Settled on a gross basis						
Outflows	**1.4**	**2.6**	**2.5**	**23.3**	**—**	**29.8**
Inflows	**(1.5)**	**(3.0)**	**(2.8)**	**(26.6)**	**—**	**(33.9)**
Total	**(28.0)**	**(22.1)**	**(42.4)**	**(125.5)**	**(6.5)**	**(224.5)**

2015 (audited)	Within 3 months	3–6 months	6–12 months	1–5 years	Over 5 years	Total
	£m	£m	£m	£m	£m	£m
Settled on a net basis						
Derivatives in economic and not accounting hedges	(1.1)	0.2	(0.6)	(13.5)	(0.9)	(15.9)
Derivatives in accounting hedge relationships	(30.9)	(25.1)	(35.8)	(41.6)	(3.2)	(136.6)
	(32.0)	(24.9)	(36.4)	(55.1)	(4.1)	(152.5)
Settled on a gross basis						
Outflows	—	—	—	—	—	—
Inflows	—	—	—	—	—	—
Total	**(32.0)**	**(24.9)**	**(36.4)**	**(55.1)**	**(4.1)**	**(152.5)**

External credit ratings

Virgin Money Holdings (UK) plc does not have an external credit rating. Disclosures below relate to its subsidiary, Virgin Money plc. Virgin Money plc's short and long-term credit ratings as at 31 December 2016 are as follows.

	Long term	Short term	Outlook	Date of last rating action	Rating action type
Fitch	BBB+	F2	Stable	03 October 2016	Affirmed

In October 2016 the rating agency Fitch revised Virgin Money plc's outlook to Stable from Positive and affirmed its long-term rating at BBB+.

The table below sets out the amount of additional collateral the Company would need to provide in the event of a one and two notch downgrade by external credit ratings agencies.

	Cumulative adjustment for a one-notch downgrade	Cumulative adjustment for a two-notch downgrade
	£m	£m
2016	—	**10.0**
2015	—	10.0

SECTION C:
HISTORICAL FINANCIAL INFORMATION RELATING TO THE VIRGIN MONEY GROUP FOR THE YEAR ENDED 31 DECEMBER 2015

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF VIRGIN MONEY HOLDINGS (UK) PLC ONLY

Opinions and conclusions arising from our audit

1. Our opinion on the financial statements is unmodified

We have audited the financial statements of Virgin Money Holdings (UK) plc for the year ended 31 December 2015 set out on pages 214 to 282. In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the parent company's affairs as at 31 December 2015 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union (IFRSs as adopted by the EU);
- the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the EU and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

2. Our assessment of risks of material misstatement

In arriving at our audit opinion above, we designed our audit procedures to reflect the risks we identified in the Group by performing increased procedures in the areas with most significant risk.

Our audit began with a risk assessment of the inherent risks facing the Group and how these are managed. This included understanding: the strength of the Group's capital and liquidity position; the impact of key strategic projects; the composition of its balance sheet; and the management of its cost base. We assessed and challenged the inherent risks with reference to:

- Our experience of the Group and the retail banking industry;
- The views of our specialists in a number of areas including regulation, IT and tax;
- The views of the Prudential Regulation Authority and Financial Conduct Authority; and
- The significant changes taking place in banking regulation in the UK.

We also considered the Group's control environment, including appropriate controls designed to prevent fraud.

The risk assessment highlighted the areas where significant judgement was required. As described on pages 103 to 104 these are also areas that have been focused on by the Group's Audit Committee. In forming our unmodified opinion on the financial statements, we undertook the following principal procedures on each of the areas as follows.

Allowance for impairment losses on loans and receivables (£39.9 million)

Refer to page 103 (Audit Committee Report), pages 224, 231 and 232 (accounting policy) and note 8 (financial disclosures).

The risk: The impairment provision relating to secured and unsecured loans is one of the key judgemental areas for our audit due to the level of subjectivity inherent in estimating the impact of certain key assumptions on the recoverability of loan balances.

The Group performs an assessment of its loans for impairment, with the key assumptions being the probability of an account falling into arrears and subsequently defaulting, the emergence period, and the valuation of any recoveries expected to be made. For secured lending, the recoveries assessment includes the market valuations of collateral provided and the estimated time and cost to sell any property repossessed by the Group. For unsecured lending, the likelihood and amount of recoveries through sales to third parties is assessed. Due to the limited historical information available on actual default patterns and loss emergence periods and the fact that past performance is not necessarily an indication of future performance, there is a risk that the actual outcome is different from the probability assumed.

Our response: Our audit procedures included:

- We assessed the accuracy of the secured and unsecured impairment models by re-performing a sample of calculations performed by the impairment models and agreed a sample of data inputs, including the loans split by arrears status, to reports from the source systems. We assessed whether these reports were complete and accurate by checking the system codes used to extract the information.
- We compared the assumptions used in the impairment models to those approved by the Group. We critically assessed those assumptions against our understanding of the Group, the historical accuracy of its estimates, the current and past performance of the Group's loans and our knowledge of the industry in respect of these types of loans.
- We benchmarked the Group's assumptions, such as arrears trends, and the ratio between provisions and total/impaired loan balances against industry data, and compared macroeconomic variables such as house price inflation to market information.
- We tested the controls designed and applied by the Group to provide assurance that the assumptions explained above are regularly updated, that changes are monitored, scrutinised and approved by appropriate personnel and that the final assumptions used in the impairment models have been appropriately approved.
- We considered the adequacy of the Group's disclosures on impairment losses and key assumptions.

Recognition of revenue from secured and unsecured lending (£824.8 million)

Refer to page 103 (Audit Committee Report), pages 222 and 231 (accounting policy) and note 3 (financial disclosures).

The risk: Interest earned on loans and receivables is recognised using the effective interest rate method which spreads the directly attributable cash flows, including transaction costs and discounts, over the expected lives of the instrument. The key assumptions in this calculation is the expected life of the instrument and the profile of the cash flows. The expected lives and usage patterns are informed by past customer behaviour, which demonstrates how and when customers have historically paid off their loans as well as spending patterns for unsecured loans. Judgement is used by the Group to convert this historical information into the assumptions of future behaviour included in the models. There is a risk that this judgement may not appropriately reflect all the facts available, which would skew the recognition of interest income.

Our response: Our audit procedures included:

- We agreed a sample of inputs into the models to source information, including comparing total secured loan balances to the loan system output and total unsecured balances to system reports.
- We used data tools to identify changes to the calculations used by the model and re-performed a sample of calculations performed to check their accuracy. We compared the methodology used to our interpretation of the requirements of the relevant accounting standards.
- We challenged the appropriateness of key assumptions, including the expected lives and usage patterns, by comparing these to historical expected life trends within the Group and to our own expectations based on our knowledge of the Group and experience of the industry in which it operates.
- We considered the adequacy of the Group's disclosures over revenue.

We continue to perform audit procedures over share based payments and capitalisation of project costs. However, due to the reduced complexity in the Group's share schemes and internal projects, we have not assessed these as being included in the risks that had the greatest effect on our audit and, therefore, they are not separately identified in our report this year.

3. Our application of materiality and an overview of the scope of our audit

The materiality for the Group financial statements as a whole was set at £6.0 million (2014: £6.0 million), determined with reference to a benchmark of profit before tax (2014: gross interest receivable plus non-funded income) of which it represents 4.3 per cent (2014: 0.7 per cent). We have considered profit before tax to be the most appropriate benchmark in the current year as profitability now reflects the scale of the business.

We report to the Audit Committee any uncorrected identified misstatements exceeding £0.3 million (2014: £0.3 million), in addition to other identified misstatements that warranted reporting on qualitative grounds.

Our audits of the six components of the Group were performed by the audit team at the Group's central hubs that perform or support the key financial processes primarily in Edinburgh and Gosforth. The audit work undertaken at these two hubs was all performed by the Group auditor to materiality levels set individually for each component, which ranged from £0.1 million to £6.0 million. These Group audit procedures covered 100% of total Group revenue, Group profit before tax and total Group assets.

4. Our opinion on other matters prescribed by the Companies Act 2006 is unmodified

In our opinion:

- the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006; and
- the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

5. We have nothing to report on the disclosures of principal risks

Based on the knowledge we acquired during our audit, we have nothing material to add or draw attention to in relation to:

- the viability statement on pages 52 to 53, concerning the principal risks, their management, and, based on that, the directors' assessment and expectations of the group's continuing in operation over the 3 years to 31 December 2018; or
- the disclosures in note 1 of the financial statements concerning the use of the going concern basis of accounting.

6. We have nothing to report in respect of the matters on which we are required to report by exception

Under ISAs (UK and Ireland) we are required to report to you if, based on the knowledge we acquired during our audit, we have identified other information in the annual report that contains a material inconsistency with either that knowledge or the financial statements, a material misstatement of fact, or that is otherwise misleading.

In particular, we are required to report to you if:

- we have identified material inconsistencies between the knowledge we acquired during our audit and the directors' statement that they consider that the annual report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's performance, business model and strategy; or
- the Audit Committee Report does not appropriately address matters communicated by us to the audit committee.

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

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

Under the Listing Rules we are required to review:

- the directors' statements, set out on page 135, in relation to going concern and longer-term viability; and
- the part of the Corporate Governance Statement on page 95 relating to the company's compliance with the eleven provisions of the 2014 UK Corporate Governance Code specified for our review.

We have nothing to report in respect of the above responsibilities.

Scope and responsibilities

As explained more fully in the Statement of Directors' Responsibilities set out on pages 137 to 138, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

A description of the scope of an audit of financial statements is provided on the Financial Reporting Council's website at www.frc.org.uk/auditscopeukprivate. This report is made solely to the company's members as a body and is subject to important explanations and disclaimers regarding our responsibilities, published on our website at www.kpmg.com/uk/auditscopeukco2014a, which are incorporated into this report as if set out in full and should be read to provide an understanding of the purpose of this report, the work we have undertaken and the basis of our opinions.

John Ellacott (Senior Statutory Auditor)

for and on behalf of KPMG LLP, Statutory Auditor

Chartered Accountants

15 Canada Square

London

E14 5GL

March 2016

CONSOLIDATED INCOME STATEMENT

For the year ended 31 December

	Note	2015	2014
		£ million	£ million
Interest and similar income		**839.3**	771.6
Interest and similar expense		**(384.5)**	(404.3)
Net interest income	3	**454.8**	367.3
Fee and commission income		**27.4**	27.4
Fee and commission expense		**(1.2)**	(1.1)
Net fee and commission income	4	**26.2**	34.0
Other operating income	5	**41.3**	36.9
Fair value (losses)/gains on financial instruments	13	**(0.4)**	0.1
Other income		**67.1**	71.0
Total income		**521.9**	438.3
Other operating expenses	6	**(353.6)**	(338.9)
Fees associated with listing		**—**	(12.6)
Total operating expenses	6	**(353.6)**	(351.5)
Profit before tax from operating activities		**168.3**	86.8
Impairment	8	**(30.3)**	(15.8)
Gain on sale of subsidiary	19	**—**	4.5
Additional Northern Rock consideration		**—**	(36.0)
Premium on repurchase of Non-core Tier 1 notes in issue		**—**	(4.5)
Loss for the period of disposal group		**—**	(1.0)
Profit before tax		**138.0**	34.0
Taxation	9	**(26.8)**	(25.3)
Profit for the year		**111.2**	8.7
Profit attributable to equity owners		**111.2**	8.7
Profit for the year		**111.2**	8.7
Basic earnings per share (pence)	10	**22.9**	(0.4)
Diluted earnings per share (pence)	10	**22.7**	(0.4)

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December

	Note	2015	2014
		£ million	£ million
Profit for the year		**111.2**	8.7
Other comprehensive income			
Items that may subsequently be reclassified to profit or loss:			
Movements in revaluation reserve in respect of available-for-sale financial assets:			
Change in fair value	31	**25.1**	12.1
Income statement transfers in respect of disposals	31	**(33.6)**	(10.3)
Taxation	31	**1.2**	(1.3)
		(7.3)	0.5
Movements in cash flow hedging reserve:			
Effective portion of changes in fair value taken to other comprehensive income	31	**(13.2)**	(14.1)
Net income statement transfers	31	**5.1**	2.6
Taxation	31	**1.6**	2.5
		(6.5)	(9.0)
Other comprehensive expense for the year, net of tax		**(13.8)**	(8.5)
Total comprehensive income for the year		**97.4**	0.2
Total comprehensive income attributable to equity owners		**97.4**	0.2

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED BALANCE SHEET

As at 31 December

	Note	2015 £ million	2014 £ million
Assets			
Cash and balances at central banks		**888.6**	851.3
Derivative financial instruments	13	**82.3**	101.2
Loans and receivables:			
—Loans and advances to banks	14	**614.5**	720.5
—Loans and advances to customers	15	**27,109.0**	23,093.1
—Debt securities		**1.1**	8.6
		27,724.6	23,822.2
Available-for-sale financial assets	16	**1,296.9**	1,539.6
Intangible assets	20	**64.4**	46.1
Tangible fixed assets	21	**74.6**	72.9
Deferred tax assets	22	**38.0**	50.2
Other assets	23	**59.6**	53.3
Total assets		**30,229.0**	26,536.8
Equity and liabilities			
Liabilities			
Deposits from banks	24	**1,298.7**	846.7
Customer deposits	25	**25,144.9**	22,365.7
Derivative financial instruments	13	**156.0**	228.2
Debt securities in issue	26	**2,039.4**	1,594.1
Provisions	27	**8.4**	9.3
Other liabilities	28	**241.3**	249.0
Total liabilities		**28,888.7**	25,293.0
Equity			
Share capital and share premium	29	**654.6**	654.6
Other equity instruments	30	**156.5**	156.5
Other reserves	31	**(15.6)**	(1.8)
Retained earnings	32	**544.8**	434.5
Total equity		**1,340.3**	1,243.8
Total liabilities and equity		**30,229.0**	26,536.8

The accompanying notes are an integral part of these consolidated financial statements.

The financial statements were approved and authorised for issue by the Board and were signed on its behalf on 1 March 2016.

Glen Moreno
Chairman

Jayne-Anne Gadhia CBE
Chief Executive

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December

Attributable to equity holders

	Share capital and 7share premium	Other equity instruments	Other reserves	Retained earnings	Total equity
	£ million	£ million	£ million	£ million	£ million
Balance at 1 January 2015	**654.6**	**156.5**	**(1.8)**	**434.5**	**1,243.8**
Comprehensive income					
Profit for the year	—	—	—	**111.2**	**111.2**
Other comprehensive income					
Net movement in available-for-sale reserve	—	—	**(7.3)**	—	**(7.3)**
Net movement in cash flow hedge reserve	—	—	**(6.5)**	—	**(6.5)**
Total other comprehensive expense	—	—	**(13.8)**	—	**(13.8)**
Total comprehensive (expense)/income for the year	—	—	**(13.8)**	**111.2**	**97.4**
Transactions with equity holders					
Share based payments—charge for the year	—	—	—	**20.0**	**20.0**
Deferred tax on share based payments	—	—	—	**0.3**	**0.3**
Purchase of own shares	—	—	—	**(5.0)**	**(5.0)**
Distribution to Additional Tier 1 security holders	—	—	—	**(12.6)**	**(12.6)**
Group relief attributable to Additional Tier 1 securities	—	—	—	**2.6**	**2.6**
Dividends paid to ordinary shareholders	—	—	—	**(6.2)**	**(6.2)**
Total transactions with equity holders	—	—	—	**(0.9)**	**(0.9)**
Balance at 31 December 2015	**654.6**	**156.5**	**(15.6)**	**544.8**	**1,340.3**

Further details of movements in the Group's share capital and reserves are provided in notes 29, 30, 31 and 32.

	Share capital and share premium	Other equity instruments	Other reserves	Retained earnings	Total equity
	£ million	£ million	£ million	£ million	£ million
Balance at 1 January 2014	509.2	—	6.7	419	934.9
Comprehensive income					
Profit for the year	—	—	—	8.7	8.7
Other comprehensive income					
Net movement in available-for-sale reserve	—	—	0.5	—	0.5
Net movement in cash flow hedge reserve	—	—	(9.0)	—	(9.0)
Total other comprehensive income	—	—	(8.5)	—	(8.5)
Total comprehensive (expense)/income for the year	—	—	(8.5)	8.7	0.2
Transactions with equity holders					
Share based payments—charge for the year	—	—	—	12.9	12.9
Share based payments—reclassifications from liabilities	—	—	—	4.2	4.2
Issue of ordinary shares (net)	145.4	—	—	—	145.4
Issue of Additional Tier 1 securities (net)	—	156.5	—	—	156.5
Distribution to Additional Tier 1 security holders	—	—	—	(3.2)	(3.2)
Distribution to Non-core Tier 1 noteholders	—	—	—	(9.2)	(9.2)
Group relief attributable to Tier 1 securities	—	—	—	2.1	2.1
Total transactions with equity holders	145.4	156.5	—	6.8	308.7
Balance at 31 December 2014	654.6	156.5	(1.8)	434.5	1,243.8

Further details of movements in the Group's share capital and reserves are provided in notes 29, 30, 31 and 32.

CONSOLIDATED CASH FLOW STATEMENT

For the year ended 31 December

	Note	2015	2014
		£ million	£ million
Profit before taxation		**138.0**	34.0
Adjustments for:			
Changes in operating assets	35(a)	**(4,037.3)**	(2,330.6)
Changes in operating liabilities	35(b)	**3,146.4**	1,805.6
Non-cash and other items	35(c)	**62.4**	(132.8)
Tax paid		**(5.0)**	—
Net cash used in operating activities		**(695.5)**	(623.8)
Cash flows from investing activities			
Net investment in intangible assets		**(29.5)**	(26.9)
Purchase of fixed assets		**(10.2)**	(10.6)
Disposal of fixed assets		—	(0.2)
Net investment in securities		**(659.2)**	(956.5)
Proceeds from sale and redemption of securities		**900.5**	1,278.5
Movement in disposal group assets and liabilities		—	7.7
Net investment in credit card portfolio		—	(362.7)
Net cash flow from disposal of Church House Trust Limited		—	11.5
Net cash provided by/(used in) investing activities		**201.6**	(59.2)
Cash flows from financing activities			
Distributions to Tier 1 noteholders		**(12.6)**	(20.2)
Repayment of Non-core Tier 1 notes		—	(154.5)
Net proceeds from issue of debt securities		**1,047.2**	998.4
Repayments of debt securities in issue		**(601.9)**	(874.1)
Proceeds from issue of Additional Tier 1 securities (net)		—	156.5
Proceeds from issue of ordinary shares (net)		—	145.4
Purchase of own shares		**(5.0)**	—
Dividends paid to ordinary shareholders	11	**(6.2)**	—
Payment of additional Northern Rock consideration		—	(50.0)
Net cash provided by financing activities		**421.5**	201.5
Change in cash and cash equivalents		**(72.4)**	(481.5)
Cash and cash equivalents at beginning of year		**1,533.8**	2,015.3
Cash and cash equivalents at end of year	35(d)	**1,461.4**	1,533.8

The accompanying notes are an integral part of these consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1: BASIS OF PREPARATION

1.1 Reporting entity

Virgin Money Holdings (UK) plc (the Company) is a public limited company incorporated and registered in England and Wales. The registered office is Jubilee House, Gosforth, Newcastle-Upon-Tyne, NE3 4PL.

The Company was incorporated on 4 August 1995 as a private limited company with registered number 03087587. On 24 July 2014 the Company was re-registered as a public limited company.

The Company is the parent entity and the ultimate controlling party of the Virgin Money Group (the Group).

1.2 Basis of preparation

The Group consolidated financial statements, which should be read in conjunction with the Directors' Report, have been prepared on a going concern basis in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU and with those parts of the Companies Act 2006 applicable to companies reporting under IFRS.

The Directors have reviewed the strategic plan which shows the financial position, cash flow, liquidity and capital forecasts for the Group. The Directors are confident that the Group will have sufficient resources to meet its liabilities as they fall due. Accordingly the Directors believe that it remains appropriate to prepare the financial statements on a going concern basis.

1.3 Changes in accounting policy

New standards, amendments to standards and interpretations adopted

The following amendment to IFRS 13 is mandatory for annual reporting periods beginning on or after 1 January 2015, has been endorsed for adoption by the EU and has been adopted by the Group during the year ended 31 December 2015:

Pronouncement	Impact of change
Amendment to IFRS 13 'Fair value measurement'	The amendment clarifies that the portfolio exception in IFRS 13, which allows an entity to measure the fair value of a group of financial assets and financial liabilities on a net basis, applies to all contracts (including non-financial contracts) within the scope of IAS 39 or IFRS 9. This amendment did not have a significant impact on the Group when adopted.

There are no other standards, amendments to standards or interpretations that are applicable in the year which have a material impact on these financial statements.

New accounting standards issued by the IASB which are effective in future periods are presented in note 39.

1.4 Presentation of information

Presentation of risk disclosures

Disclosures under IFRS 7 'Financial Instruments: Disclosure' concerning the nature and extent of risks relating to financial instruments have been included within the audited sections of the Risk Management Report. Where marked as 'audited' these are covered by the Independent Auditor's Report.

1.5 Basis of consolidation

The Group consists of the Company and its subsidiaries. The subsidiaries are listed in note 3 of the parent company financial statements. The consolidated financial statements comprise the financial statements of the Group.

Entities are regarded as subsidiaries where the Group has the power over an investee, exposure or rights to variable returns from its involvement with the investee and the ability to affect those returns. Inter-company transactions and balances are eliminated upon consolidation. Subsidiaries are consolidated from the date on which control is transferred to the Group and are deconsolidated from the date that power over an investee, exposure or rights to variable returns and the ability to affect these returns ceases. Accounting policies are applied consistently across the Group.

The Virgin Money Foundation, launched in August 2015, is managed and controlled by a Board of independent Trustees, such that the Group has no power over the Foundation or, exposure or ability to affect variable returns. The Foundation is therefore not consolidated in the financial statements of the Group.

Special Purpose Vehicles (SPV) are entities created to accomplish a narrow and well defined objective. For the Group this is the securitisation of mortgage assets. An SPV is consolidated if the Group has control over the SPV, is exposed to rights of variable returns from its involvement in the SPV and has the ability to affect those returns through its power over the entity.

1.6 Basis of measurement

The financial statements have been prepared under the historical cost convention as modified by the revaluation of derivative financial instruments, available-for-sale and other assets held at fair value through profit or loss. A summary of the material accounting policies of the Group are included within note 1.9. Policies which are relevant to the financial statements as a whole are set out below.

The accounting policies set out in the note 1.9 have been applied consistently to all periods presented in these financial statements.

1.7 Client money

The Group's unit trust management and investment intermediary subsidiaries administer money on behalf of some clients in accordance with the Client Money Rules of the Financial Conduct Authority. Client money is not recognised in the balance sheet or in the notes to the financial statements as the Group is not the beneficial owner.

1.8 Foreign currency translation

The Group's financial statements are presented in sterling, which is the functional currency of the Company, all of its subsidiaries and the SPVs included within the consolidated financial statements.

Foreign currency transactions are translated into functional currency using the exchange rates prevailing at the dates of the transactions. Monetary items denominated in foreign currencies are translated at the rate prevailing at the balance sheet date. Foreign exchange gains and losses resulting from the restatement and settlement of such transactions are recognised in the income statement, except when recognised in other comprehensive income if relating to a qualifying cash flow hedge or available-for-sale assets. Non-monetary items (which are assets or liabilities which do not attach to a right to receive or an obligation to pay currency) measured at amortised cost and denominated in foreign currencies are translated at the exchange rate at the date of the transaction. Non-monetary items measured at fair value are translated at the exchange rate at the date of valuation. Where these are held at fair value through the income statement, exchange differences are reported as part of the fair value gain or loss.

1.9 Accounting policies

The accounting policies of the Group are set out below.

(a) Operating segments

The Group determines operating segments according to similar economic characteristics and the nature of its products and services in accordance with IFRS 8 'Operating Segments'. Management reviews the Group's internal reporting based around these segments in order to assess performance and allocate resources.

Segment performance is evaluated based on underlying profit or loss and is measured consistently with underlying profit or loss in the consolidated financial statements (income tax is unallocated). Segment results are regularly reviewed and reported to the Board of Directors to allocate resources to segments and to assess their performance.

Operating segments are reported in a manner consistent with the internal reporting provided to the Board. The Group Executive Committee (management) has been determined to be the chief operating decision maker for the Group.

(b) Interest income and expense

Interest income and expense are recognised in the income statement for all instruments measured at amortised cost using the effective interest rate method.

This method calculates the amortised cost of a financial asset or liability, and allocates the interest income or expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts or payments through the expected life of the financial instrument or, where appropriate, a shorter period to the net carrying amount of the financial asset or liability. The Group estimates cash flows considering all contractual terms of the financial instrument (for example prepayment options) but does not consider future credit losses. The calculation includes all amounts received or paid by the Group that are an integral part of the overall return, direct incremental transaction costs related to the acquisition or issue of a financial instrument and all other premiums and discounts.

Once a financial asset or group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

Interest receivable or payable on derivatives, whether in economic or accounting hedges, is recorded on an accruals basis in interest receivable or payable. Interest on available-for-sale (AFS) debt securities is recorded in interest receivable using the effective interest rate method.

(c) Fees and commissions

Where they are not included in the effective interest rate calculation, fees and commissions are recognised on an accruals basis when the service has been received or provided. Loan commitment fees for loans that are likely to be drawn down are deferred (together with related incremental direct costs) and recognised as an adjustment to the effective interest rate on the loan.

Fee income from general insurance and life insurance policies is recognised in full on the effective date of commencement or renewal of the related policies to reflect underlying contracts with product providers.

(d) Other operating income

Other operating income comprises the fair value for services, net of value added tax, rebates and discounts. Other operating income is attributable to the sale and management of stocks and shares ISAs, pensions, authorised unit trusts, the marketing of credit cards and other financial services products.

Other operating income from sales of units in managed funds is recognised daily based on the average volume of funds under management.

Fees charged to charities for registering with Virgin Money Giving are recognised from the date on which recovery is reasonably certain. The commission charged on donations and event fees is recognised from the date donations and event fees are transacted on the website. Both of these income streams contribute towards costs incurred by Virgin Money Giving.

Other income includes commission on donations, interest received from related parties and other sundry income.

The Group recognises ongoing credit card income from strategic partners as other income.

(e) Total operating expenses

Operating expenses are recognised on an accruals basis as services are provided. Included within the employee benefits expense are employee share based payments. The accounting policy in relation to share based payments is set out in policy (f).

Staff costs

The Group accounts for components of employee costs on the following bases:

- **Short-term employee benefits**

Short term employee benefits include salaries and social security costs and are recognised over the period in which the employees provide the services to which the payments relate.

Cash bonus awards are recognised to the extent that the Group has a present obligation to its employees that can be measured reliably and are recognised over the period of service that employees are required to work to qualify for the payment.

- **Other long-term employee benefits**

Other long-term employee benefits include deferred cash bonus awards. Deferred cash bonus awards are recognised at the present value of the obligation at the reporting date. These costs are recognised over the period of service that employees are required to work to qualify for the payment.

- **Retirement benefit obligations**

A defined contribution plan is a post-employment benefit plan into which the Group pays fixed contributions and has no legal or constructive obligation to pay further amounts. Contributions are recognised as staff expenses in profit or loss in the periods during which related employee services are fulfilled.

The Group operates defined contribution pension schemes for its Directors and employees. The assets of the schemes are held separately from those of the Group in independently administered funds.

The accounting policies for employee share based payments are set out in policy (f).

Leases

If the lease agreement in which the Group is a lessee transfers the risks and rewards of the asset, the lease is recorded as a finance lease and the related asset is capitalised. At inception, the asset is recorded at the lower of the present value of the minimum lease payments or fair value and is depreciated over the estimated useful life. The lease obligations are recorded as borrowings.

If the lease does not transfer the risks and rewards of the asset, the lease is recorded as an operating lease.

Operating lease payments are charged to profit or loss on a straight line basis over the lease term unless a different systematic basis is more appropriate. Where an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor in compensation is charged to profit or loss in the period in which termination is made.

(f) Share based payments

The Group puts in place share schemes for employees to reward strong long-term business performance and to incentivise growth for the future.

The Group engages in equity and cash settled share based payment transactions in respect of services received from certain of its employees.

For equity settled share based payment transactions the grant date fair value of the award is recognised as an employee expense with a corresponding increase in equity over the period that the employees become unconditionally entitled to the awards.

The grant date fair value of the award is determined using valuation models which take into account the terms and conditions attached to the awards. Inputs into valuation models may include the exercise price, the risk-free interest rate, the expected volatility of the Company's share price and other various factors which relate to performance conditions attached to the awards.

The amount recognised as an expense is adjusted to reflect the actual number of awards for which the related service and non-market vesting conditions are expected to be met such that the amount ultimately recognised as an expense is based on the number of awards that do meet the related service and non-market performance conditions at the vesting date.

For share based payment awards with market performance conditions or non-vesting conditions the grant date fair value of the award is measured to reflect such conditions and there is no true-up for differences between expected and actual outcomes.

For cash settled share based payment transactions the fair value of the amount payable to the employee is recognised as an expense with a corresponding increase in liabilities. The fair value is initially measured at grant date and spread over the period during which the employees become unconditionally entitled to payment. The fair value is measured based on a valuation model taking into account the terms and conditions of the grant. The liability is revalued at each balance sheet date and settlement date with any changes to fair value being recognised in profit or loss.

(g) Impairment losses

The Group assesses its financial assets or groups of financial assets for objective evidence of impairment at each balance sheet date. An impairment loss is recognised if a loss event (or events) has occurred after initial recognition, and on or before the balance sheet date, that has a reliably measurable impact on the estimated future cash flows of the financial assets or groups of financial assets. Losses incurred as a result of events occurring after the balance sheet date are not recognised in these financial statements.

- **Assets held at amortised cost**

The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. Objective evidence that a financial asset is impaired includes observable data that comes to the attention of the Group about the following loss events:

- there is evidence of the customer or issuer experiencing financial difficulty;
- there is a breach of contract, such as a default or delinquency in repayments;
- the customer is granted a concession that would otherwise not be considered;
- the borrower will enter bankruptcy or other financial reorganisation;
- the disappearance of an active market for that financial asset because of financial difficulties; and
- observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the portfolio, including:
- there are adverse changes in the payment status of borrowers in the portfolio; and
- economic conditions that correlate with defaults on the assets in the portfolio.

If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. In assessing collective impairment the Group uses statistical modelling of historic trends to assess the probability of a group of financial assets going into default and the subsequent loss incurred. Regular model monitoring is performed to ensure model assumptions remain appropriate.

Assets that are individually assessed and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss on loans and receivables has been incurred, the amount of the loss is measured as the difference between the asset carrying amount and the present value of the estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an impairment allowance and the amount of the loss is recognised in profit or loss.

When a loan or receivable is uncollectible, it is written off against the related provision for loan impairment. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off are recognised directly in the income statement. If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the customer's credit rating), the previously recognised impairment loss is reversed by adjusting the impairment allowance. The amount of the reversal is recognised in profit or loss.

A provision is also made in the case of accounts, which may not currently be in arrears, where losses may have been incurred but not yet recognised. An increased level of provision is held for accounts where an impairment trigger event has occurred which includes accounts benefiting from forbearance and those in arrears. Refer to page 156 of the Risk Management Report for details of the forbearance policy.

(h) Taxation

Taxation comprises current tax and deferred tax. Current tax and deferred tax are recognised in profit or loss except to the extent that they relate to items recognised directly in equity or other comprehensive income. Current tax is based on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years. The Group has adopted the Code of Practice on Taxation for Banks issued by HM Revenue and Customs.

Further disclosures relating to deferred tax are included in policy (s).

(i) Earnings per share

Basic earnings per share is calculated by dividing the profit attributable to ordinary shareholders of the parent company by the weighted-average number of ordinary shares outstanding during the period excluding own shares held in employee benefit trusts or held for trading.

The diluted earnings per share is calculated by adjusting the profit or loss that is attributable to ordinary shareholders and the weighted-average number of ordinary shares outstanding for the effects of all dilutive potential ordinary shares, which comprise share options granted to employees.

For the calculation of diluted earnings per share the weighted-average number of ordinary shares in issue is adjusted to assume conversion of all dilutive potential ordinary shares, if any, that arise in respect of share options and rewards granted to employees. The number of shares that could have been acquired at the average annual share price of the Company's shares based on the monetary value of the subscription rights attached to outstanding share options and awards is determined. This is deducted from the number of shares issuable under such options and awards to leave a residual bonus amount of shares which are added to the weighted-average number of ordinary shares in issue, but no adjustment is made to the profit attributable to equity shareholders.

(j) Financial instruments

- **Financial assets**

Financial assets can be classified in the following categories:

- loans and receivables;
- available-for-sale;
- held to maturity; or
- financial assets at fair value through profit or loss.

Management determines the classification of its financial instruments at initial recognition. The Group measures all of its financial liabilities at amortised cost, other than derivatives and those instruments which have been designated as part of a hedging relationship (refer policy (n)). Purchases and sales of financial assets at fair value through profit or loss, held to maturity and available-for-sale are recognised on the trade date, the date on which the Group commits to purchase or sell the asset.

- **Loans and receivables at amortised cost**

The Group's loans and advances to banks and customers and some investment securities are classified as loans and receivables. Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, whose recoverability is based solely on the credit risk of the customer and where the Group has no intention of trading the loan or receivable. Loans and receivables are initially recognised at fair value including direct and incremental transaction costs. Subsequent recognition is at amortised cost using the effective interest rate method, less any provision for impairment.

- **Available-for-sale financial assets**

Available-for-sale financial assets are non-derivative assets that are either designated as available-for-sale or are assets that do not meet the definition of loans and receivables and are not derivatives or assets held at fair value through profit or loss. These are principally but not exclusively investment securities intended to be held for an indefinite period of time which may be sold in response to a need for liquidity or changes in interest rates, exchange rates or equity prices. They are initially measured at fair value including direct and incremental transaction costs. Fair values are obtained from quoted market prices in active markets and, where these are not available, from valuation techniques including discounted cash flow models (refer to policy (m)). With the exception of unquoted equity instruments measured at cost less impairment because their fair value cannot be measured reliably, subsequent measurement is at fair value, with changes in fair value being recognised in other comprehensive income except for impairment losses and translation differences, which are recognised in profit or loss. Upon derecognition of the asset, or where there is objective evidence that the investment security is impaired, the cumulative gains and losses recognised in other comprehensive income are removed from other comprehensive income and recycled to profit or loss.

- **Held to maturity financial assets**

Held to maturity financial assets are non-derivative financial assets with fixed or determinable payments that the Group has the ability and intention to hold to maturity. They are initially measured at fair value including direct and incremental transaction costs. Subsequent measurement is at amortised cost using the effective interest rate method. No financial assets were classified as held to maturity during either the current or prior year.

- **Financial assets at fair value through profit or loss**

This category consists of derivative financial assets. Assets in this category are carried at fair value. The fair values of derivative instruments are calculated by discounted cash flow models using yield curves that are based on observable market data or are based on valuations obtained from counterparties. Gains and losses arising from the changes in the fair values are recognised in profit or loss.

The fair values of quoted investments in active markets are based on current bid prices. If the market for a financial asset is not active (and for unlisted securities), the Group establishes fair value using valuation techniques. These include the use of recent arm's length transactions, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants.

- **Financial liabilities**

Borrowings, including deposits and debt securities in issue are recognised initially at fair value, being the issue proceeds net of premiums, discounts and transaction costs incurred. All borrowings are subsequently measured at amortised cost using the effective interest rate method. Amortised cost is adjusted for the amortisation of any premiums, discounts and transaction costs. The amortisation is recognised in interest expense and similar charges using the effective interest rate method. The Group does not hold any financial liabilities classified as held for trading.

- **Offsetting financial instruments**

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

- **Sale and repurchase agreements**

Securities sold subject to repurchase agreements (repos) are reclassified in the financial statements as assets pledged when the transferee has the right by contract or custom to sell or repledge the collateral. The counterparty liability is included in amounts due to other banks, deposits from banks, other deposits or deposits due to customers, as appropriate. Securities purchased under agreements to resell (reverse repos) are recorded as loans and advances to banks or customers as appropriate. The difference between sale and repurchase price is treated as interest and accrued over the life of the agreements using the effective interest rate method. Securities lent to counterparties are also retained in the financial statements.

- **Derecognition of financial assets and liabilities**

Derecognition is the point at which the Group removes an asset or liability from its balance sheet. The Group's policy is to derecognise financial assets only when the contractual right to the cash flows from the financial asset expires or when the Group transfers the financial assets to another party provided the transfer of the asset also transfers the right to receive the cash flows of the financial asset or where the Group has transferred substantially all the risks and rewards of ownership. Where the transfer does not result in the Group transferring the right to receive the cash flows of the financial assets, but it does result in the Group assuming a corresponding obligation to pay the cash flows to another recipient, the financial assets are also accordingly derecognised. The Group derecognises financial liabilities only when the obligation specified in the contract is discharged, converted to shares, cancelled or has expired or is transferred to a third party. There were no transactions in the year where the Group transferred financial assets that should have been derecognised in their entirety.

(k) Loans and advances to banks

The Group's loans and advances to banks are classified as loans and receivables.

(l) Loans and advances to customers

The Group's loans and advances to customers are classified as loans and receivables.

Further details of the application of the effective interest rate method are included in policy (b) and provision for impairment in policy (g).

(m) Available-for-sale financial assets

Debt securities are designated as either available-for-sale or loans and receivables. Debt securities are principally available-for-sale as they are intended to be held for an indefinite period of time but may be sold in response to a need for liquidity or changes in interest rates, exchange rates or equity prices. Debt securities classified as loans and receivables are asset backed securities for which there is no active market.

The Group's debt securities, treasury bills and equity instruments are classified as available-for-sale assets. For available-for-sale financial assets, the Group assesses at each balance sheet date whether there is objective evidence that a financial asset, or group of financial assets are impaired. The amount of the loss is measured as the difference between the asset's acquisition cost less principal repayments and amortisation and the current fair value. The amount of the impairment loss is recognised in profit or loss. This includes cumulative gains and losses previously recognised in other comprehensive income which are recycled from other comprehensive income to the income statement. If, in a subsequent period, the fair value of an instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through profit or loss.

(n) Derivative financial instruments and hedge accounting

The Group is authorised to undertake the following types of derivative financial instrument transactions for non-trading purposes: cross currency swaps, interest rate swaps, equity swaps, interest rate caps, forward rate agreements, options, foreign exchange contracts and similar instruments.

The Group's derivative activities are entered into for the purpose of matching or eliminating risk from potential movements in interest rates, foreign exchange rates and equity exposures inherent in the Group's assets, liabilities and positions. All derivative transactions are for economic hedging purposes and it is decided at the outset which position the derivative will be hedging. Derivatives are reviewed regularly for their effectiveness as hedges and corrective action taken, if appropriate. Derivatives are measured initially at fair value and subsequently remeasured to fair value. Fair values are obtained from quoted market prices in active markets and, where these are not available, from valuation techniques including discounted cash flow models and option pricing models. Where derivatives are not designated as part of a hedging relationship, changes in fair value are recorded in the income statement. Where derivatives are designated within hedging relationships, the treatment of the changes in fair value depends on the nature of the hedging relationship as explained below.

Hedge accounting is used for derivatives designated in this way provided certain criteria are met. The Group documents at the inception of the hedge relationship the link between the hedging instrument and the hedged item as well as its risk management objective and strategy for undertaking various hedge transactions. The Group also documents its assessment both at hedge inception and on an ongoing basis of whether the derivatives used in hedging transactions are highly effective in offsetting changes in the fair values or cash flows of hedged items. The Group designates certain derivatives as either:

- **Cash flow hedges**

A cash flow hedge is used to hedge exposures to variability in cash flows, such as variable rate financial assets and liabilities. The effective portion of changes in the derivative fair value is recognised in other comprehensive income, and recycled to the income statement in the periods when the hedged item will affect profit and loss. Interest rate derivatives designated as cash flow hedges primarily hedge the exposure to cash flow vulnerability from forecast loans and advances to customers. The fair value gain or loss relating to the ineffective portion is recognised immediately in profit or loss.

- **Fair value hedges**

A fair value hedge is used to hedge exposures to variability in the fair value of financial assets and liabilities, such as fixed rate loans. Changes in 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. If the hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of the hedged item is amortised to the income statement over the period to maturity.

The most frequently used fair value hedges are:

- hedging the interest rate risk of a portfolio of prepayable fixed rate assets with interest rate derivatives. This solution is used to establish a macro fair value hedge for derivatives hedging fixed rate mortgages;
- hedging the interest rate risk of a portfolio of fixed rate liabilities with interest rate derivatives. This solution is used to establish a macro fair value hedge for derivatives hedging fixed rate savings;
- hedging the interest rate risk of a portfolio of non-prepayable fixed rate assets with interest rate derivatives. This solution is used to establish a macro fair value hedge for fixed rate investments; and
- hedging the interest rate and foreign currency exchange risk of non-prepayable, foreign currency denominated fixed rate assets or liabilities on a one-for-one basis with fixed/floating or floating/fixed cross currency interest rate swaps.

(o) Securitisation transactions

Certain Group companies have issued debt securities in order to finance specific loans and advances to customers. Both the debt securities in issue and the loans and advances to customers remain on the Group balance sheet within the appropriate balance sheet headings unless:

- a fully proportional share of all or of specifically identified cash flows have been transferred to the holders of the debt securities, in which case that proportion of the assets are derecognised;
- substantially all the risks and rewards associated with the assets have been transferred, in which case the assets are fully derecognised; and
- a significant proportion of the risks and rewards have been transferred, in which case the assets are recognised only to the extent of the Group's continuing involvement.

The Group has also entered into self-issuance of securitised debt which may be used as collateral for repurchase or similar transactions. Investments in self-issued debt and the equivalent deemed loan, together with the related income, expense and cash flows, are eliminated on consolidation in the financial statements.

- **Debt securities in issue**

Issued securities are classified as liabilities where the contractual arrangements result in the Group having an obligation to deliver either cash or another financial asset to the security holder, or to exchange financial instruments under conditions that are potentially unfavourable to the Group. Issued securities are classified as equity where they meet the definition of equity and confer a residual interest in the Group's assets on the holder of the securities.

Financial liabilities are carried at amortised cost using the effective interest rate method (see policy (j)). Equity instruments are initially recognised at net proceeds, after deducting transaction costs and any related income tax. Appropriations to holders of equity securities are deducted from equity, net of any related income tax, as they become irrevocably due to the holders of the securities.

Securitisation is a means used by the Group to fund an element of its mortgage portfolio. These securitised advances are subject to non-recourse finance arrangements. These advances have been transferred at their principal value to Special Purpose Vehicles (SPV) and have been funded through the issue of amortising mortgage backed securities to investors.

As discussed in note 1.5, the Group controls the securitisation SPVs and therefore consolidates the assets and liabilities of the securitisation SPVs, on a line by line basis.

(p) Business combinations

Business combinations are accounted for using the acquisition method as at the acquisition date, being when control is transferred to the Group. Control is having the power over an investee, exposure or rights to variable returns from its involvement with the investee and the ability to use its power to affect those returns.

The Group measures goodwill at the acquisition date as the fair value of the consideration transferred less the fair value of the net identifiable assets acquired and liabilities assumed.

When the excess is negative, the negative goodwill is recognised immediately in profit or loss.

The consideration transferred does not include amounts related to the settlement of pre-existing relationships. Such amounts are generally recognised in profit or loss.

Transaction costs, other than those associated with the issue of debt or equity securities, that the Group incurs in connection with a business combination are expensed as incurred.

Any contingent consideration payable is measured at fair value at the acquisition date. If the contingent consideration is classified as equity, then it is not remeasured and settlement is accounted within equity. Otherwise, subsequent changes in the fair value of the contingent consideration are recognised in profit or loss.

(q) Intangible assets and amortisation

Intangible assets purchased separately from a business combination are capitalised at their cost and amortised from the date from which they become available for use over their useful economic life which is generally 3 to 10 years. Intangible assets acquired as part of an acquisition are capitalised at their fair value where this can be measured reliably in accordance with IFRS 13 'Fair Value Measurement'.

Expenditure incurred in relation to scoping, planning and researching the build of an asset as part of a project is expensed as incurred.

Development expenditure incurred on a project is capitalised only if the following criteria are met:

- an asset is created that can be identified;
- it is probable that the asset created will generate future economic benefits; and
- the development cost of the asset can be measured reliably.

Following the initial recognition of development expenditure, the cost is amortised over the estimated useful lives of the assets created. Amortisation commences on the date that the asset is brought into use.

Internally generated intangible assets relate to computer software and core banking platforms.

- **Computer software**

Costs incurred in acquiring and developing computer software for internal use are capitalised as intangible assets where the software leads to the creation of an identifiable non-monetary asset and it is probable that the expected future economic benefits that are attributable to the asset will flow to the Group from its use for a period of over one year. The software is classified as an intangible asset where it is not an integral part of the related hardware and amortised over its estimated useful life on a straight line basis which is generally 3 to 10 years.

Costs associated with maintaining software are expensed as they are incurred.

- **Core deposit intangible**

The core deposit intangible was recognised on acquisition of Northern Rock plc (now renamed Virgin Money plc). It was recognised in respect of the intrinsic value of the retail savings book acquired. This will be amortised over its remaining useful life of one year.

- **Goodwill**

Purchased goodwill (representing the excess of the fair value of the consideration given over the fair value of the separable net assets acquired) arising on business combinations in respect of acquisitions since 1 January 1998 is capitalised.

Positive goodwill is held on the balance sheet and tested for impairment annually.

- **Core banking platforms**

Core banking platforms primarily represent the construction of core operating platforms, which are internally generated. Core banking platforms are amortised on a straight line basis over 3 to 10 years.

- **Impairment of intangible assets**

Intangible assets are assessed for indications of impairment at each balance sheet date, or more frequently where required by events or changes in circumstances. If indications of impairment are found, these assets are subject to an impairment review. The impairment review compares the carrying value of the assets with their recoverable amounts, which are defined as the higher of the fair value less costs to sell and their value in use. Fair value less costs to sell is the amount at which the asset could be sold in a binding agreement in an arm's length transaction. Value in use is calculated as the discounted cash flows generated as a result of the asset's continued use including those generated by its ultimate disposal, discounted at a market rate of interest on a pre-tax basis.

Where impairments are indicated, the carrying values of intangible assets are written down by the amount of the impairment and the charge is recognised in the income statement in the period in which it occurs. A previously recognised impairment charge on a fixed asset may be reversed in full or in part where a change in circumstances leads to a change in the estimates used to determine its recoverable amount. The carrying value of the intangible asset will only be increased to the carrying value at which it would have been held had the impairment not been recognised.

(r) Tangible fixed assets and depreciation

Tangible fixed assets are stated at cost less accumulated depreciation and provision for impairment, as appropriate. Cost includes the original purchase price of the asset and the costs attributable to bringing the asset to its working condition for its intended use. Additions and subsequent expenditure are included in the asset's carrying value or are recognised as a separate asset only when they improve the expected future economic benefits to be derived from the asset. All other repairs and maintenance are charged to the income statement in the period in which they are incurred.

Depreciation is provided using the straight line method to allocate costs less residual values over estimated useful lives, as follows:

Freehold property	50–100 years
Leasehold property	Unexpired period of the lease
Plant and leasehold improvements	5–30 years
Computer equipment	3–5 years
Office equipment	3–10 years
Motor vehicles	4 years

The residual values and useful lives of assets are reviewed, and adjusted if appropriate, at each balance sheet date. Where the cost of freehold land can be identified separately from buildings, the land is not depreciated. Tangible fixed assets are subject to impairment testing, as appropriate.

- **Impairment of tangible fixed assets**

Tangible fixed assets are assessed for indications of impairment at each balance sheet date, or more frequently where required by events or changes in circumstances. If indications of impairment are found, these assets are subject to an impairment review. The impairment review compares the carrying value of the assets with their recoverable amount, which are defined as the higher of the fair value less costs to sell and their value in use. Fair value less costs to sell is the amount at which the asset could be sold in a binding agreement in an arm's length transaction. Value in use is calculated as the discounted cash flows generated as a result of the asset's continued use including those generated by its ultimate disposal, discounted at a market rate of interest on a pre-tax basis.

Where impairments are indicated, the carrying values of fixed assets are written down by the amount of the impairment and the charge is recognised in the income statement in the period in which it occurs. A previously recognised impairment charge on a fixed asset may be reversed in full or in part where a change in circumstances leads to a change in the estimates used to determine its recoverable amount. The carrying value of the fixed asset will only be increased to the carrying value at which it would have been held had the impairment not been recognised.

(s) Deferred tax

Deferred tax is recognised in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

Deferred tax assets are recognised for unused tax losses, tax credits and deductible temporary differences, to the extent that it is probable that future taxable profits will be available against which they can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

(t) Other assets

Other assets include prepayments and other amounts the Group is due to receive from third parties in the normal course of business.

(u) Deposits from banks

Deposits by banks are initially measured at fair value, which is normally the proceeds received net of any directly attributable transaction costs incurred. Subsequent measurement is at amortised cost, using the effective interest rate method.

(v) Customer deposits

Customer deposits are initially measured at fair value, which is normally the proceeds received. Subsequent measurement is at amortised cost, using the effective interest rate method.

(w) Provisions

Provisions are recognised for present obligations arising from past events where it is more likely than not that an outflow of resources will be required to settle the obligations and they can be estimated reliably.

A provision for bank levies is recognised when the condition that triggers the payment of the levy is met. If a levy obligation is subject to a minimum activity threshold so that the obligating event is reaching a minimum activity, then a provision is recognised when that minimum activity threshold is reached.

(x) Other liabilities

Deferred income represents amounts received in advance of the Group providing services, and will be recognised as income in profit or loss when the services have been provided.

Other creditors represent amounts the Group is due to pay to third parties in the normal course of business. These include expense accruals, which have been incurred, but not yet billed.

Accrued expenses are amounts that the Group is due to pay to third parties in the normal course of business.

(y) Share capital and share premium

- **Share capital**

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:

- 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
- 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.

- **Share issue costs**

Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction, net of tax, from the proceeds.

- **Dividends and appropriations**

Dividends are recognised in equity in the period in which they are approved by the Company's shareholders or paid.

- **Share premium**

Share premium substantially represents the aggregate of all amounts that have ever been paid above par value to the Company when it has issued ordinary and non-voting Ordinary Shares. Certain expenses in relation to the issue of share capital can be offset against the share premium account. These expenses must be the incremental expenses arising on issue of the shares.

(z) Other equity instruments

Issued financial instruments are recognised as equity where there is no contractual obligation to deliver either cash or another financial asset. The proceeds are included in equity, net of transaction costs. Dividends and other returns to equity holders are treated as a deduction from equity.

(aa) Other reserves

- **Available-for-sale reserve**

The available-for-sale reserve represents the unrealised change in the fair value of available-for-sale investments since initial recognition.

- **Cash flow hedge reserve**

For derivatives designated in a cash flow hedge, the effective portion of changes in fair value is recognised in the cash flow hedge reserve and recycled to profit or loss in the periods when the hedged item will affect profit or loss.

(ab) Contingent liabilities

Contingent liabilities are possible obligations whose existence depends upon the outcome of uncertain future events or are present obligations where the outflows of resources are uncertain or cannot be reliably measured. Contingent liabilities are not recognised in the financial statements but are disclosed unless they are remote.

(ac) Fair value of financial assets and liabilities

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 in the principal, or in its absence, the most advantageous market to which the Group has access at that date. The fair value of a liability reflects its non-performance risk.

For the majority of instruments, fair value is determined with reference to quoted prices in an active market. A market is regarded as active if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

Refer to note 34 for a description of different levels within the fair value hierarchy. Levels are reviewed at each balance sheet date and this determines where transfers between levels are required.

Where quoted prices are not available, fair value is based upon cash flow models, which use wherever possible independently sourced observable market parameters such as interest rate yield curves, currency rates and option volatilities. The chosen valuation technique incorporates all the factors that market participants would take into account in pricing a transaction and is discounted at a risk free rate.

The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price—i.e. the fair value of consideration given or received. The Group does not apply a credit valuation adjustment (CVA) or debit valuation adjustment (DVA) to reflect the credit risk of its derivative exposures as the Group's portfolio is fully collateralised.

If an asset or a liability measured at fair value has a bid price and an ask price, the Group measures assets and long positions at bid price and liabilities and short positions at an ask price.

Portfolios of financial assets and financial liabilities that are exposed to market risk and credit risk that are managed by the Group on the basis of the net exposure to either market or credit risk, are measured on the basis of a price that would be received to sell a net long position (or transferred to sell a net short position) for a particular risk exposure. Those portfolio risk adjustments are allocated to the individual assets and liabilities on the basis of the relative risk adjustment of each of the individual instruments in the portfolio.

1.10 Critical estimates and judgements

The preparation of financial statements in conformity with IFRS requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the reporting period. Although these estimates are based on management's best knowledge of the amount, actual results ultimately may differ from those estimates.

The areas involving a higher degree of judgement or complexity, or where assumptions and estimates are significant to the 2015 financial statements were as follows:

(a) Effective interest rates

IAS 39 requires interest earned from mortgages and credit cards to be measured under the effective interest rate method. Management must therefore use judgement to estimate the expected life of each instrument and hence the expected future cash flows relating to it. The accuracy of the effective interest rate would therefore be affected by unexpected market movements resulting in altered customer behaviour, inaccuracies in the models or incorrect assumptions.

If the estimated life of secured loans were increased or reduced by one month, the value of such loans on the balance sheet would be increased or decreased by £3.6 million (2014: £2.5 million) and £3.7 million (2014: £2.6 million) respectively.

If the estimated life of credit cards were increased or reduced by one month, the value of such assets on the balance sheet would be increased or decreased by £1.1 million (2014: £0.6 million) and £1.1 million (2014: £0.5 million) respectively.

(b) Impairment of loans and receivables

Individual impairment losses on secured loans and advances are calculated based on an individual valuation of the underlying asset. Collective impairment losses on loans and advances are calculated using a statistical model.

The key assumptions used in the model are the probability of default; the probability of this default resulting in possession and/or write off; and the subsequent loss incurred. These key assumptions are monitored regularly to ensure the impairment allowance is entirely reflective of the current portfolio.

The accuracy of the impairment calculation would therefore be affected by unanticipated changes to the economic environment and assumptions which differ from actual outcomes. For mortgage loan receivables to the extent that:

- the loss given default differs by +/– 10%, for example if the loss given default is 10% then it is increased to 11%, the impairment allowance would be an estimated £0.3 million (2014: £0.2 million) higher or £0.3 million (2014: £0.2 million) lower respectively;
- the level of house prices differs by +/– 10%, for example a property value of £100,000 is increased to £110,000, the impairment allowance would be an estimated £1.3 million (2014: £0.7 million) lower or £3.0 million (2014: £3.4 million) higher respectively;
- the emergence period of 6 months differs by +/– 3 months, the impairment allowance would be an estimated £0.2 million (2014: £0.1 million) higher or £0.2 million (2014: £0.1 million) lower respectively.

For credit card receivables, to the extent that the loss given default differs by +/– 10%, the impairment allowance would be an estimated £2.9 million (2014: £2.7 million) higher or £2.9 million (2014: £2.7 million) lower respectively, and to the extent the emergence period of 6 months differs by +/–3 months, the impairment allowance would be an estimated £3.8 million (2014: £2.0 million) higher or £3.8 million (2014: £2.0 million) lower respectively.

(c) Capitalisation and impairment of intangibles

Intangibles are initially recognised when they are separable or arise from contractual or other legal rights, the cost can be measured reliably and, in the case of intangible assets not acquired in a business combination, where it is probable that future economic benefits attributable to the assets will flow from their use. Management review and monitor the capitalisation of significant project development costs on a regular basis to ensure that they meet the recognition criteria for capitalisation of an intangible asset and to ensure the costs are directly attributable to the individual projects where an asset is under construction. A review of capitalisation of intangibles has been undertaken to ensure these conditions have been met.

A review of intangible assets which are not yet in use for indications of impairment is undertaken at each reporting date. If there are indicators of impairment, an estimate of the recoverable amount is made. The recoverable amount of the asset is the higher of its fair value less costs to sell and its value in use. Value in use is calculated by discounting the future cash flows (both costs to complete and benefits post completion) generated from the continuing use of the asset. If the carrying value of the asset is less than the greater of the value in use and the fair value less costs to sell, an impairment charge is recognised.

Through their assessment of intangible assets and review for impairment indicators Management have not identified any assets that have an impairment, therefore a £nil impairment charge has been recognised (2014: £nil).

(d) Deferred tax

Taxation involves estimation techniques to assess the liability in terms of possible outcomes. The assessment of the recoverability or otherwise of deferred tax assets is based mainly on a determination of whether the relevant entity will generate sufficient profits within 5 years to realise the deferred tax assets.

This is reviewed at each reporting date by the Directors with a detailed exercise conducted to establish the validity of profit forecasts and other relevant information including timescales over which the profits are expected to arise and the deferred tax assets will reverse. Deferred tax is determined using tax rates that have been enacted or substantially enacted by the balance sheet date and which are expected to apply when the related deferred tax assets are realised or the deferred tax liabilities are settled.

The judgement required in the assessment of whether to recognise deferred tax assets is set out in policy (s). A deferred taxation asset in respect of the subsidiary Virgin Money plc was not recognised at acquisition on 1 January 2012 but subsequently recognised because in the period since acquisition, Management have taken certain actions to have greater certainty about the profitability going forward.

Based on their interpretation of the timing and level of reversal of existing taxable temporary differences, in line with relevant accounting standards, the Directors conclude that a net deferred tax asset of £38.0 million (2014: £50.2 million) should be recognised at the balance sheet date.

(e) Fair value of financial assets and liabilities

Management must use judgement and estimates calculating fair value where not all necessary inputs are observable or where factors specific to the Group's holdings need to be considered. The accuracy of the fair value calculations would therefore be affected by unexpected market movements, inaccuracies within the models used compared to actual outcomes and incorrect assumptions. For example, if Management were to use a tightening in the credit spread of ten basis points, the fair values of liabilities (including derivatives) would increase from the reported fair values by £25.7 million (2014: £23.3 million).

Estimates and judgements significant to the 2014 financial statements

The following were considered as estimates and judgements significant to the financial statements for the year ended 31 December 2014:

- **Fair value of share based payments**

The fair values of share awards granted in 2014 were calculated using statistical models, requiring application of management judgement on the inputs to these models. The nature of schemes with awards granted in 2015 are such that there is a reduced degree of judgement and complexity in calculations for the 2015 financial statements.

- **Tax uncertainty**

The degree of judgement and uncertainty involved in determining the Group's provision for income taxation, deferred taxation assets and liabilities and potential taxation liabilities was more significant in 2014. The ultimate outcome of certain tax matters is considered more certain.

- **Disposal group classification and measurement**

The Group fully disposed of its interests in Church House Trust (CHT) on 30 November 2014 and there are no disposal group assets or liabilities recognised at 31 December 2014 or 31 December 2015.

- **Provisions and contingent liabilities**

Provision values and determining whether to recognise contingent liabilities are both based on the best information available at the reporting date, and the degree of judgement and uncertainty is not considered as significant as in 2014.

- **Additional Northern Rock consideration**

The final payment to HM Treasury in respect of additional consideration of £50.0 million was made in 2014. With no further payments to come, no estimation uncertainty exists.

Additional information on the above estimates and judgements is provided in the Virgin Money Group Annual Report and Accounts 2014.

NOTE 2: OPERATING SEGMENTS

Segmental reporting

For Management reporting purposes, the Group is organised into the following business groupings:

- Mortgages and savings;
- Credit cards;
- Current accounts, insurance and investments; and
- Central functions.

These business groupings reflect how the Executive assesses performance and makes decisions regarding the allocation of resources to the business on the basis of product and customers. Internal and external sources of revenue are allocated to the appropriate business segment.

Mortgages and savings

Mortgage products include Residential and Buy-to-Let mortgages. The Group also participates in the Help to Buy Scheme and the Help to Buy Equity Loan Scheme. The savings products currently include ISAs, easy access and fixed term accounts.

Credit cards

The Credit Card business was previously delivered through a successful partnership with MBNA. In March 2015 the Group successfully migrated over 675,000 customer accounts to its own platform. This resulted in an in-house capability to issue credit cards and manage the portfolio. The Group's credit card manufacturing capability was developed in partnership with leading credit card systems provider TSYS.

The capability of the new platform allows the Group to respond to market conditions more quickly and better align products to customer needs. The Group will continue its presence in the balance transfer market and further diversify the product range.

Current accounts, insurance and investments

Current accounts, insurance and investments include current accounts and other financial products. Other financial products are those offered beyond the core products of savings, mortgages and credit cards and include investments, international money transfers, travel money, pensions, life insurance, travel insurance, home insurance, motor insurance and pet insurance.

Central functions

Central functions provide shared support services to each of the Group's business lines and Virgin Money Giving (VMG). These services include information technology and property along with central services such as Risk, Finance, Human Resources and Management. It is not the policy of the Group to allocate the cost of these shared services to each business line. All depreciation and amortisation is allocated to the central functions business line.

The Group does not manage Treasury as a profit centre, and so the interest expense incurred from its Group funding and liquidity operations has been allocated to the other business lines. Treasury is not engaged in trading activities. Central functions segment assets and liabilities includes fixed assets and treasury assets and liabilities.

Due to the nature of the Group's operations there are no inter-segmental transactions.

	Mortgages and savings	Credit cards	Current accounts, insurance and investments	Central functions	Underlying basis total
	£ million	£ million	£ million	£ million	£ million
Year ended 31 December 2015					
Net interest income	**358.5**	**97.6**	—	—	**456.1**
Other income	**2.5**	**18.0**	**36.6**	**9.9**	**67.0**
Total underlying income	**361**	**115.6**	**36.6**	**9.9**	**523.1**
Total costs	**(92.7)**	**(37.1)**	**(16.7)**	**(186.0)**	**(332.5)**
Impairment	**(3.0)**	**(27.3)**	—	—	**(30.3)**
Underlying profit/(loss) before tax	**265.3**	**51.2**	**19.9**	**(176.1)**	**160.3**
Segment assets	**25,457.9**	**1,585.2**	**2.3**	**3,183.6**	**30,229.0**
Segment liabilities	**25,063.3**	**4.0**	**235.5**	**3,585.9**	**28,888.7**

	Mortgages and savings	Credit cards	Current accounts, insurance and investments	Central functions(1)	Underlying basis total
	£ million	£ million	£ million	£ million	£ million
Year ended 31 December 2014					
Net interest income	291.0	75.1	—	—	366.1
Other income	3.1	25.2	32.8	11.0	72.1
Total underlying income	294.1	100.3	32.8	11.0	438.2
Total costs	(85.7)	(40.5)	(13.5)	(177.9)	(317.6)
Impairment	(1.2)	(14.6)	—	—	(15.8)
Underlying profit/(loss) before tax	207.2	45.2	19.3	(166.9)	104.8
Segment assets	22,005.6	1,112.8	3.6	3,414.8	26,536.8
Segment liabilities	22,322.6	4.8	202.5	2,763.1	25,293.0

(1) The FSCS Levy was previously excluded from underlying performance measures, but is now included in central functions as it is considered to be a recurring cost to the Group.

Reconciliation of statutory results to underlying basis

The underlying basis is the basis on which financial information is presented to the chief operating decision maker which excludes certain items included in the statutory results. The table below reconciles the statutory results to the underlying basis.

		Adjusted for					
					Costs associated with listing		
	Virgin Money Group statutory	Compensation for senior leavers	Strategic items	Fair value adjustments	Share based payments	Fees associated with listing	Underlying basis total
	£ million	£ million	£ million	£ million	£ million	£ million	£ million
Year ended 31 December 2015							
Net interest income	**454.8**	—	—	**1.3**	—	—	**456.1**
Other income	**67.1**	—	—	**(0.1)**	—	—	**67.0**
Total income	**521.9**	—	—	**1.2**	—	—	**523.1**
Total operating expenses	**(353.6)**	**3.7**	**7.4**	**(0.5)**	**10.5**	—	**(332.5)**
Profit before tax from operating activities	**168.3**	**3.7**	**7.4**	**0.7**	**10.5**	—	**190.6**
Impairment	**(30.3)**	—	—	—	—	—	**(30.3)**
Profit before tax	**138.0**	**3.7**	**7.4**	**0.7**	**10.5**	—	**160.3**

		Adjusted for				
				Costs associated with listing		
	Virgin Money Group statutory	Strategic items	Fair value adjustments	Share based payments	Fees associated with listing	Underlying basis total[(1)]
	£ million	£ million	£ million	£ million	£ million	£ million
Year ended 31 December 2014						
Net interest income	367.3	—	(1.2)	—	—	366.1
Other income	71.0	—	1.1	—	—	72.1
Total income	438.3	—	(0.1)	—	—	438.2
Total operating expenses	(351.5)	9.0	1.0	11.3	12.6	(317.6)
Profit before tax from operating activities	86.8	9.0	0.9	11.3	12.6	120.6
Impairment	(15.8)	—	—	—	—	(15.8)
Gain on sale of subsidiary	4.5	(4.5)	—	—	—	—
Additional Northern Rock consideration	(36.0)	36.0	—	—	—	—
Premium on repurchase of Non-core Tier 1 notes	(4.5)	4.5	—	—	—	—
Loss for the year of disposal group	(1.0)	1.0	—	—	—	—
Profit before tax	34.0	46.0	0.9	11.3	12.6	104.8

(1) The FSCS Levy was previously excluded from underlying performance measures, but is now included in central functions as it is considered to be a recurring cost to the Group.

Geographical areas

As the Group's operating activities are exclusively in the UK, further analysis is not provided.

NOTE 3: NET INTEREST INCOME

Net interest income comprises:

	2015 £ million	2014[1] £ million
Interest and similar income:		
Loans and advances to customers	**822.4**	751.8
Loans and advances to banks	**2.4**	1.7
Debt securities held as loans and receivables	**—**	0.1
Interest receivable on loans and receivables	**824.8**	753.6
Available-for-sale financial assets	**10.5**	11.5
Cash and balances at central banks	**4.0**	5.9
Other interest	**—**	0.6
Total interest and similar income	**839.3**	771.6
Interest and similar expense:		
Deposits from banks including liabilities under sale and repurchase agreements	**(6.8)**	(3.3)
Customer deposits	**(342.7)**	(373.3)
Debt securities in issue	**(29.0)**	(23.6)
Other	**(6.0)**	(4.1)
Total interest and similar expense	**(384.5)**	(404.3)
Net interest income	**454.8**	367.3

(1) Items within interest income and expense have been reclassified to better reflect the interest bearing assets and liabilities to which they relate.

Interest accrued on individually impaired assets was £6.8 million (2014: £6.8 million).

NOTE 4: NET FEE AND COMMISSION INCOME

Net fee and commission income comprises:

	2015 £ million	2014 £ million
Fee and commission income:		
On loans and advances to customers	**21.0**	28.9
Other fee and commission income	**6.4**	6.2
Total fee and commission income	**27.4**	35.1
Fee and commission expense:		
Other fee and commission expense	**(1.2)**	(1.1)
Net fee and commission income	**26.2**	34.0

NOTE 5: OTHER OPERATING INCOME

Other operating income comprises:

	2015 £ million	2014 £ million
Investment income	**31.5**	28.7
Gain on sale of available-for-sale assets (refer note 16)	**8.8**	7.5
Other	**1.0**	0.7
Total other operating income	**41.3**	36.9

Total other operating income is derived in the United Kingdom and relates to trade with third parties and continuing operations.

NOTE 6: TOTAL OPERATING EXPENSES

Total operating expenses comprise:

	2015 £ million	2014 £ million
Staff costs		
Salaries	**138.9**	125.6
Social security costs	**16.2**	14.3
Other pension costs	**10.6**	9.6
Employee share option schemes	**20.0**	13.5
	185.7	163
Premises and equipment		
Hire of equipment	**4.6**	4.8
Rent and rates	**9.0**	8.5
	13.6	13.3
Other expenses		
Marketing costs	**22.3**	16.5
FSCS levy	**12.5**	16.4
Professional fees	**10.7**	8.5
Other	**89.2**	106.4
	134.7	147.8
Depreciation and amortisation		
Depreciation of tangible fixed assets	**8.4**	8.0
Amortisation of intangible assets	**11.2**	6.8
	19.6	14.8
Total other operating expenses	**353.6**	338.9
Fees associated with listing	**—**	12.6
Total operating expenses	**353.6**	351.5

Average headcount

The monthly average number of persons (including Directors) employed by the Group was as follows:

	2015	2014
Full time	**2,359**	2,244
Part time	**699**	660
Total	**3,058**	2,904

Retirement benefit obligations

The Group operates defined contribution pension schemes for its Directors and employees. The assets of the schemes are held separately from those of the Group in independently administered funds.

The Group made contributions of £10.5 million (2014: £9.6 million) during the year. There were no contributions overdue at the year end (2014: £nil).

Fees payable to the auditor

During the year the Group obtained the following services from the Group's auditor as detailed below:

	2015 £ million	2014 £ million
Fees payable for the audit of the current year annual report and accounts	**0.3**	0.2
Fees payable for other services:		
Audit of the subsidiaries pursuant to legislation	**0.6**	0.7
Total audit fees	**0.9**	0.9
Audit-related assurance services	**0.2**	0.2
Total audit and audit-related fees	**1.1**	1.1
Services relating to taxation:		
Taxation services	—	0.2
Total taxation related fees	—	0.2
Other non-audit fees:		
Services relating to corporate finance transactions	—	1.3
Other assurance services	**0.2**	0.7
Total other non-audit fees	**0.2**	2.0
Total fees payable to the auditor by the Group	**1.3**	3.3

All amounts are shown exclusive of VAT.

The following types of services are included in the categories listed above:

Audit and audit-related fees

This category includes fees in respect of the audit of the Group's annual financial statements and other services in connection with regulatory filings and services for assurance and related services that are reasonably related to the performance of the audit or review of the financial statements.

Other non-audit fees

Included within the total other non-audit fees of £2.0 million within 2014 are fees in relation to the listing of the Group which totalled £1.9 million exclusive of VAT.

NOTE 7: SHARE BASED PAYMENTS

Share based payments charges comprise:

	2015 £ million	2014 £ million
Equity settled	**20.0**	12.9
Cash settled	**—**	0.6
Total share based payment charge	**20.0**	13.5

The scheme details are summarised below.

Equity settled schemes

	Award plan	Eligible employees	Nature of award	Vesting conditions[1]	Issue dates[2]
(A)	IPO incentive scheme	Selected senior employees	Conditional share award	Continuing employment or leavers in certain circumstances	2013
(B)	Phantom share award	Selected senior employees	Deferred bonus—conditional share award	Continuing employment or leavers in certain circumstances	2012 & 2013
(C)	Recruitment award	Two senior employees	Conditional share award	Continuing employment or leavers in certain circumstances	2013
(D)	Long-term incentive plan	Selected senior employees	Conditional share award	Continuing employment or leavers in certain circumstances and achievement of performance conditions	2015
(E)	IPO share award	All employees excluding the Group's Executive Committee	Conditional share award	Continuing employment or leavers in certain circumstances	2014
(F)	Deferred bonus share plan	Selected senior employees	Deferred bonus—conditional share award	Continuing employment or leavers in certain circumstances	2014 & 2015

(1) All awards have vesting conditions and therefore some may not vest.

(2) Issue dates show the year in which issues have been made under the relevant scheme. There could be further issuances in future years under the scheme.

The terms of the equity settled schemes the Group operated during the year are as follows:

(A) IPO incentive scheme

The IPO incentive scheme was introduced in December 2013 for selected senior employees. Participants were entitled to receive shares in the event of a listing. The award was a pre-determined percentage of the listing value, which was then converted to a number of Ordinary Shares based on the listing price. The fair value of the IPO incentive scheme was determined at grant date using a binomial valuation model and is being recorded in the income statement over the vesting period.

During 2014 modifications were made to the scheme including removal of the minimum listing market value. The impact of each modification was determined at the modification date and is being recorded in the income statement over the remaining vesting period.

(B) Phantom share award

In late 2012 a notional (phantom) share award for senior individuals was established. The plan was designed to comply with PRA requirements for deferral and clawback on treatment of variable remuneration. In 2013 the award was a cash payment based on Tangible Net Asset Value (TNAV) and was accounted for as a long-term employee benefit.

During 2014 the Remuneration Committee approved that existing awards under this scheme would be converted into Ordinary Shares awards on listing, with no acceleration of vesting. This resulted in a change in accounting treatment to an equity settled share based payment therefore during 2014 the Group reclassified an existing liability of £4.2 million to equity. The fair value of the converted award was recalculated and is being recognised over the remaining vesting period within the income statement through to 2018.

(C) Recruitment award

Under the scheme the participants received shares in 2014 and 2015 and will receive the final tranche of shares in 2016. No awards were granted in 2015 (2014: none) under this scheme.

(D) Long-term incentive plan (LTIP)

The LTIP introduced in 2014 is aimed at delivering shareholder value by linking the receipt of shares to performance measures that are based on delivering the Group's strategic objectives over a 3 year period. Awards are made within limits set by the rules of the plan. The maximum number of shares that can be awarded equates to 120% of total annual remuneration under normal circumstances.

During 2015, selected senior employees of the Group were granted up to a maximum of 1,494,125 Ordinary Shares under the LTIP scheme. To the extent that performance measures are satisfied, the LTIP awards will vest equally on the third, fourth and fifth anniversary of the date of the grant. The performance period is three years commencing on 1 January 2015.

Details of the performance measures and weightings can be found in the Directors' Remuneration Report on page 135 of the 2014 Annual Report and Accounts. All performance measures are non-market based conditions. For each performance measure, if performance reaches threshold, target or maximum, then 20%, 80% or 100% respectively of this element of the award will vest. Vesting between threshold, target and maximum will be calculated on a straight line basis.

During 2015, awards over 233,645 Ordinary Shares were granted under this scheme to three senior employees on recruitment. The awards were granted in recognition that the employees' outstanding awards over shares in their previous employing company lapsed on accepting employment with the Group. Vesting dates replicate those of the forfeited awards. One of the awards is subject to performance conditions. The performance measures mirror those attached to the 2015 LTIP grant discussed above, however in recognition of the earlier vesting dates in March 2016 and March 2017, performance will be assessed against the Group's strategic plan for financial years 2015 and 2016 respectively.

The weighted-average fair value of awards granted during 2015 was £4.04 based on market prices at the date of grant. Participants may be entitled to any dividends paid during the vesting period if the performance measures and service conditions are met.

(E) IPO share award

On listing, the Group granted all employees below Executive level a one-off share award. A small number of senior employees received an award over Ordinary Shares of either 10% or 20% of salary. All other employees received an award over Ordinary Shares with a value of £1,000. The majority of awards vested on the first anniversary of the listing. Certain awards granted to senior employees were subject to different vesting schedules, and holding periods, to comply with the PRA Remuneration Code.

(F) Deferred bonus share plan

The deferred bonus share plan is an equity settled scheme that is operated in conjunction with the short term incentive plan for Executive Directors and other senior managers of the Group.

Share awards for the deferred element of 2015 bonuses will be granted under this scheme in 2016. During 2015, awards over 1,960,273 Ordinary Shares for 2014 bonuses were granted to selected senior employees of the Group. The awards have service conditions, with vesting dates in 2015, 2018 and 2019.

During 2015, awards over 72,410 Ordinary Shares were granted under the scheme to three senior employees on recruitment. The awards were granted in recognition that the employees' outstanding awards over shares in their previous employing company lapsed on accepting employment with the Group. The awards have service conditions and vesting dates replicate those of the forfeited awards.

The weighted-average fair value of awards granted during 2015 was £4.04 based on market prices at the date of grant. Participants may be entitled to any dividends paid during the vesting period if the service conditions are met.

Cash settled schemes

In 2015 there were no cash settled shared based payment schemes.

During 2014 cash payments of £1.7 million were made in relation to cash settled share based payment schemes, resulting in a charge of £0.6 million to the income statement for the year ended 31 December 2014.

Movement in share options and conditional shares

	Ordinary Shares			
	Former Chairman's interest in share options[1]	Recruitment award[2]	Phantom share award[2]	IPO share award[2]
Shares in existence at 1 January 2015	**625,328**	**327,760**	**3,120,900**	**1,773,880**
Granted in year	**—**	**—**	**—**	**—**
Exercised or vested in year	**—**	**(151,950)**	**—**	**(1,431,866)**
Forfeited in year	**—**	**—**	**(59,080)**	**(202,973)**
Outstanding 31 December 2015	**625,328**	**175,810**	**3,061,820**	**139,041**
Of which exercisable	**625,328**	**—**	**—**	**—**

	Ordinary Shares		
	Long-term incentive plan[2]	Deferred bonus share plan[2]	IPO incentive scheme[2]
Shares in existence at 1 January 2015	**—**	**14,918**	**664,658**
Granted in year	**1,727,770**	**2,032,683**	**—**
Exercised or vested in year	**(95,075)**	**(761,247)**	**(332,324)**
Less: forfeited in year	**(233,242)**	**(128,554)**	**—**
Outstanding at 31 December 2015	**1,399,453**	**1,157,800**	**332,334**
Of which exercisable	**—**	**—**	**—**

(1) This scheme was set up for the previous Chairman, Sir David Clementi. All share options granted under the scheme had vested as at 31 December 2014. No share options have been exercised during 2015. The weighted-average exercise price for options outstanding at 1 January 2015 and 31 December 2015 was £2.15. The options outstanding will expire 10 years from the date of listing if not exercised.

(2) Awards have vesting conditions.

	Ordinary Shares				
	Former Chairman's interest in share options[1]	Employee share award plan	Recruitment award[2]	Phantom share Award[2]	IPO share award[2]
Shares in existence at 1 January 2014	65,824	104,232	39,014	—	—
Modification to Phantom share award	—	—	—	312,090	—
Impact of share reorganisation[3]	592,416	871,911	294,984	2,808,810	—
Granted in year	—	—	—	—	1,773,880
Exercised or vested in year	(32,912)	(968,790)	(6,238)	—	—
Forfeited in year	—	(7,353)	—	—	—
Outstanding 31 December 2014	625,328	—	327,760	3,120,900	1,773,880
Of which exercisable	625,328	—	—	—	—

	Ordinary Shares			A & B Ordinary Shares
	Long-term incentive plan(2)	Deferred bonus share plan(2)	IPO incentive scheme(2)(4)	Growth shares(5)
Shares in existence at 1 January 2014	—	—	—	1,123,407
Conversion of A and B Ordinary Shares	—	—	—	(1,123,407)
Crystallisation of IPO incentive scheme	—	—	1,661,631	—
Granted in year	105,448	14,918	—	—
Exercised or vested in year	(105,448)	—	(996,973)	—
Outstanding 31 December 2014	—	14,918	664,658	—
Of which exercisable	—	—	—	—

(1) This scheme was set up for the previous Chairman, Sir David Clementi. All share options granted under the scheme had vested as at 31 December 2014. During 2014, 32,912 share options were exercised for a weighted-average exercise price of £2.15. The weighted-average exercise price for options outstanding at 1 January 2014 and 31 December 2014 was £2.15. The options outstanding will expire 10 years from the date of listing if not exercised.

(2) Awards have vesting conditions.

(3) Immediately prior to listing, there was a reorganisation of share capital.

(4) The IPO incentive scheme was awarded as a percentage of the listing value, which is then converted to a number of shares based on the listing price. On listing 1,661,631 Ordinary Shares were awarded.

(5) Growth shares were A and B Ordinary Shares. The return on these shares on listing was calculated as set out in the Company's Articles of Association. A Ordinary Shares were converted into 38,055 Ordinary Shares and 1,064,927 Deferred Shares. B Ordinary Shares were converted into 9,192 Ordinary Shares and 92,936 Deferred Shares. The Deferred Shares created on the conversion of the A and B Ordinary Shares were then cancelled.

NOTE 8: ALLOWANCE FOR IMPAIRMENT LOSSES ON LOANS AND RECEIVABLES

	On secured loans	On unsecured loans	Total
	£ million	£ million	£ million
At 1 January 2014	7.6	27.1	34.7
Advances written off	(1.2)	(27.6)	(28.8)
Gross charge to the income statement	1.2	23.5	24.7
At 31 December 2014	7.6	23.0	30.6
Advances written off	**(1.9)**	**(26.0)**	**(27.9)**
Gross charge to the income statement	**3.0**	**34.2**	**37.2**
As at 31 December 2015	**8.7**	**31.2**	**39.9**

Of the total allowance in respect of loans and advances to customers, £38.8 million (2014: £27.6 million) was assessed on a collective basis.

During the year, sales of credit card receivables which had previously been written-off resulted in net recoveries of £6.9 million (2014: £8.9 million). The full amount of the proceeds have been recognised as a gain and the net charge to the income statement is summarised below.

	2015	2014
	£ million	£ million
Gross charge to the income statement	**37.2**	24.7
Debt sale recoveries	**(6.9)**	(8.9)
Net charge to the income statement	**30.3**	15.8

NOTE 9: TAXATION

(A) Analysis of the tax charge for the year

	2015 £ million	2014 £ million
UK corporation tax		
Current tax on profit for the year	**(13.6)**	(0.7)
Adjustments in respect of prior years	**—**	(2.3)
Current tax charge to the income statement	**(13.6)**	(3.0)
Deferred tax (refer note 22)		
Origination and reversal of temporary differences	**(15.0)**	(16.5)
Adjustments in respect of prior years	**(0.7)**	(6.0)
Reduction in UK corporation tax rate	**2.5**	0.2
Deferred tax charge to the income statement	**(13.2)**	(22.3)
Tax charge	**(26.8)**	(25.3)

Analysis of tax charge recognised in Other Comprehensive Income:

	2015 £ million	2014 £ million
Current tax		
Available-for-sale financial assets	**2.1**	(1.3)
Deferred tax		
Available-for-sale financial assets	**(0.9)**	—
Cash flow hedge	**1.6**	2.5
Total credit	**2.8**	1.2

(B) Factors affecting the tax charge for the year

A reconciliation of the charge that would result from applying the standard UK corporation tax rate to the profit before tax to the actual tax charge for the year is given below:

	2015 £ million	2014 £ million
Profit before tax	**138.0**	34.0
Tax charge at effective corporation tax rate of 20.25% (2014: 21.5%)	**(27.9)**	(7.3)
Factors affecting charge:		
Disallowed items	**(1.5)**	(11.6)
Non-taxable income	**0.8**	1.1
UK corporation tax rate change	**2.5**	0.2
Adjustments in respect of previous years	**(0.7)**	(8.3)
Gains covered by the substantial shareholding exemption	—	1.0
Other items	—	(0.4)
Total tax charge	**(26.8)**	(25.3)

The Group has been engaged in discussion with HM Revenue and Customs (HMRC) regarding the tax treatment of certain commercial funding transactions that were entered into during 2009 involving Virgin Money Cards Limited (since renamed Sapphire Cards Limited), which is no longer part of the Group. Tax charges of £8.8 million in relation to the settlement of the HMRC enquiry were reflected within the 2014 Adjustments in respect of prior periods. This includes an anticipated benefit from the surrender of up to £62.9 million of tax losses by the Virgin Group for an expected payment in the region of £15.5 million.

The Finance Act 2013 (the Act) was substantively enacted on 2 July 2013. The Companies Act 2006 reduced the main rate of corporation tax to 21% with effect from 1 April 2014 and 20% with effect from 1 April 2015. The Finance (No. 2) Act 2015 was substantively enacted on 26 October 2015. This reduced the main rate of corporation tax further to 19% with effect from 1 April 2017 and to 18% with effect from 1 April 2020.

A bank corporation tax surcharge of 8%, effective from 1 January 2016, was enacted in November 2015. Whilst the surcharge will not apply to the banking profits of the Group's operating bank subsidiary, Virgin

Money plc until 2016, it has been necessary to rebase deferred tax assets and liabilities, where relevant, to ensure that such assets and liabilities continue to be held on the balance sheet using the rate at which they are expected to reverse in the future. As at 31 December 2015, this rate uplift has been reflected for Virgin Money plc's deferred tax assets and liabilities, except in relation to brought forward trading losses which fall outside of the surcharge rules. The most material element of the rate change impact of £2.5 million, set out above, is accounted for by this surcharge rate uplift.

NOTE 10: EARNINGS PER SHARE

The Group presents basic and diluted earnings per share (EPS) data in relation to the ordinary shares of the Company.

Earnings per share

	2015 £ million	2014 £ million
Profit attributable to equity shareholders—basic and diluted	**111.2**	8.7
Distributions to Non-core Tier 1 noteholders and Additional Tier 1 security holders (net of group relief)	**(10.0)**	(10.3)
Profit/(loss) attributable to equity holders for the purposes of basic and diluted EPS	**101.2**	(1.6)

	2015 Number of shares (million)	2014 Number of shares (million)
Weighted-average number of ordinary shares in issue—basic	**441.0**	391.3
Adjustment for share options and awards	**4.7**	0.3
Weighted-average number of ordinary shares in issue—diluted	**445.7**	391.6
Basic earnings per share (pence)	**22.9**	(0.4)
Diluted earnings per share (pence)	**22.7**	(0.4)

Basic earnings per share has been calculated after deducting 1.8 million (2014: 1.6 million) ordinary shares representing the Group's holdings of own shares in respect of employee share schemes.

Of the total number of employee share options and share awards at 31 December 2015 none were anti-dilutive (2014: 6.6 million).

NOTE 11: DIVIDENDS

The Directors have recommended for approval at the 2016 AGM the payment of a final dividend in respect of the year ended 31 December 2015 of 3.1p per ordinary share, amounting to £13.7 million. If approved, this final dividend will be paid on 25 May 2016 to shareholders on the register at close of business on 15 April 2016. The financial statements for the year ended 31 December 2015 do not reflect this final dividend, which will be accounted for in shareholders' equity as an appropriation of retained profits in the year ending 31 December 2016.

The 2015 interim dividend of 1.4p per ordinary share, amounting to £6.2 million, was paid in October 2015 and has been deducted from retained profits.

Under the trust deed of the Employee Benefit Trust (EBT), a standing waiver is in force in respect of any dividends declared on shares held by the EBT.

There were no dividends declared or paid in the year ending 31 December 2014.

NOTE 12: ANALYSIS OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES BY MEASUREMENT BASIS

	Held at amortised cost	Loans and receivables	Available-for-sale securities	Derivatives not designated as hedging instruments	Derivatives designated as hedging instruments		Total
					Fair value hedges	Cash flow hedges	
	£ million	£ million	£ million	£ million	£ million	£ million	£ million
As at 31 December 2015							
Financial assets							
Cash and balances at central banks	—	**888.6**	—	—	—	—	**888.6**
Derivative financial instruments	—	—	—	**18.3**	**63.5**	**0.5**	**82.3**
Loans and receivables:							
—Loans and advances to banks	—	**614.5**	—	—	—	—	**614.5**
—Loans and advances to customers	—	**27,109.0**	—	—	—	—	**27,109.0**
—Debt securities	—	**1.1**	—	—	—	—	**1.1**
Available-for-sale financial assets	—	—	**1,296.9**	—	—	—	**1,296.9**
Other assets—trade debtors and accrued income	—	**14.6**	—	—	—	—	**14.6**
Total financial assets	—	**28,627.8**	**1,296.9**	**18.3**	**63.5**	**0.5**	**30,007.0**
Non financial assets							**222.0**
Total assets							**30,229.0**
Financial liabilities							
Deposits from banks	**1,298.7**	—	—	—	—	—	**1,298.7**
Customer deposits	**25,144.9**	—	—	—	—	—	**25,144.9**
Derivative financial instruments	—	—	—	**15.4**	**139.6**	**1.0**	**156.0**
Debt securities in issue	**2,039.4**	—	—	—	—	—	**2,039.4**
Other liabilities—trade creditors and accrued interest	**155.1**	—	—	—	—	—	**155.1**
Total financial liabilities	**28,638.1**	—	—	**15.4**	**139.6**	**1.0**	**28,794.1**
Non financial liabilities							**94.6**
Total liabilities							**28,888.7**
Equity							**1,340.3**
Total liabilities and equity							**30,229.0**

	Held at amortised cost	Loans and receivables	Available-for-sale securities	Derivatives not designated as hedging instruments	Derivatives designated as hedging instruments: Fair value hedges	Derivatives designated as hedging instruments: Cash flow hedges	Total
	£ million	£ million	£ million	£ million	£ million	£ million	£ million
As at 31 December 2014							
Financial assets							
Cash and balances at central banks	—	851.3	—	—	—	—	851.3
Derivative financial instruments	—	—	—	25.9	75.3	—	101.2
Loans and receivables:							
—Loans and advances to banks	—	720.5	—	—	—	—	720.5
—Loans and advances to customers	—	23,093.1	—	—	—	—	23,093.1
—Debt securities	—	8.6	—	—	—	—	8.6
Available-for-sale financial assets	—	—	1,539.6	—	—	—	1,539.6
Other assets—trade debtors and accrued income	—	17.5	—	—	—	—	17.5
Total financial assets	—	24,691.0	1,539.6	25.9	75.3	—	26,331.8
Non financial assets							205.0
Total assets							26,536.8
Financial liabilities							
Deposits from banks	846.7	—	—	—	—	—	846.7
Customer deposits	22,365.7	—	—	—	—	—	22,365.7
Derivative financial instruments	—	—	—	22.0	203.7	2.5	228.2
Debt securities in issue	1,594.1	—	—	—	—	—	1,594.1
Other liabilities—trade creditors and accrued interest	165.2	—	—	—	—	—	165.2
Total financial liabilities	24,971.7	—	—	22.0	203.7	2.5	25,199.9
Non financial liabilities							93.1
Total liabilities							25,293.0
Equity							1,243.8
Total liabilities and equity							26,536.8

NOTE 13: DERIVATIVE FINANCIAL INSTRUMENTS

	2015			2014		
	Contract/ notional amount	Asset fair value	Liability fair value	Contract/ notional amount	Asset fair value	Liability fair value
	£ million	£ million	£ million	£ million	£ million	£ million
Derivatives in accounting hedge relationships						
Derivatives designated as fair value hedges:						
Interest rate swaps	**23,421.6**	**63.5**	**(139.6)**	22,160.5	74.4	(203.7)
Cross currency interest rate swaps	—	—	—	21.8	0.9	—
	23,421.6	**63.5**	**(139.6)**	22,182.3	75.3	(203.7)
Derivatives designated as cash flow hedges:						
Interest rate swaps	**369.7**	**0.5**	**(1.0)**	811.8	—	(2.5)
Total derivative assets/ (liabilities)—in accounting hedge relationships	**23,791.3**	**64.0**	**(140.6)**	22,994.1	75.3	(206.2)
Derivatives in economic hedging relationships but not in accounting hedge relationships						
Interest rate swaps	**3,651.4**	**16.8**	**(15.4)**	3,345.9	24.8	(21.8)
Options:						
Equity FTSE 100 options	—	**1.5**	—	—	1.1	(0.2)
Total derivative assets/(liabilities)—in economic hedging relationship but not in accounting hedge relationships	**3,651.4**	**18.3**	**(15.4)**	3,345.9	25.9	(22.0)
Total recognised derivative assets/(liabilities)	**27,442.7**	**82.3**	**(156.0)**	26,340.0	101.2	(228.2)

The principal amount of the derivative contracts does not represent the Group's real exposure to credit risk which is limited to the current cost of replacing contracts with a positive value to the Group should the counterparty default. To reduce credit risk the Group uses a variety of credit enhancement techniques such as netting and collateralisation, where security is provided against the exposure. Further details are provided in the Risk Management Report.

Hedged cash flows

For designated cash flow hedges the following table shows when the Group's hedged cash flows are expected to occur and when they will impact income:

	2015	2014
	£ million	£ million
Within one year	**(5.5)**	(2.9)
In one to five years	**(9.8)**	(5.9)
Total	**(15.3)**	(8.8)

Gains/(losses) from derivatives and hedge accounting

	2015	2014
	£ million	£ million
Gain/(loss) from fair value hedge accounting[1]:		
Derivatives designated as fair value hedges	**53.7**	(156.3)
Fair value movement attributable to hedged risk	**(50.7)**	155.1
	3.0	(1.2)
Loss from cash flow hedges	**(5.1)**	(2.7)
Fair value gains from other derivatives[2]	**1.7**	4.0
(Loss)/gain from derivatives and hedge accounting	**(0.4)**	0.1

(1) Gains or losses from fair value hedges can arise where there is an IFRS hedge accounting relationship in place and either:

—the fair value of the derivative was not exactly offset by the change in fair value attributable to the hedged risk; or

—the derivative was designated in or redesignated from the IFRS hedge accounting relationship and in the following months leads to amortisation of existing balance sheet positions.

(2) Other derivatives are those used for economic hedging but which are not in an IAS 39 hedge accounting relationship.

NOTE 14: LOANS AND ADVANCES TO BANKS

	2015	2014
	£ million	£ million
Balances within securitisation vehicles	**384.3**	447.9
Money market placements with banks	**97.1**	120.8
Other lending to banks	**133.1**	151.8
Total	**614.5**	720.5

NOTE 15: LOANS AND ADVANCES TO CUSTOMERS

	2015	2014
	£ million	£ million
Advances secured on residential property not subject to securitisation	**17,389.9**	15,631.2
Advances secured on residential property subject to securitisation	**3,670.4**	3,128.3
	21,060.3	18,759.5
Residential buy-to-let loans not subject to securitisation	**4,401.9**	3,135.6
Total loans and advances to customers secured on residential property	**25,462.2**	21,895.1
Unsecured receivables not subject to securitisation	**1,610.0**	1,121.3
Total loans and advances to customers before allowance for impairment losses	**27,072.2**	23,016.4
Impairment allowance (refer note 8)	**(39.9)**	(30.6)
Total loans and advances to customers excluding portfolio hedging	**27,032.3**	22,985.8
Fair value of portfolio hedging	**76.7**	107.3
Total loans and advances to customers	**27,109.0**	23,093.1

The fair value of portfolio hedging represents an accounting adjustment which offsets the fair value movement on the related derivatives. Such relationships are established to protect the Group from interest rate risk on fixed rate products. See the Risk Management Report for further details.

For collateral held in respect of the values included in the table above, refer to the Risk Management Report.

NOTE 16: AVAILABLE-FOR-SALE FINANCIAL ASSETS

	2015	2014
	£ million	**£ million**
At 1 January	**1,539.6**	1,679.2
Additions	**659.2**	567.6
Disposals (sales and redemptions)	**(859.9)**	(789.1)
Reclassification of equity investments	**1.3**	—
Exchange differences	**(0.7)**	(1.3)
Net gains on changes in fair value	**(42.6)**	83.2
At 31 December	**1,296.9**	1,539.6

(1) Represents investments in unquoted equity securities relating to the Group's participation in banking and credit card operations, previously recognised within Other assets.

Gains on sale of available-for-sale securities amounted to £8.8 million (2014: £7.5 million).

Analysis of the composition of debt securities categorised as available-for-sale financial assets is set out in the Risk Management Report. All assets have been individually assessed for impairment and following this assessment no write down of assets was required.

For amounts included above which are subject to repurchase agreements refer to note 17.

NOTE 17: COLLATERAL PLEDGED AND RECEIVED

The Group receives and accepts collateral in the form of cash and marketable securities in respect of the following transactions:

- derivatives;
- sale and repurchase and reverse sale and repurchase agreements; and
- securities lending and borrowing.

Collateral in respect of derivatives is subject to the standard industry terms of ISDA Credit Support Annex. This means that securities received or given as collateral can be pledged or sold during the term of the transaction but must be returned on maturity of the transaction. The terms also give each counterparty the right to terminate the related transactions upon the counterparty's failure to post collateral.

At 31 December 2015 cash collateral of £94.6 million (2014: £121.8 million) had been pledged by the Group and £23.8 million (2014: £11.4 million) has been received as cash collateral by the Group.

At 31 December 2015 available-for-sale financial assets of £nil (2014: £291.4 million) are pledged as collateral in respect of sale and repurchase agreements under terms that are usual and customary for such activities.

At 31 December 2015 loans and advances of £755.0 million (2014: £723.9 million) are pledged as collateral in respect of sale and repurchase agreements under terms that are usual and customary for such activities.

The value of collateral pledged in respect of repurchase agreements that was transferred, accounted for as secured borrowings, where the transfer is permitted by contract or custom to repledge collateral was £nil (2014: £274.3 million).

NOTE 18: SECURITISATION

Assets and liabilities of the SPVs included in these consolidated financial statements comprise:

	2015	2014
	£ million	£ million
Assets		
Loans and advances to customers	**3,670.4**	3,128.3
Loans and advances to banks	**384.3**	447.9
Other assets	**0.3**	0.2
Total assets	**4,055.0**	3,576.4
Liabilities		
Debt securities in issue	**1,741.9**	1,594.1
Deposits by banks	**13.2**	0.1
Derivative financial instruments	—	0.1
Other liabilities	**3.1**	4.9
Total liabilities	**1,758.2**	1,599.2

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

	2015	2014
	£ million	£ million
Carrying amount of transferred assets	**3,670.4**	3,128.3
Fair value of transferred assets	**3,728.4**	3,197.4
Carrying amount of associated liabilities	**1,741.9**	1,594.1
Fair value of associated liabilities	**1,740.0**	1,599.6

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

NOTE 19: OFFERS AND DISPOSALS

Disposal of CHT (2014)

The disposal of CHT was completed on 30 November 2014. A gain on disposal of £4.5 million was recognised on that date by the Group.

Purchase of credit card portfolio (2014)

From the point of acquisition of the credit card book from MBNA on 18 January 2013, until 30 November 2014, MBNA agreed to underwrite and administer new Virgin Money branded credit cards on a commission basis. On 30 November 2014, the Group completed an agreement to purchase the assets originated during this period. The portfolio was purchased for a consideration of £362.7 million. The fair value of the assets purchased was £354.5 million (a premium of £8.2 million). This included credit cards that had previously been charged-off. The premium will be unwound over the life of the purchased assets.

The acquisition was determined to be an asset purchase as the assets were purchased without staff contracts or processes or other aspects of the business being transferred to them.

NOTE 20: INTANGIBLE ASSETS

Intangible assets comprise:

	Core deposit intangible	Goodwill	Software	Core banking platform	Total
	£ million	£ million	£ million	£ million	£ million
Cost:					
Cost at 1 January 2014	4.8	4.6	68.1	6.9	84.4
Additions	—	—	13.9	13.0	26.9
Disposals	—	(4.6)	—	—	(4.6)
Cost at 31 December 2014	4.8	—	82	19.9	106.7
Additions	—	—	**27.9**	**1.6**	**29.5**
Disposals	—	—	**(24.8)**	—	**(24.8)**
At 31 December 2015	**4.8**	—	**85.1**	**21.5**	**111.4**
Accumulated amortisation:					
Accumulated amortisation at 1 January 2014	2.7	4.6	51.1	—	58.4
Charge for the year	1.0	—	5.8	—	6.8
Disposals	—	(4.6)	—	—	(4.6)
Accumulated amortisation at 31 December 2014	3.7	—	56.9	—	60.6
Charge for the year	**(0.3)**	—	**8.6**	**2.9**	**11.2**
Disposals	—	—	**(24.8)**	—	**(24.8)**
At 31 December 2015	**3.4**	—	**40.7**	**2.9**	**47.0**
Balance sheet amount at 31 December 2015	**1.4**	**—**	**44.4**	**18.6**	**64.4**
Balance sheet amount at 31 December 2014	1.1	—	25.1	19.9	46.1

Additions during the year relate to software and core banking platform intangible assets. Software additions primarily relate to the purchase of new office software for employee workstations, as well as further development of the Group's digital banking channel.

NOTE 21: TANGIBLE FIXED ASSETS

Tangible fixed assets comprise:

	Land and buildings	Plant, equipment fixtures, fittings and vehicles	Total
	£ million	£ million	£ million
Cost:			
Cost at 1 January 2014	59.1	35.5	94.6
Additions	4.2	6.4	10.6
Disposals	(2.1)	(0.3)	(2.4)
Cost at 31 December 2014	61.2	41.6	102.8
Additions	**2.1**	**8.1**	**10.2**
Disposals	**—**	**(10.2)**	**(10.2)**
At 31 December 2015	**63.3**	**39.5**	**102.8**
Accumulated depreciation and impairment:			
Accumulated depreciation and impairment at 1 January 2014	6.5	16.9	23.4
Depreciation charge for the year	2.1	5.9	8.0
Disposals	(1.3)	(0.2)	(1.5)
Accumulated depreciation and impairment at 31 December 2014	7.3	22.6	29.9
Depreciation charge for the year	**2.2**	**6.2**	**8.4**
Disposals	**—**	**(10.1)**	**(10.1)**
At 31 December 2015	**9.5**	**18.7**	**28.2**
Balance sheet amount at 31 December 2015	**53.8**	**20.8**	**74.6**
Balance sheet amount at 31 December 2014	53.9	19.0	72.9

NOTE 22: DEFERRED TAX ASSETS

Deferred tax assets and liabilities comprise:

	2015	2014
	£ million	£ million
Deferred tax assets/(liabilities):		
Accelerated capital allowances	**15.1**	7.1
Cash flow hedge reserve	**3.8**	2.2
Change in accounting basis on adoption of IFRS	**(4.8)**	(3.0)
Tax losses carried forward	**18**	38.1
Other temporary differences	**4.3**	4.4
Fair value adjustments on acquisition of Northern Rock	**1.6**	1.4
Total deferred tax assets	**38.0**	50.2

The Group has not recognised deferred tax assets in respect of gross unused tax losses of £31.2 million (2014: £28.8 million).

The movement in the net deferred tax balance is as follows:

	2015	2014
	£ million	£ million
At 1 January	**50.2**	70.0
Income statement (charge)/credit (refer note 9):		
Accelerated capital allowances	**8.0**	(1.5)
Tax losses carried forward	**(20.1)**	(24.1)
Other temporary differences	**(1.1)**	3.3
	(13.2)	(22.3)
Amounts credited/(charged) to equity:		
Available-for-sale financial assets	**(0.9)**	—
Cash flow hedges	**1.6**	2.5
Adjustments relating to share based payments	**0.3**	—
	1.0	2.5
At 31 December	**38.0**	50.2

NOTE 23: OTHER ASSETS

Other assets comprise:

	2015	2014
	£ million	£ million
Trade debtors	**9.7**	12.6
Prepayments and accrued income	**22.4**	16.8
Other	**27.5**	23.9
Total other assets	**59.6**	53.3

NOTE 24: DEPOSITS FROM BANKS

Deposits from banks comprise:

	2015	2014
	£ million	£ million
Liabilities in respect of securities sold under repurchase agreements	**1,274.9**	835.3
Other deposits from banks	**23.8**	11.4
Total deposits from banks	**1,298.7**	846.7

NOTE 25: CUSTOMER DEPOSITS

Customer deposits comprise:

	2015	2014
	£ million	£ million
Savings and investment accounts	**24,914.6**	22,164.1
Personal current accounts	**230.3**	201.6
Total customer deposits	**25,144.9**	22,365.7

NOTE 26: DEBT SECURITIES IN ISSUE

Debt securities in issue comprise:

	Secured	Unsecured	Total
	£ million	£ million	£ million
At 1 January 2014	1,469.8	—	1,469.8
Repayments	(874.1)	—	(874.1)
Issues	1,000.0	—	1,000.0
Other movements	(1.6)	—	−1.6
At 31 December 2014	1,594.1	—	1,594.1
Repayments	**(601.9)**	—	**(601.9)**
Issues	**750.0**	**298.9**	**1,048.9**
Other movements	**(0.3)**	**(1.4)**	**(1.7)**
At 31 December 2015	**1,741.9**	**297.5**	**2,039.4**

Other movements comprise accrued interest, unamortised issue costs or hedge accounting adjustments.

On 16 April 2015, the Group issued 5 year Medium Term Notes with a nominal value of £300 million at a coupon of 2.25% per annum. The notes were issued as part of the Group's recently launched £3 billion Global Medium Term Note programme, which was established to diversify the Group's wholesale funding base further.

On 8 June 2015, the Group raised £750 million from institutional investors through the issuance of Residential Mortgage Backed Securities in the Gosforth Funding 2015-1 transaction.

NOTE 27: PROVISIONS

The movement in provisions was as follows:

	FSCS	Other	Total
	£ million	£ million	£ million
At 1 January 2015	**8.7**	**0.6**	**9.3**
Provisions applied	**(14.6)**	**(0.2)**	**(14.8)**
Charge for the year	**12.5**	**1.4**	**13.9**
At 31 December 2015	**6.6**	**1.8**	**8.4**

The Financial Services Compensation Scheme (FSCS) is the UK's statutory fund of last resort for customers of authorised financial services firms and pays compensation if a firm is unable to pay claims against it. The FSCS has borrowed from HM Treasury to fund the compensation costs associated with institutions that failed in 2008 and will receive the receipts from asset sales, surplus cash flows and other recoveries from these institutions in the future. The FSCS meets its obligations by raising management expense and compensation levies. These include amounts to cover the interest on its borrowings and on-going management expenses. Each deposit taking institution contributes in proportion to its share of total protected deposits.

The FSCS can only raise a levy within its scheme year (which commences 1 April) and under IFRIC 21 'Levies' the Group recognises its FSCS provision in the scheme year itself.

NOTE 28: OTHER LIABILITIES

Other liabilities comprise:

	2015	2014
	£ million	£ million
Trade creditors	**24.0**	26.3
Deferred income	**5.0**	4.8
Other creditors and accruals	**206.0**	215.6
Current tax liabilities	**6.3**	2.3
Total other liabilities	**241.3**	249.0

Deferred income represents income advanced from partners that will be recognised in future periods.

Accrued interest included within 'Other creditors and accruals' primarily represents interest which has accrued on retail funds and deposits.

The Group's exposure to liquidity risk related to trade and other payables is disclosed in the Risk Management Report.

NOTE 29: SHARE CAPITAL AND SHARE PREMIUM

Share capital and share premium

	2015 £ million	2014 £ million
Share capital	**0.1**	0.1
Share premium		
At 1 January	**654.5**	509.2
Premium on shares issued in the year	—	149.9
Ordinary Share issue costs charged directly to equity	—	(4.6)
As at 31 December	**654.5**	654.5
At 31 December	**654.6**	654.6

	2015 Number of shares	2014 Number of shares
Ordinary Shares of £0.0001 each		
At 1 January	**441,933,180**	38,742,729
Share conversion	—	47,247
Subdivision of shares	—	349,109,784
Issued during year	**1,778,278**	53,003,534
Issued under employee share schemes	—	1,029,886
At 31 December	**443,711,458**	441,933,180
Deferred Shares of £0.001 each		
At 1 January	**10,052,161**	731,113
Issued during year	—	9,321,048
Share conversion	—	1,157,863
Shares cancellation	—	(1,157,863)
At 31 December	**10,052,161**	10,052,161

During the year, the Company issued 1,778,278 Ordinary Shares in advance of the vesting of awards granted under the IPO share award and the IPO incentive scheme.

The total number of Ordinary Shares in issue at 31 December 2015 was 443,711,458 with a nominal value of £0.0001, amounting to £44,371 (2014: 441,933,180 Ordinary Shares with a nominal value of £0.0001, amounting to £44,193). The total number of Deferred Shares in issue at 31 December 2015 was 10,052,161, with a nominal value of £0.001, amounting to £10,052 (2014: 10,052,161 Deferred Shares with a nominal value of £0.001, amounting to £10,052).

Previously the Company had issued A Ordinary Shares and B Ordinary Shares, neither of which carried any voting rights. During 2014 all of the 1,102,982 A Ordinary Shares (1 January 2014: 1,102,982) and 102,128 B Ordinary Shares (1 January 2014: Nil) each with a nominal value of £0.001 per share, were converted into a combination of Ordinary Shares and Deferred Shares (refer note 7). The conversion was based on the calculation and hurdle rate specified in the Articles of Association of the Company.

The following describes the rights attaching to each share class at 31 December 2015:

Ordinary Shares

The holders of Ordinary Shares are entitled to one vote per share at meetings of the Group. All Ordinary Shares in issue in the Company rank equally and carry the same voting rights and the same rights to receive dividends and other distributions declared or paid by the Company.

Deferred Shares

As set out in the Articles of Association adopted on listing (and pursuant to the provisions of the Companies Act 2006 in respect of shares held in own shares), the Deferred Shares have no voting or dividend rights and, on a return of capital on a winding up, have no valuable economic rights. No application has been made or is currently intended to be made for the Deferred Shares to be admitted to the Official List or to trade on the London Stock Exchange or any other investment exchange.

The Deferred Shares are held in treasury. This is to ensure that the aggregate nominal value of the Company's share capital will be not less than £50,000, which is the minimum level of nominal share capital required by the Companies Act 2006 for a company to be established as a public limited company.

NOTE 30: OTHER EQUITY INSTRUMENTS

The Company issued Fixed Rate Resettable Additional Tier 1 (AT1) securities of £160.0 million on the Luxembourg Stock Exchange on 31 July 2014. This issue is treated as an equity instrument in accordance with IAS 32 'Financial Instruments: Presentation' with the proceeds included in equity, net of transaction costs of £3.5 million. Dividends and other returns to equity holders are treated as a deduction from equity. The principal terms of the securities are described below:

- the securities constitute direct, unsecured and subordinated obligations of the Company and rank pari passu with holders of other Tier 1 instruments and the holders of that class or classes of preference shares but rank junior to the claims of senior creditors;
- the securities bear a fixed rate of interest from the issue date of 7.875% until the first reset date on the 5th anniversary;
- interest on the securities will be due and payable only at the sole discretion of the Company, and the Company has sole and absolute discretion at all times and for any reason to cancel (in whole or in part) any interest payment that would otherwise be payable on any interest payment date;
- the securities are undated and are redeemable, at the option of the Company, all (but not part) on the first reset date or any reset date thereafter. In addition, the AT1 securities are redeemable, at the option of the Company, in whole for certain regulatory or tax reasons. Any optional redemption requires the prior consent of the PRA; and
- all AT1 securities will be converted into Ordinary Shares of the Company, at a pre-determined price, should the Common Equity Tier 1 ratio of the Group fall below 7.0% as specified in the terms.

NOTE 31: OTHER RESERVES

Other reserves comprise:

	2015 £ million	2014 £ million
Available-for-sale reserve		
At 1 January	**7.0**	6.5
Net (losses)/gains from changes in fair value	**(0.8)**	86.9
Net gains on disposal transferred to net income	**(33.6)**	(10.3)
Amounts transferred to net income due to hedge accounting	**25.9**	(74.8)
Taxation	**1.2**	(1.3)
At 31 December	**(0.3)**	7.0

	2015 £ million	2014 £ million
Cash flow hedge reserve		
At 1 January	**(8.8)**	0.2
Amounts recognised in equity	**(13.2)**	(14.1)
Amounts transferred to income statement	**5.1**	2.6
Deferred tax	**1.6**	2.5
At 31 December	**(15.3)**	(8.8)

NOTE 32: RETAINED EARNINGS

Retained earnings comprise:

	2015	2014
	£ million	£ million
At 1 January	**434.5**	419.0
Profit for the year	**111.2**	8.7
Dividends and distributions to Tier 1 security holders (net of tax)	**(16.2)**	(10.3)
Purchase of own shares	**(5.0)**	—
Share based payments (including deferred tax)	**20.3**	17.1
As at 31 December	**544.8**	434.5

Employee Benefit Trust (EBT)

Retained earnings are stated after deducting £2.9 million (2014: £2.1 million) representing 1,815,387 (2014: 1,561,013) own shares held in an EBT.

As part of an arrangement to allow holders of certain shares in the Company an opportunity to access some of the value increase in the Group since the original grant date, the Company established an EBT in 2011. The Company funded the EBT by means of a cash loan and is therefore considered to be the sponsoring entity. The EBT purchased shares in the Company using the cash loan which is accounted for as a purchase of own shares by the Company. The investment in own shares at 31 December 2015 is £2.9 million (2014: £2.1 million). The market value of the shares held in the EBT at 31 December 2015 was £6.9 million.

NOTE 33: CONTINGENT LIABILITIES AND COMMITMENTS

CONTINGENT LIABILITIES

The Board was not aware of any significant contingent liabilities as at 31 December 2015 (31 December 2014: none).

The Company is, from time to time and in the normal course of business, subject to a variety of legal or regulatory claims, actions or proceedings. When such circumstances arise, the Board considers the likelihood of a material outflow of economic resources and provides for its best estimate of costs where an outflow of economic resources is considered probable. While there can be no assurances, the Directors believe, based on information currently available to them, that the likelihood of material outflows from such matters is remote.

The Board does not expect the ultimate resolution of any other threatened or actual legal proceedings to have a significant adverse effect on the financial position of the Group.

Loan commitments

Contractual amounts to which the Group is committed for extension of credit to customers.

	2015	2014
	£ million	£ million
Not later than 1 year	**3,958.7**	3,100.2
Later than one year and not later than 5 years	—	—
Later than 5 years	**521.1**	594.0
Total loan commitments	**4,479.8**	3,694.2

Operating lease commitments—land and buildings

Minimum future lease payments under non-cancellable operating leases.

	2015	2014
	£ million	£ million
Not later than 1 year	**7.2**	7.1
Later than one year and not later than 5 years	**25.2**	24.3
Later than 5 years	**24.1**	23.3
Total operating lease commitments—land and buildings	**56.5**	54.7

Operating lease commitments—other operating leases

Minimum future lease payments under non-cancellable operating leases.

	2015	2014
	£ million	£ million
Not later than 1 year	**4.6**	4.6
Later than one year and not later than 5 years	**9.2**	13.8
Later than 5 years	**—**	—
Total operating lease commitments—other operating leases	**13.8**	18.4

Capital commitments

Capital commitments for the acquisition of buildings and equipment.

	2015	2014
	£ million	£ million
Not later than 1 year	**2.9**	5.7
Later than one year and not later than 5 years	**—**	—
Later than 5 years	**—**	—
Total capital commitments	**2.9**	5.7

NOTE 34: FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES

Fair value of financial assets and liabilities recognised at cost

The following table summarises the fair values of those financial assets and liabilities not presented on the Group's balance sheet at their fair value, by the level in the fair value hierarchy into which each fair value measurement is categorised. The accounting policy in note 1.9 (j) sets out the key principles for estimating the fair values of financial instruments.

	Level 1	Level 2	Level 3	Total fair value	Total carrying value
	£ million	£ million	£ million	£ million	£ million
At 31 December 2015					
Cash and balances at central banks	—	**888.6**	—	**888.6**	**888.6**
Loans and advances to banks	—	**614.5**	—	**614.5**	**614.5**
Loans and advances to customers	—	—	**27,243.2**	**27,243.2**	**27,109.0**
Debt securities held as loans and receivables	**1.2**	—	—	**1.2**	**1.1**
Available-for-sale financial assets	—	—	**1.3**	**1.3**	**1.3**
Other assets—trade debtors and accrued income	—	**14.6**	—	**14.6**	**14.6**
Total financial assets at fair value	**1.2**	**1,517.7**	**27,244.5**	**28,763.4**	**28,629.1**
Deposits from banks	—	**1,298.7**	—	**1,298.7**	**1,298.7**
Customer deposits	—	**25,162.5**	—	**25,162.5**	**25,144.9**
Debt securities in issue	**2,032.1**	—	—	**2,032.1**	**2,039.4**
Other liabilities—trade payables and accrued interest	—	**155.1**	—	**155.1**	**155.1**
Total financial liabilities at fair value	**2,032.1**	**26,616.3**	—	**28,648.4**	**28,638.1**

(1) Amounts shown in respect of loans and advances to customers includes fair value adjustments of portfolio hedging.

	Level 1	Level 2	Level 3	Total fair value	Total carrying value
	£ million	£ million	£ million	£ million	£ million
At 31 December 2014					
Cash and balances at central banks	—	851.3	—	851.3	851.3
Loans and advances to banks	—	720.5	—	720.5	720.5
Loans and advances to customers	—	—	23,197.2	23,197.2	23,093.1
Debt securities held as loans and receivables	10.0	—	—	10.0	8.6
Other assets—trade debtors and accrued income	—	17.5	—	17.5	17.5
Total financial assets at fair value	10.0	1,589.3	23,197.2	24,796.5	24,691.0
Deposits from banks	—	846.7	—	846.7	846.7
Customer deposits	—	22,424.3	—	22,424.3	22,365.7
Debt securities in issue	1,599.6	—	—	1,599.6	1,594.1
Other liabilities—trade creditors and accrued interest	—	165.2	—	165.2	165.2
Total financial liabilities at fair value	1,599.6	23,436.2	—	25,035.8	24,971.7

(1) Amounts shown in respect of loans and advances to customers includes fair value adjustments of portfolio hedging.

Fair value hierarchy

The table above summarises the carrying value and fair value of assets and liabilities held on the balance sheet. There are three levels to the hierarchy as follows:

Level 1—Quoted prices (unadjusted) in active markets for identical assets and liabilities.

Level 2—Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, whether directly (i.e. as prices) or indirectly (i.e. derived from prices).

Level 3—Inputs for the asset or liability that are not based on observable market data (unobservable inputs).

Valuation methods for calculations of fair values in the table above are set out below:

Cash and balances at central banks

Fair value approximates to carrying value because cash and balances at central banks have minimal credit losses and are either short-term in nature or reprice frequently.

Loans and advances to banks

Fair value was estimated by using discounted cash flows applying either market rates where practicable or rates offered by other financial institutions for loans with similar characteristics. The fair value of floating rate placements, fixed rate placements with less than six months to maturity and overnight deposits is considered to approximate to their carrying amount.

Loans and advances to customers

The Group provides loans of varying rates and maturities to customers. The fair value of loans with variable interest rates is considered to approximate to carrying value as the interest rate can be moved in line with market conditions. For loans with fixed interest rates, fair value was estimated by discounting cash flows using market rates or rates normally offered by the Group. The change in interest rates since the majority of these loans were originated means that their fair value can vary significantly from their carrying value.

However, as the Group's policy is to hedge fixed rate loans in respect of interest rate risk, this does not indicate that the Group has an exposure to this difference in value. However, were the Group to dispose of a portfolio of mortgages, it would be likely the fair value would be lower than disclosed, as there is currently no active market for the sale of mortgage books. The fair value of a loan takes into account credit risk at the balance sheet date.

Loans and advances to customers are categorised as level 3 as unobservable pre-payment rates are applied.

Debt securities classified as loans and receivables

Fair values are based on quoted prices, where available, or by discounting cash flows using market rates.

Available-for-sale financial assets

These are unquoted equity securities held by the Group and relating to participation in banking and credit card operations (refer note 16). They are categorised as level 3 as the fair value of these securities cannot be reliably measured, due to the lack of equivalent instruments with observable prices.

Other assets and liabilities—trade debtors/creditors, accrued income and accrued interest

Fair value is deemed to approximate the carrying value.

Deposits from banks and customer deposits

Fair values of deposit liabilities repayable on demand or with variable interest rates are considered to approximate to carrying value. The fair value of fixed interest deposits with less than six months to maturity is their carrying amount. The fair value of all other deposit liabilities was estimated by discounting cash flows, using market rates or rates currently offered by the Group for deposits of similar remaining maturities.

Debt securities in issue

Fair values are based on quoted prices where available or by discounting cash flows using market rates.

Fair value of financial assets and liabilities recognised at fair value

The following table summarises the fair values of those financial assets and liabilities recognised at fair value, by the level in the fair value hierarchy into which each fair value measurement is categorised. The accounting policy in note 1 sets out the key principles for estimating the fair values of financial instruments.

2015	**Level 1**	**Level 2**	**Level 3**	**Total**
	£ million	**£ million**	**£ million**	**£ million**
Financial assets				
Derivative financial instruments	**—**	**82.3**	**—**	**82.3**
Available-for-sale financial assets	**1,233.3**	**59.0**	**3.3**	**1,295.6**
Financial liabilities				
Derivative financial instruments	**—**	**156.0**	**—**	**156.0**

2014	**Level 1**	**Level 2**	**Level 3**	**Total**
	£ million	**£ million**	**£ million**	**£ million**
Financial assets				
Derivative financial instruments	—	101.2	—	101.2
Available-for-sale financial assets	1,539.6	—	—	1,539.6
Financial liabilities				
Derivative financial instruments	—	228.2	—	228.2

Level 1 Valuations

The fair value of debt securities categorised as available-for-sale financial assets is derived from unadjusted quoted prices in an active market.

Level 2 Valuations

The fair values of derivative instruments are calculated by discounted cash flow models using yield curves that are based on observable market data or are based on valuations obtained from counterparties.

The fair value of level 2 available-for-sale securities are calculated using valuation techniques, including discounted cash flow models.

Level 3 Valuations

This represents the Group's best estimate of the value of its equity investment in Visa Europe Limited. Management has assessed that a reliable estimate of fair value is possible at the year end, following correspondence from Visa Inc. of the consideration expected to be received by the Group from its proposed acquisition of Visa Europe Limited, expected to complete in 2016.

The Group's share of the sale proceeds will comprise upfront consideration and preferred stock. The preferred stock is convertible into Class A common stock, at a future date, subject to the satisfaction of certain conditions. The Group may be entitled to additional deferred consideration four years post completion of the sale, contingent on a number of variable factors including the performance of Visa over that period.

The most significant unobservable input to the valuation is the discount applied to the value of the preferred stock to reflect the risks of future reduction in conversion to Visa Inc. Class A common stock and restrictions on transferability.

NOTE 35: CASH FLOW STATEMENTS

(a) Change in operating assets

	2015	2014
	£ million	£ million
Changes in loans and advances to customers	**(4,046.2)**	(2,403.6)
Change in derivative financial assets	**18.9**	86.3
Change in other operating assets	**(10.0)**	(13.3)
Change in operating assets	**(4,037.3)**	(2,330.6)

(b) Change in operating liabilities

	2015	2014
	£ million	£ million
Change in customer deposits	**2,779.2**	1,244.3
Change in derivative financial liabilities	**(72.2)**	81.1
Change in other operating liabilities	**439.4**	480.2
Change in operating liabilities	**3,146.4**	1,805.6

(c) Non-cash and other items

	2015	2014
	£ million	£ million
Depreciation and amortisation	**19.6**	14.8
Gain on sale of subsidiary	—	(4.5)
Other non-cash items	**42.8**	(143.1)
Total non-cash and other items	**62.4**	(132.8)

(d) Analysis of cash and cash equivalents as shown in the balance sheet

	2015	2014
	£ million	£ million
Cash and balances at central banks	**888.6**	851.3
Less: mandatory reserve deposits(1)	**(41.7)**	(38.0)
	846.9	813.3
Loans and advances to banks	**614.5**	720.5
Total cash and cash equivalents	**1,461.4**	1,533.8

(1) Mandatory reserves with central banks are not available for use in day to day operations .

NOTE 36: CAPITAL RESOURCES

Capital is a regulatory measure held by the Group to protect its depositors, to cover inherent risks in a normal and stressed operating environment and to support its business strategy against losses, inherent risks and stress events. In assessing the adequacy of its capital resources, the Group considers its risk appetite, the material risks to which it is exposed and the appropriate strategies required to manage those risks.

The Group manages capital in accordance with prudential rules issued by the PRA and FCA, in line with the EU Capital Requirements Directive (referred to as CRD IV) which implements Basel III in Europe. CRD IV legislation became effective from 1 January 2014.

The Group is committed to maintaining a strong capital base and has complied with all capital requirements set by the regulators throughout the year.

The tables below and on the following page analyse the composition of the regulatory capital resources of the Group on a CRD IV basis in both 2015 and 2014. Throughout 2014, transitional rules for calculating capital under CRD IV were in place and capital resources under those transitional rules were disclosed in the 2014 Annual Report and Accounts.

Own funds

	2015	2014
	£ million	£ million
Common Equity Tier 1		
Share capital and share premium account	**654.6**	654.6
Other equity instruments	**156.5**	156.5
Other reserves	**(15.6)**	(1.8)
Retained earnings	**544.8**	434.5
Total equity	**1,340.3**	1,243.8
Regulatory capital adjustments (unaudited)		
Deconsolidation of non regulated companies	**4.5**	4.1
Expected distribution on Additional Tier 1 securities	**(2.1)**	(2.1)
Expected distribution on ordinary shares	**(13.7)**	—
Other equity instruments	**(156.5)**	(156.5)
Cash flow hedge reserve	**15.3**	8.8
Intangible assets	**(64.4)**	(46.1)
Excess of expected loss over impairment	**(35.4)**	(33.4)
Deferred tax on tax losses carried forward	**(18.0)**	(38.1)
Common Equity Tier 1 capital (unaudited)	**1,070.0**	980.5
Additional Tier 1 securities	**156.5**	156.5
Total Tier 1 capital (unaudited)	**1,226.5**	1,137.0
Tier 2 capital (unaudited)		
General credit risk adjustments	**7.6**	5.9
Total Tier 2 capital	**7.6**	5.9
Total own funds (unaudited)	**1,234.1**	1,142.9

Movements in Common Equity Tier 1 capital are summarised below.

(unaudited)	2015	2014
	£ million	£ million
Common Equity Tier 1 capital at 1 January	**980.5**	808.9
Movement in retained earnings	**110.3**	15.5
Net impact of share capital issue	—	145.4
Movement in available-for-sale reserve	**(7.3)**	0.5
Movement in expected distribution on Additional Tier 1 securities	—	(2.1)
Movement in expected distribution on ordinary shares	**(13.7)**	—
Exclude losses from non regulated companies	**0.4**	0.6
Movement in intangible assets	**(18.3)**	(20.1)
Movement in excess of expected loss over impairment	**(2.0)**	7.7
Movement in deferred tax on tax losses carried forward	**20.1**	24.1
Common Equity Tier 1 capital at 31 December	**1,070.0**	980.5

Risk-weighted assets—Pillar 1

(unaudited)	2015	2014
	£ million	£ million
Retail mortgages	**3,952.9**	3,489.7
Retail unsecured lending	**1,192.7**	830.0
Treasury	**229.0**	221.7
Other assets	**196.3**	175.0
Credit valuation adjustments	**14.3**	13.7
Operational risk	**525.2**	430.5
Total risk-weighted assets	**6,110.4**	5,160.6

The Group calculates its capital requirement for mortgages on an Internal Ratings Based approach, and on the Standardised Basis for credit cards and other assets.

Capital ratios

Capital ratios are calculated as the capital measure shown divided by the total risk-weighted assets of the Group.

(unaudited)	2015	2014
	%	%
Common Equity Tier 1 ratio	**17.5%**	19.0%
Tier 1 ratio	**20.1%**	22.0%
Total capital ratio	**20.2%**	22.1%

NOTE 37: RELATED PARTY TRANSACTIONS

(a) Key Management Personnel

Key Management Personnel refer to the Executive Team of the Virgin Money Group, Non-Executive Directors and Directors of subsidiary companies.

	2015	2014
	£ million	£ million
Compensation		
Salaries and other short-term benefits	**8.2**	6.3
Amounts received under long-term incentive plans	—	1.2
Share based payments (Refer note 7)	**12.3**	10.2
Post-employment benefits	**0.9**	0.6
Total compensation	**21.4**	18.3

Aggregate contributions in respect of Key Management Personnel to defined contribution pension schemes £0.9 million (2014: £0.6 million).

	2015	2014
	£ million	£ million
Deposits		
At 1 January	**1.1**	0.9
Placed	**1.8**	0.4
Withdrawn	**(0.7)**	(0.2)
Deposits outstanding at 31 December	**2.2**	1.1

Deposits placed by Key Management Personnel attracted interest rates of up to 2.8% (2014: 2.8%). At 31 December 2015, the Group did not provide any guarantees in respect of Key Management Personnel (2014: none).

At 31 December 2015, transactions, arrangements and agreements entered into by the Group's banking subsidiaries with Key Management Personnel included amounts outstanding in respect of loans and credit card transactions of £0.3 million with 5 Key Management Personnel (2014: £nil with 4 Key Management Personnel).

(b) Subsidiaries

Transactions and balances with subsidiaries have been eliminated on consolidation. A full list of the company's subsidiaries and SPVs included within the consolidation is provided in note 3 to the parent company financial statements.

(c) Other transactions

	2015	2014
	£ million	£ million
Transaction value at year end:		
Trademark licence fees to Virgin Enterprises Ltd	**5.1**	4.3
Virgin Atlantic Airways	**—**	2.8
Dividend payment to Virgin Group Holdings Limited	**2.2**	—
Other costs to Virgin Management Group Companies	**0.4**	0.2

	2015	2014
	£ million	£ million
Balance outstanding at year end:		
Trademark licence fees to Virgin Enterprises Ltd	**(0.4)**	(0.4)
Virgin Atlantic Airways	**—**	—
Dividend payment to Virgin Group Holdings Limited	**—**	—
Other costs to Virgin Management Group Companies	**(0.1)**	(0.1)

Trademark licence fees to Virgin Enterprises Limited

Licence fees are payable to Virgin Enterprises Limited for the use of the Virgin Money brand trademark.

Virgin Atlantic Airways

The Group incurs credit card commissions and air mile charges to Virgin Atlantic Airways Limited (VAA) in respect of an agreement between the two parties. Prior to 2014, there was a tripartite agreement between the Group, VAA and MBNA for the credit card commission and air mile charges to VAA.

Dividend payment to Virgin Group Holdings Limited

The Group made a dividend payment of £2.2 million to Virgin Group Holdings Limited in October 2015, which represented that company's proportionate share of the total interim dividend (refer note 11).

Other costs to Virgin Management Group Companies

These costs include transactions with other companies in the Virgin Group.

It is anticipated that Sapphire Cards Limited (formerly Virgin Money Cards Limited), which is no longer part of the Group, will benefit from the surrender of tax losses by the Virgin Group in the years 2009 to 2011. This anticipated transaction is considered to meet the definition of a related party transaction (refer note 9).

The Group incurs credit card point of sale discount fees to Virgin Holidays Limited.

A number of banking transactions are entered into with related parties as part of normal banking business. These include deposits.

NOTE 38: EVENTS AFTER BALANCE SHEET DATE

On 25 January 2016, the Group raised £803.0 million from institutional investors through the issuance of Residential Mortgage Backed Securities in the Gosforth Funding 2016-1 transaction.

NOTE 39: FUTURE ACCOUNTING DEVELOPMENTS

A number of new accounting standards and amendments to accounting standards have been issued by the IASB, however have not been endorsed by the European Union. Those which may be relevant to the Group are set out below.

Pronouncement	Nature of change	IASB effective date
IFRS 9 'Financial Instruments'	IFRS 9 'Financial Instruments', published in July 2014, replaces the existing guidance in IAS 39 'Financial Instruments: Recognition and Measurement'. IFRS 9 is split over 3 phases: Phase 1 includes revised guidance on the classification and measurement of financial instruments. Financial assets will be classified and measured based on the business model under which they are held and the characteristics of their contractual cash flows. Financial liabilities designated under the fair value option will be required to generally present fair value changes that are attributable to the liability's credit risk in other comprehensive income rather than profit or loss. Phase 2 is a new expected credit loss model for calculating impairment on financial assets. Under this approach, it is no longer necessary for a credit event to have occurred before credit losses are recognised. Instead, the Group will always account for expected credit losses and changes in those expected credit losses. Phase 3 is the new general hedge accounting requirements. These requirements aim to more closely align hedge accounting with the Group's risk management strategy. The work on macro hedging by the IASB is still at a preliminary stage and has not yet been issued as part of the finalised standard. A project team has been mobilised to begin work on assessing the impact of IFRS 9 across the Group, with particular emphasis on phase 2—the new impairment expected credit loss model. At this stage a full assessment of the impact of IFRS 9 has not been made by the Group. The Group is on track to successfully deliver the changes required to adopt IFRS 9 on 1 January 2018 (subject to EU endorsement).	1 January 2018 (has not been EU endorsed)
IFRS 15 'Revenue from Contracts with Customers'	Current revenue recognition accounting standards have led to inconsistencies in accounting for similar transactions and inadequate disclosures. IFRS 15 specifies comprehensive principles on whether, how much and when an entity should recognise revenue arising from customer contracts. In addition, extensive disclosure requirements have been introduced to provide more informative and relevant disclosures, particularly around estimates and judgements.	1 January 2018 (has not been EU endorsed)

Pronouncement	Nature of change	IASB effective date
	The Group is reviewing the requirements of the new standard to determine its effect on its financial reporting.	
IFRS 16 'Leases'	This standard replaces IAS 17 'Leases' and will result in most leases for lessees being brought on to the Balance Sheet under a single lease model, removing the distinction between finance and operating leases. It requires a lessee to recognise a 'right-of-use' asset and a lease liability. Lessor accounting remains largely unchanged. The Group is reviewing the requirements of the new standard to determine its effect on its financial reporting.	1 January 2019 (has not been EU endorsed)

NOTE 40: COUNTRY BY COUNTRY REPORTING

The Capital Requirements (Country by Country Reporting) Regulations came into effect on 1 January 2014 and place certain reporting obligations on financial institutions within CRD IV.

All companies consolidated within the Group's financial statements are UK registered entities.

The activities of the Group are described in the Strategic Report.

	UK
Number of employees (average FTE)	2,824
Turnover (total income)	£521.9 million
Pre tax profit	£138.0 million
Corporation tax paid	£ 5.0 million
Public subsidies received	£ 0.0 million

The Group received no public subsidies during the year.

FULL ANALYSIS OF RISK CLASSES

Credit risk

Definition

Credit risk is defined as the risk that a borrower or counterparty fails to pay the interest or the capital due on a loan or other financial instrument (both on and off-balance sheet).

Risk appetite

The Group has appetite for high-quality and affordable lending. Credit risk appetite is reported through a comprehensive suite of metrics, supported by triggers, limits and policies.

Exposures

The principal sources of credit risk arise from loans and advances to customers, cash, debt securities and derivatives. The credit risk exposures of the Group are set out on page 159. Credit risk exposures are categorised as retail (secured and unsecured) and wholesale.

In terms of loans and advances, credit risk arises both from amounts lent and commitments to extend credit to a customer. This applies to the secured and unsecured portfolios. The existing overdraft book is a small closed portfolio with overdraft balances anticipated to reduce over time.

Loans and advances expose the Group to customer re-mortgage risk. Re-mortgage risk is the possibility that an outstanding exposure cannot be repaid at its contractual maturity date. If the Group does not wish to re-mortgage the exposure then there is re-mortgage risk if the customer is unable to repay by securing alternative finance. Re-mortgage risk exposures are managed in accordance with the Group's existing credit risk policies, processes and controls. They are not considered to be material given the Group's prudent risk appetite which is designed to be resilient through the cycle.

Where re-mortage risk exists (such as in the interest only retail mortgage portfolio) exposures are minimised through intensive account management and are impaired, where appropriate, with balance sheet provisions raised.

The Group regularly reviews lending practices in line with market conditions and regulatory focus. Growth in buy-to-let lending has been undertaken in a controlled manner, with Board oversight against risk appetite. Buy-to-let lending policy is targeted towards retail customers rather than portfolio landlords, with specific restrictions in place on total exposures by loan amount and number of properties.

Credit risk can also arise from debt securities, derivatives and foreign exchange activities. The Group's wholesale credit risk exposure is reflected on page 173.

Measurement

The Group uses statistical models to measure credit risk exposures. Models are supported by both internal and external data.

The 'probability of default' (that borrowers will not meet their contractual obligations), current exposures, and the likely loss ratio on defaulted obligations are calculated to measure and mitigate credit risk.

Portfolios are assessed by using segmentation for measurement and reporting purposes. Details of the classifications used for asset quality can be found on page 158.

The Group uses Advanced Internal Ratings Based (AIRB) models in measuring the credit risk of secured loans and advances to customers. All retail unsecured and wholesale exposures are measured under the Standardised Approach for regulatory capital.

Page 161 provides details of the Group's approach to the impairment of financial assets. Further details can also be found in note 1 to the financial statements in the Annual Report and Accounts.

Mitigation

The Group uses a range of approaches to mitigate credit risk.

Credit principles and policy

The Risk Function sets out the credit principles and policy for each type of credit risk. Principles and policies are reviewed regularly, and any changes are subject to a review and approval process. Policies, where appropriate, are supported by the lending manual, which defines the responsibilities of underwriters and provides a rule set for credit decisions. These policies and the lending manual define chosen target market and risk acceptance criteria. The Risk Function also uses early warning indicators to help anticipate future areas of concern and allow the Group to take early and proactive mitigating actions. Risk oversight teams monitor credit performance trends, review and challenge exceptions to planned outcomes, and test the adequacy of credit risk infrastructure and governance processes throughout the Group. This includes tracking portfolio performance against an agreed set of key risk indicators. Counterparty exposures are regularly reviewed and appropriate interventions are used where necessary. Oversight and reviews are also undertaken by Risk Assurance and Internal Audit.

Controls over rating systems

The Group has established an Independent Model Validation team that sets common minimum standards. The standards are designed to ensure risk models and associated rating systems are developed consistently, and are of sufficient quality to support business decisions and meet regulatory requirements. Internal rating systems are developed and owned by the Risk Function which takes responsibility for ensuring the validation of the rating systems, supported and challenged by an independent specialist.

Specialist expertise

Credit quality is managed and controlled by specialist units in Operations providing intensive management and control (see Debt management for customers in financial difficulty), maintenance and retention, expertise in documentation for lending and associated products, sector specific expertise, and legal services applicable to the particular market place and product range offered by the business.

Credit decisions may be manually underwritten, where appropriate. This is performed by skilled and competent colleagues acting within their agreed delegated authority.

Stress testing and scenario analysis

The Group's credit portfolios are subjected to regular stress testing, with stress scenario assessments run at various levels of the organisation from Group-led to individual portfolio exercises. For further information on the stress testing process, methodology and governance refer to page 150.

Credit risk assurance and review

A specialist team within Risk Assurance, comprising of experienced credit professionals, is in place to perform credit risk assurance. This team performs independent risk-based reviews providing an assessment of the effectiveness of internal controls and risk management practices. In addition to these 'standard' risk-based reviews, bespoke assignments are also undertaken in response to emerging risks and regulatory requirements.

Additional mitigation for retail customers

The Group uses a variety of lending criteria when assessing applications for mortgages and unsecured lending. The general approval process uses credit acceptance scorecards and involves a review of an applicant's previous credit history using information held by credit reference agencies.

The Group also assesses the affordability of the borrower under stressed scenarios including increased interest rates. In addition, the Group has in place quantitative limits such as maximum limits on the level of borrowing to income and the ratio of borrowing to collateral. Some of these limits relate to internal approval levels and others are hard limits above which the Group will reject the application. The Group also has certain criteria that are applicable to specific products such as applications for a mortgage on a property that is to be let by the applicant.

For residential mortgages, the Group's policy is to accept only standard applications with a loan-to-value (LTV) less than 95%. Applications with a LTV up to 95% are permitted for certain schemes, for example, applications between 90% and 95% LTV are only permitted under the Help to Buy loan guarantee scheme. The Group has maximum % LTV limits which depend upon the loan size. Residential mortgage limits are:

Loan size from	To	Maximum LTV
£1	£ 500,000	95% (purchase) 90% (remortgage)
£500,001	£1,000,000	80%

Buy-to-let is limited to a maximum of 75% LTV and residential interest only is limited to a maximum of 70% LTV, regardless of loan size.

The Group's approach to underwriting applications for unsecured products takes into account the total unsecured debt held by a customer and its affordability.

The Group rejects any application for an unsecured product where a customer is registered as bankrupt or insolvent, or has a County Court Judgement registered at a credit reference agency used by the Group. In addition, the Group rejects any credit card applicant with excessive levels of secured or unsecured debt.

The Group uses statistically based decisioning techniques (primarily credit scoring models) for its retail portfolios. The Risk Function reviews model effectiveness, while new models and model changes are referred to the appropriate model governance committee for approval.

Collateral for secured retail and wholesale exposures

The Group maintains guidelines on the acceptability of specific classes of collateral.

The sole collateral type for loans and advances to customers (mortgages) is residential real estate. Property offered as collateral must be of acceptable construction and located in England, Wales, Scotland or Northern Ireland. Title to the property must be good, marketable and free from onerous restrictions and conditions. The Group requires first legal charge over the property offered as collateral and does not accept charges over part of the collateral. The Group does not lend where the collateral is land only.

Collateral held as security for financial assets other than loans and advances is determined by the nature of the instrument. Debt securities, treasury and other bills are generally unsecured, with the exception of asset-backed securities and similar instruments such as covered bonds, which are secured by portfolios of financial assets. Collateral is generally not held against loans and advances to financial institutions, except where a collateral agreement has been entered into under a master netting agreement. Derivative transactions with wholesale counterparties are collateralised under a Credit Support Annex in conjunction with the ISDA Master Agreement.

It is the Group's policy that collateral should always be realistically valued by an appropriately qualified source, independent of both the credit decision process and the customer, at the time of borrowing. Collateral is reviewed on a regular basis and will vary according to the type of lending and collateral involved.

In order to minimise credit loss, the Group may seek additional collateral from a wholesale counterparty as soon as impairment indicators are identified for the relevant wholesale exposures.

The Group considers risk concentrations by collateral providers and collateral type, as appropriate, with a view of ensuring that any potential undue concentrations of risk are identified and suitably managed by changes to strategy, policy and/or business plans (refer to 'Concentration Risk').

Master netting agreements for wholesale exposures

Where it is appropriate, the Group seeks to enter into master netting agreements, or the netting of exposures to a single wholesale counterparty. Master netting agreements do not generally result in an offset of balance sheet assets and liabilities for accounting purposes, as transactions are usually settled on a gross basis. They do reduce the credit risk to the extent that, if an event of default occurs, all amounts with the counterparty are terminated and settled on a net basis. The Group's overall exposure to credit risk on derivative instruments subject to master netting agreements can change substantially within a short period, since this is the net position of all trades under the master netting agreement.

Monitoring

In conjunction with the Risk Function, the business identifies and defines portfolios of credit and related risk exposures and the key benchmarks, behaviours and characteristics by which those portfolios are managed in terms of credit risk exposures. This entails the production and analysis of regular portfolio monitoring reports for review by senior management. The Risk Function in turn produces a review of credit risk throughout the Group, including reports on significant credit exposures, which are presented to the Risk Management Committee and the Board Risk Committee.

The performance of all rating models is monitored on a regular basis to ensure that models provide appropriate risk differentiation capability, the generated ratings remain as accurate and robust as practical, and the models assign appropriate risk estimates to grades/pools. All models are monitored against a series of agreed key performance indicators. In the event that the monitoring identifies material exceptions or deviations from expected outcomes, these will be escalated in accordance with the governance framework.

Debt management for customers in financial difficulty

The Group operates a number of treatments to assist borrowers who are experiencing financial stress. The material elements of these treatments through which the Group has granted a concession, whether temporarily or permanently, are set out as follows.

The Group's aim in offering forbearance and other assistance to retail customers in financial distress is to benefit both the customer and the Group by discharging the Group's regulatory and social responsibilities to support customers and act in their best long-term interests. This allows customer facilities to be brought back into a sustainable position which, for residential mortgages, may also mean keeping customers in their homes. The Group offers a range of tools and assistance to support customers who are encountering financial difficulties. Cases are managed on an individual basis, with the circumstances of each customer considered separately and the action taken judged as being affordable and sustainable for the customer. Operationally, the provision and review of such assistance is controlled by various methods. These include the application of an appropriate policy framework, controls around the execution of policy, regular review of the different treatments to confirm that they remain appropriate, monitoring of customers' performance including the level of payments received, and management visibility of the nature and extent of assistance provided and the associated risk.

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

One component of the management approach is to contact customers showing signs of financial difficulty to discuss their circumstances and offer solutions to prevent their accounts falling into arrears.

Debt management for secured lending

The specific tools available to assist customers vary by product and the customer's status. In defining the treatments offered to customers who have experienced financial distress, the Group distinguishes between the following categories for secured assets:

- payment arrangements: a temporary arrangement for customers in financial distress where arrears accrue at the contractual payment, for example, short-term arrangements to pay less than the contractual payment;
- transfers to interest only: an account change to assist customers through periods of financial difficulty where arrears do not accrue at the original contractual payment. Any arrears existing at the commencement of the arrangement are retained;
- term extensions: a permanent account change for customers in financial distress where the overall term of the mortgage is extended, resulting in a lower contractual monthly payment; and
- discretionary payment holidays: a temporary account change to assist customers through periods of financial difficulty where arrears do not accrue at the original contractual payment. Any arrears existing at the commencement of the arrangement are retained.

To assist customers in financial distress, the Group benefits from Income Support for Mortgage Interest, a UK Government sponsored programme for households. This is a Government medium-term initiative that provides a payment to the Group for certain defined categories of customers (principally those who are unemployed with access to a benefit scheme). Qualifying customers are able to claim for mortgage interest on up to £200,000 of the mortgage. All decisions regarding an individual's eligibility and any amounts payable under the scheme rest solely with the Government. Where this scheme provides borrowers with a state benefit that is used to service the loan, there is no change in the reported status of the loan which is managed and reported in accordance with its original terms.

The Group assesses whether a loan benefiting from this UK Government sponsored programme is impaired using the same accounting policies and practices as it does for loans not benefiting from such a programme. Loans included within the Income Support for Mortgage Interest scheme may be impaired, in accordance with the normal definition of impairment.

The Group is monitoring developments in relation to the ruling by the Northern Ireland courts against capitalisation of arrears in Bank of Scotland versus Rea.

Debt management for unsecured lending

Income and expenditure assessments are undertaken for all customers entering into a long-term repayment plan to ensure that customers are provided with a sustainable and affordable solution that allows customers a realistic opportunity to repay their debt in the short to medium-term. In addition, the Group will signpost customers to contact debt management companies (such as Citizens Advice Bureau, Stepchange and Payplan). These companies do not charge any fees and will offer advice to customers as well as work with creditors to agree affordable repayment plans. Understanding what has changed and establishing the customers' current and future financial situation is imperative to ensuring that the right level of support is offered and that customers receive the appropriate solution to help them manage their debt when in financial difficulty.

Forbearance and provisioning

The Group measures the success of forbearance schemes for secured loans. This is based upon the proportion of customers who remain neither past due nor impaired or repay their loan fully over the 12 months following the exit from a forbearance treatment. For temporary treatments, 100% of customers accepting reduced payment arrangements have remained within contractual terms following the end of their treatment, and are either fully up to date or had redeemed their loan as at 31 December 2015. For permanent treatments, 94% of customers who have accepted interest only concessions, 96% of customers who have had a discretionary payment holiday and 95% of customers who have accepted term extensions, remained within contractual terms following the end of their treatment as at 31 December 2015.

The Group classifies a retail account as forborne at the time a customer in financial difficulty is granted a concession. Accounts are classified as forborne only for the period of time which the exposure is known to be, or may still be, in financial difficulty. Where temporary forbearance is granted, exit criteria are applied to include accounts until they are known to no longer be in financial difficulty.

Where the treatment involves a permanent change to the contractual basis of the customer's account, such as conversion to interest only or term extension, the Group classifies the balance as forborne for a period of 12 months, after which no distinction is made between these accounts and others where no change has been made.

The Group's approach is to ensure that provisioning models, supported by management judgement, appropriately reflect the incurred loss risk of exposures. The Group uses sophisticated behavioural scoring to assess customers' credit risk. The underlying behavioural scorecards consider many different characteristics of customer behaviour, both static and dynamic, from internal sources and also from credit bureau data, including characteristics that may identify when a customer has been in arrears on products held with other firms. Hence, these models take a range of potential indicators of customer financial distress into account.

The performance of provision models is monitored and challenged on an ongoing basis in line with the Retail Credit Provisioning Policy. The models are also regularly recalibrated to reflect up to date customer behaviour and market conditions. Specifically, regular detailed analysis of modelled provision outputs is undertaken to demonstrate that the risk of forbearance or other similar activities is recognised, that the outcome period adequately captures the risk and that the underlying risk is appropriately reflected. Where this is not the case, additional provisions are applied to capture the risk.

Forbearance provisioning for secured lending

At 31 December 2015, £259.5 million (2014: £267.5 million) of retail secured loans and advances were currently, or recently, subject to forbearance.

Collective impairment assessment of retail secured loans subject to forbearance: Loans which are forborne are grouped with other assets with similar risk characteristics and assessed collectively for impairment. The loans are not considered as impaired loans unless they meet the Group's definition of an impaired asset.

Forbearance provisioning for unsecured lending

At 31 December 2015, total retail unsecured loans and advances benefiting from forbearance totalled £10.7 million (2014: £12.9 million).

Collective impairment assessment of retail unsecured loans and advances subject to forbearance: Credit risk provisioning for the retail unsecured portfolio is undertaken on a collective basis, except for fraud cases which are fully provided for. The approach used is based on roll rates for various behavioural and arrears status segments, measuring the likelihood of default and the probability of charge-off given default.

Following the migration of the credit card portfolio, the Group widened its definition of forbearance. The migration of the credit card portfolio to the Group's infrastructure has allowed an improvement to management information and better identification of individual customer circumstances.

Credit risk portfolio 31 December 2015

Overview

- impairment provisions increased 30% to £39.9 million as at 31 December 2015 (2014: £30.6 million);
- impairment assets as a percentage of loans and advances to customers remained stable at 0.4% as at 31 December 2015 (2014: 0.5%); and
- there were no wholesale impairment provisions as at 31 December 2015. The table below shows total credit exposures.

	Secured		Unsecured		Wholesale		
2015 (audited)	**Residential mortgage loans**	**Residential buy-to-let mortgage loans**	**Credit cards**	**Overdrafts**	**Treasury assets**	**Derivative exposures**	**Total**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Total gross loans and advances to customers	**21,060.3**	**4,401.9**	**1,609.8**	**0.2**	—	—	**27,072.2**
Loans and advances to banks	—	—	—	—	**614.5**		**614.5**
Cash and balances at central banks	—	—	—	—	**888.6**	—	**888.6**
Debt securities classified as loans and receivables	—	—	—	—	**1.1**	—	**1.1**
Available-for-sale financial assets	—	—	—	—	**1,296.9**	—	**1,296.9**
Gross positive fair value of derivative assets	—	—	—	—	—	**82.3**	**82.3**
Total	**21,060.3**	**4,401.9**	**1,609.8**	**0.2**	**2,801.1**	**82.3**	**29,955.6**

	Secured		Unsecured		Wholesale		
2014 (audited)	**Residential mortgage loans**	**Residential buy-to-let mortgage loans**	**Credit cards**	**Overdrafts**	**Treasury assets**	**Derivative exposures**	**Total**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Total gross loans and advances to customers	18,759.5	3,135.6	1,121.1	0.2	—	—	23,016.4
Loans and advances to banks excluding Bank of England	—	—	—	—	720.5	—	720.5
Cash and balances at central banks	—	—	—	—	851.3		851.3
Debt securities classified as loans and receivables	—	—	—	—	8.6	—	8.6
Available-for-sale financial assets	—	—	—	—	1,539.6		1,539.6
Gross positive fair value of derivative assets	—	—	—	—	—	101.2	101.2
Total	**18,759.5**	**3,135.6**	**1,121.1**	**0.2**	**3,120.0**	**101.2**	**26,237.6**

Credit quality of assets

Loans and receivables

The Group defines three classifications of credit quality (low risk, medium risk and higher risk) for all credit exposures. These are based on the following criteria for the different credit risk exposure types.

Secured credit exposures are segmented according to the credit quality classification and a point in time probability of default (PD). The point in time PD is an internal parameter used within the Group's AIRB capital models which aims to estimate the probability of default over the next 12 months based on account characteristics and customer behavioural data. Default occurs where a borrower has missed six months of mortgage repayments or the borrower is deemed to be unlikely to repay their loan. Exposures are categorised as:

- higher risk where assets are past due or have a point in time PD greater than 2%;
- medium risk where assets are not past due and have a PD greater than 0.8% and less than or equal to 2%; and
- low risk where assets are not past due and have a PD less than or equal to 0.8%.

Unsecured exposures are categorised as:

- higher risk where assets are past due;
- medium risk where assets are currently not past due and benefiting from a forbearance solution; and
- low risk where assets are neither past due nor in forbearance.

Wholesale credit exposures are assessed by reference to credit rating. The Group's wholesale exposures are investment grade and therefore classified as low risk.

Further asset quality categorisation is disclosed on page 161, which reflects the impairment status of assets.

No wholesale loans and receivables credit exposures are past due nor impaired as at 31 December 2015 or 2014.

Maximum credit exposure

The maximum credit risk exposure of the Group in the event of other parties failing to perform their obligations is detailed below. No account is taken of any collateral held, other credit enhancements or provisions for impairment.

The maximum credit risk exposure for off-balance sheet items relates to applications that have been approved and have not yet been drawn by the customer and undrawn loan commitments (pipeline). These commitments represent agreements to lend in the future and may be decreased or removed by the Group, subject to product notice requirements.

2015 (audited)	Low risk	Medium risk	Higher risk	Total exposures	Low risk	Medium risk	Higher risk
	£m	£m	£m	£m	%	%	%
On-balance sheet							
Wholesale							
Cash and balances at central banks	**888.6**	—	—	**888.6**	**100.0**	—	—
Debt securities classified as loans and receivables	**1.1**	—	—	**1.1**	**100.0**	—	—
Available-for-sale financial assets	**1,296.9**	—	—	**1,296.9**	**100.0**	—	—
Loan and advances to banks	**614.5**	—	—	**614.5**	**100.0**	—	—
Derivative financial instruments	**82.3**	—	—	**82.3**	**100.0**	—	—
Retail							
Gross loans and advances to customers—secured	**22,916.7**	**1,652.7**	**892.8**	**25,462.2**	**90.0**	**6.5**	**3.5**
Gross loans and advances to customers—unsecured	**1,579.7**	**2.9**	**27.4**	**1,610.0**	**98.1**	**0.2**	**1.7**
Total on-balance sheet	**27,379.8**	**1,655.6**	**920.2**	**29,955.6**	**91.4**	**5.5**	**3.1**
Off-balance sheet							
Loan commitments (pipeline and undrawn commitments)	**4,479.8**	—	—	**4,479.8**	**100.0**	—	—

2014 (audited)	Low risk	Medium risk	Higher risk	Total exposures	Low risk	Medium risk	Higher risk
	£m	£m	£m	£m	%	%	%
On-balance sheet							
Wholesale							
Cash and balances at central banks	851.3	—	—	851.3	100.0	—	—
Debt securities classified as loans and receivables	8.6	—	—	8.6	100.0	—	—
Available-for-sale financial assets	1,539.6	—	—	1,539.6	100.0	—	—
Loan and advances to banks	720.5	—	—	720.5	100.0	—	—
Derivative financial instruments	101.2	—	—	101.2	100.0	—	—
Retail							
Gross loans and advances to customers—secured	19,636.3	1,574.5	684.3	21,895.1	89.7	7.2	3.1
Gross loans and advances to customers—unsecured(1)	1,090.7	3.2	27.4	1,121.3	97.3	0.3	2.4
Total on-balance sheet	**23,948.2**	**1,577.7**	**711.77**	**26,237.6**	**91.3**	**6.0**	**2.7**
Off-balance sheet							
Loan commitments (pipeline and undrawn commitments)	3,694.2	—	—	3,694.2	100.0	—	—

(1) The December 2014 forbearance balance was restated to reflect a change in the definition to include customers categorised as in hardship and on a payment plan or vulnerable.

Loans and advances to customers comprise:

(audited)	2015	2014
	£m	£m
Advances secured on residential property not subject to securitisation	**17,389.9**	15,631.2
Advances secured on residential property subject to securitisation	**3,670.4**	3,128.3
Total advances secured on residential property	**21,060.3**	18,759.5
Residential buy-to-let loans not subject to securitisation	**4,401.9**	3,135.6
Total loans and advances to customers secured on residential property	**25,462.2**	21,895.1
Impairment allowance-secured	**(8.7)**	(7.6)
Loans and advances-secured	**25,453.5**	21,887.5
Credit cards	**1,609.8**	1,121.1
of which relates to the fair value of expected losses on acquired assets	—	*(5.4)*
Overdrafts	**0.2**	0.2
Unsecured receivables not subject to securitisation	**1,610.0**	1,121.3
Impairment allowance—unsecured	**(31.2)**	(23.0)
Loans and advances—unsecured	**1,578.8**	1,098.3
Total loans and advances to customers excluding portfolio hedging	**27,032.3**	**22,985.8**

The mortgage portfolio has grown by 16% (£3.6 billion) during 2015. Buy-to-let loans grew by 40% (£1.3 billion) to £4.4billion, accounting for 17% of total secured loans (2014: 14%). This increase is in line with growth in the private rental sector and buy-to-let mortgage lending in the market. Growth in buy-to-let lending has been undertaken in a controlled manner, with the intention of moving BTL mix broadly in line with the market average.

Secured impairment allowances increased from £7.6 million to £8.7 million during 2015 in line with portfolio growth. Unsecured impairment provisions increased by £8.2 million to £31.2 million as a result of the unwinding of the fair value adjustment (£5.4 million unwound during 2015 of the original £5.9 million adjustment) for the credit card assets transferred onto the Group's balance sheet in November 2014 (accounts acquired and on MBNA systems from January 2013), and by the increase in new lending.

Credit risk categorisation	Description
Neither past due nor impaired	Loans that are not in arrears and which do not meet the impaired asset definition. This segment can include assets subject to forbearance solutions.
Neither past due nor impaired and in forbearance	Loans that are categorised as neither past due nor impaired, and are currently subject to one of the defined forbearance solutions.
Past due and not impaired	Loans that are in arrears or where there is objective evidence of impairment and the asset does not meet the definition of impaired assets, as the expected recoverable amount exceeds the carrying amount. This category is not applicable for unsecured lending.
Arrears	For secured lending, where the customer's payment shortfall exceeds 1% of the current monthly contractual payment amount. For unsecured lending, customers are classified as in arrears at one day past due.
Impaired assets	Loans that are in arrears or where there is objective evidence of impairment, including changes in customer behaviour or circumstances, and where the carrying amount of the loan exceeds the expected recoverable amount. Unsecured lending assets are treated as impaired at one day past due. All fraud and operational risk loans are categorised as impaired irrespective of the expected recoverable amount.

The credit quality of retail assets is detailed in the tables below.

2015 (audited)	Secured				Unsecured					
	Residential mortgage loans		Residential buy-to-let mortgage loans		Credit cards		Overdrafts		Total	
	£m	%	£m	%	£m	%	£m	%	£m	%
Neither past due nor impaired	**20,837.5**	**98.9**	**4,379.9**	**99.5**	**1,582.4**	**98.3**	**0.2**	**100.0**	**26,800.0**	**99.0**
—of which in receipt of forbearance[1]	*238.6*	*1.1*	*8.8*	*0.2*	*2.9*	*0.2*	—	—	*250.3*	*0.9*
Past due and not impaired	**145.2**	**0.7**	**15.0**	**0.3**	—	—	—	—	**160.2**	**0.6**
Impaired	**77.6**	**0.4**	**7.0**	**0.2**	**27.4**	**1.7**	—	—	**112.0**	**0.4**
Total	**21,060.3**	**100.0**	**4,401.9**	**100.0**	**1,609.8**	**100.0**	**0.2**	**100.0**	**27,072.2**	**100.0**

(1) This category reflects accounts which are neither past due nor impaired and subject to forbearance solutions. Accounts in this category are also included in the neither past due nor impaired categorisation.

2015 (audited)	Secured				Unsecured					
	Residential mortgage loans		Residential buy-to-let mortgage loans		Credit cards		Overdrafts		Total	
	£m	%	£m	%	£m	%	£m	%	£m	%
Neither past due nor impaired	18,508.0	98.6	3,110.4	99.2	1,093.7	97.6	0.2	100.0	22,712.3	98.6
—of which in receipt of forbearance[1]	*241.7*	*1.3*	*7.2*	*0.2*	*3.2*	*0.3*	—	—	*252.1*	*1.1*
Past due and not impaired	182.6	1.0	17.6	0.6	—	—	—	—	200.2	0.9
Impaired	68.9	0.4	7.6	0.2	27.4	2.4	—	—	103.9	0.5
Total	**18,759.5**	**100.0**	**3,135.6**	**100.0**	**1,121.1**	**100.0**	**0.2**	**100.0**	**23,016.4**	**100.0**

(1) This category reflects accounts which are neither past due nor impaired and subject to forbearance solutions. Accounts in this category are also included in the neither past due nor impaired categorisation. The December 2014 forbearance balance was restated to reflect a change in the definition to include customers categorised as in hardship and on a payment plan or vulnerable.

The criteria the Group use to determine that there is objective evidence of impairment are disclosed on page 161. All loans, where specific circumstances indicate that a loss is likely to be incurred (for example, mortgage accounts which have entered possession or loans where fraud has been confirmed), are individually assessed for impairment by reviewing expected future cash flows including those that could arise from the realisation of security.

Loans and advances which are neither past due nor impaired

Neither past due nor impaired balances account for 99.0% of the total portfolio (2014: 98.6%). This improvement is driven by new lending in the period, along with an overall reduction of customers in arrears.

There has been an increase in the higher risk balances within this categorisation due to accounts which have moved from being past due, and therefore remain to hold a higher probability of default.

The table below shows the details of the credit quality for neither past due nor impaired loans.

2015 (audited)	Residential mortgage loans		Residential buy-to-let mortgage loans		Total	
	£m	%	£m	%	£m	%
PD by internal ratings						
Low risk	**18,681.1**	**89.6**	**4,235.6**	**96.7**	**22,916.7**	**90.8**
Medium risk	**1,519.0**	**7.3**	**133.7**	**3.1**	**1,652.7**	**6.6**
Higher risk	**637.4**	**3.1**	**10.6**	**0.2**	**648.0**	**2.6**
Total neither past due nor impaired	**20,837.5**	**100.0**	**4,379.9**	**100.0**	**25,217.4**	**100.0**

2014 (audited)	Residential mortgage loans		Residential buy-to-let mortgage loans		Total	
	£m	%	£m	%	£m	%
PD by internal ratings						
Low risk	16,597.7	89.7	3,038.6	97.6	19,636.3	90.8
Medium risk	1,507.5	8.1	67.0	2.2	1,574.5	7.3
Higher risk	402.8	2.2	4.8	0.2	407.6	1.9
Total neither past due nor impaired	**18,508.0**	**100.0**	**3,110.4**	**100.0**	**21,618.4**	**100.0**

Loans and advances which are past due and not impaired

The balance of mortgages which are past due and not impaired totalled £160.2 million at 31 December 2015. There are no past due and not impaired balances relating to unsecured loans as these are included in the impaired definition. This represents a 20% (£40.0 million) decrease from 2014, attributable to improved arrears performance. These assets now represent 0.6% of secured loans (2014: 0.9%).

2015 (audited)	Residential mortgage loans		Residential buy-to-let mortgage loans		Total	
	£m	%	£m	%	£m	%
Up to one month	**44.4**	**30.6**	**4.3**	**28.7**	**48.7**	**30.4**
One to three months	**63.5**	**43.7**	**8.3**	**55.3**	**71.8**	**44.8**
Three to six months	**24.1**	**16.6**	**1.3**	**8.7**	**25.4**	**15.9**
Over six months	**13.2**	**9.1**	**1.1**	**7.3**	**14.3**	**8.9**
Total past due and not impaired	**145.2**	**100.0**	**15.0**	**100.0**	**160.2**	**100.0**

2014 (audited)	Residential mortgage loans		Residential buy-to-let mortgage loans		Total	
	£m	%	£m	%	£m	%
Up to one month	59.3	32.5	5.2	29.5	64.5	32.2
One to three months	72.1	39.5	8.2	46.6	80.3	40.1
Three to six months	29.6	16.2	2.6	14.8	32.2	16.1
Over six months	21.6	11.8	1.6	9.1	23.2	11.6
Total past due and not impaired	**182.6**	**100.0**	**17.6**	**100.0**	**200.2**	**100.0**

Impaired assets

The tables below show the movement of impaired loan balances during 2015 and 2014.

	Secured		Unsecured		Wholesale		
2015 (audited)	Residential mortgage loans	Residential buy-to-let mortgage loans	Credit cards	Overdrafts	Treasury assets	Derivative exposures	Total
	£m	£m	£m	£m	£m	£m	£m
As at 1 January 2015	**68.9**	**7.6**	**27.4**	**—**	**—**	**—**	**103.9**
Classified as impaired during the year	**174.9**	**22.2**	**81.9**	**—**	**—**	**—**	**279.0**
Transferred from impaired to unimpaired	**(151.2)**	**(21.6)**	**(42.7)**	**—**	**—**	**—**	**(215.5)**
Amounts written off	**(1.7)**	**(0.2)**	**(26.0)**	**—**	**—**	**—**	**(27.9)**
Repayments	**(13.3)**	**(1.0)**	**(13.2)**	**—**	**—**	**—**	**(27.5)**
As at 31 December 2015	**77.6**	**7.0**	**27.4**	**—**	**—**	**—**	**112.0**

2014 (audited)	Secured: Residential mortgage loans	Secured: Residential buy-to-let mortgage loans	Unsecured: Credit cards	Unsecured: Overdrafts	Wholesale: Treasury assets	Wholesale: Derivative exposures	Total
	£m	£m	£m	£m	£m	£m	£m
As at 1 January 2014	103.2	8.5	26.6	—	—	—	138.3
Classified as impaired during the year	121.6	14.5	77.0	—	—	—	213.1
Transferred from impaired to unimpaired	(136.5)	(13.7)	(39.4)	—	—	—	(189.6)
Amounts written off	(1.1)	(0.1)	(27.6)	—	—	—	(28.8)
Repayments	(18.3)	(1.6)	(9.2)	—	—	—	(29.1)
As at 31 December 2014	**68.9**	**7.6**	**27.4**	—	—	—	**103.9**

Total impaired assets increased by £8.1 million in the year to 31 December 2015. The increase in impaired asset balances on the secured portfolio is a result of a higher rate of discount cost observed on sold possessions, which have reduced the estimated recoverable loan amount of assets in this category. Observed discount costs are based on a low volume of possession sales during 2015 which have reduced to 47 cases (2014: 63). Possession stock reduced to 12 cases at 31 December 2015 from 18 cases in 2014. Despite this, secured impaired assets as a proportion of total secured loans remain stable at 0.3%.

An analysis of impaired assets by overdue term and assets where the borrower's property is in possession is provided in the table below.

2015 (audited)	Residential mortgage loans		Residential buy-to-let mortgage loans		Credit cards		Overdrafts		Total	
	£m	%	£m	%	£m	%	£m	%	£m	%
Up to one month	**50.6**	**65.1**	**4.5**	**64.3**	**11.8**	**43.1**	—	—	**66.9**	**59.7**
One to three months	**13.7**	**17.7**	**1.4**	**20.0**	**7.6**	**27.7**	—	—	**22.7**	**20.3**
Three to six months	**5.2**	**6.7**	**0.3**	**4.3**	**7.7**	**28.1**	—	—	**13.2**	**11.8**
Over six months	**7.2**	**9.3**	**0.7**	**10.0**	**0.3**	**1.1**	—	—	**8.2**	**7.3**
Possession	**0.9**	**1.2**	**0.1**	**1.4**	—	—	—	—	**1.0**	**0.9**
Total impaired assets	**77.6**	**100.0**	**7.0**	**100.0**	**27.4**	**100.0**	—	—	**112.0**	**100.0**

2014 (audited)	Residential mortgage loans		Residential buy-to-let mortgage loans		Credit cards		Overdrafts		Total	
	£m	%	£m	%	£m	%	£m	%	£m	%
Up to one month	44.1	64.0	4.0	52.7	11.0	40.1	—	—	59.1	56.9
One to three months	10.3	14.9	2.3	30.3	8.0	29.2	—	—	20.6	19.8
Three to six months	4.5	6.5	0.3	3.9	8.4	30.7	—	—	13.2	12.7
Over six months	9.0	13.1	0.7	9.2	—	—	—	—	9.7	9.3
Possession	1.0	1.5	0.3	3.9	—	—	—	—	1.3	1.3
Total impaired assets	**68.9**	**100.0**	**7.6**	**100.0**	**27.4**	**100.0**	—	—	**103.9**	**100.0**

The tables below show impaired assets and impairment provisions.

2015 (audited)	Gross balances	Impaired balances	Impaired balances as a % of gross balances	Impairment provisions	Impairment provisions as a % of impaired balances
	£m	£m	%	£m	%
Residential mortgage loans	**21,060.3**	**77.6**	**0.4**	**7.7**	**9.9**
Residential buy-to-let mortgage loans	**4,401.9**	**7.0**	**0.2**	**1.0**	**14.3**
Total secured	**25,462.2**	**84.6**	**0.3**	**8.7**	**10.3**
Credit cards	**1,609.8**	**27.4**	**1.7**	**31.1**	**113.5**
Overdrafts	**0.2**	**—**	**—**	**0.1**	**—**
Total unsecured	**1,610.0**	**27.4**	**1.7**	**31.2**	**113.9**
Wholesale treasury assets	**2,801.1**	**—**	**—**	**—**	**—**
Wholesale derivative exposures	**82.3**	**—**	**—**	**—**	**—**
Total wholesale	**2,883.4**	**—**	**—**	**—**	**—**
Total	**29,955.6**	**112.0**	**0.4**	**39.9**	**35.6**

2014 (audited)	Gross balances	Impaired balances	Impaired balances as a % of gross balances	Impairment provisions	Impairment provisions as a % of impaired balances
	£m	£m	%	£m	%
Residential mortgage loans	18,759.5	68.9	0.4	6.2	9.0
Residential buy-to-let mortgage loans	3,135.6	7.6	0.2	1.4	18.4
Total secured	21,895.1	76.5	0.3	7.6	9.9
Credit cards	1,121.1	27.4	2.4	22.9	83.6
Overdrafts	0.2	—	—	0.1	—
Total unsecured	1,121.3	27.4	2.4	23.0	83.9
Wholesale treasury assets	3,120.0	—	—	—	—
Wholesale derivative exposures	101.2	—	—	—	—
Total wholesale	**3,221.2**	—	—	—	—
Total	**26,237.6**	**103.9**	**0.4**	**30.6**	**29.5**

Impairment provisions:

- have increased by £1.1 million for secured loans in line with portfolio growth; and
- have increased by £8.2 million for unsecured loans, of which £5.4 million was attributable to unwinding the fair value adjustment described on page 161.

Impairment provisions as a percentage of impaired loans:

- for secured loans have increased from 9.9% to 10.3% despite an increase in impaired loans; and
- for unsecured loans have increased from 83.9% to 113.9% as result of the aforementioned unwinding of the fair value adjustment, showing a stable underlying performance.

The table below shows the movement of impairment provisions during the year.

(audited)	Secured: Residential mortgage loans	Secured: Residential buy-to-let mortgage loans	Unsecured: Credit cards	Unsecured: Overdrafts	Wholesale: Treasury assets	Wholesale: Derivative exposures	Total
	£m	£m	£m	£m	£m	£m	£m
At 1 January 2014	**7.0**	**0.6**	**27.0**	**0.1**	—	—	**34.7**
Advances written off	**(1.1)**	**(0.1)**	**(27.6)**	—	—	—	**(28.8)**
Gross charge to the income statement[(1)]	**0.3**	**0.9**	**23.5**	—	—	—	**24.7**
As 31 December 2014	**6.2**	**1.4**	**22.9**	**0.1**	—	—	**30.6**
Amounts written off during the year	**(1.7)**	**(0.2)**	**(26.0)**	—			**(27.9)**
Gross charge to the income statement[(1)]	**3.2**	**(0.2)**	**34.2**	—	—	—	**37.2**
As at 31 December 2015	**7.7**	**1.0**	**31.1**	**0.1**	—	—	**39.9**

(1) The net charge to the income statement in 2015 was £30.3 million (2014: £15.8 million). The difference between the gross and net charge represents sales of credit card receivables which had previously been written-off resulting in net recoveries of £6.9 million (2014: £8.9 million).

The Group's impairment charge increased from £24.7 million in 2014 to £37.2 million as at 31 December 2015.

Collateral held as security for financial assets

A general description of collateral held as security in respect of financial instruments is provided on page 154. The Group holds collateral against loans and receivables on the mortgage portfolio. Quantitative and, where appropriate, qualitative information is provided in respect of this collateral on page 170.

Loans and receivables to customers

The Group holds collateral in respect of loans and advances to customers as set out on page 154. The Group does not hold collateral against debt securities, comprising asset-backed securities and corporate and other debt securities, which are classified as loans and receivables.

The table below shows retail secured loan-to-value (LTV) %—indexed value at financial period end.

2015 (audited)	Residential mortgage loans		Residential buy-to-let mortgage loans		Total	
	£m	%	£m	%	£m	%
<50%	**8,125.8**	**38.6**	**1,443.5**	**32.8**	**9,569.3**	**37.6**
50%–<60%	**4,680.7**	**22.2**	**1,202.9**	**27.3**	**5,883.6**	**23.1**
60%–<70%	**4,026.2**	**19.1**	**1,069.7**	**24.3**	**5,095.9**	**20.0**
70%–<80%	**2,247.7**	**10.7**	**680.5**	**15.5**	**2,928.2**	**11.5**
80%–<90%	**1,720.1**	**8.2**	**3.4**	**0.1**	**1,723.5**	**6.8**
90%–<100%	**250.4**	**1.2**	**1.4**	—	**251.8**	**1.0**
>100%	**9.4**	—	**0.5**	—	**9.9**	—
Total	**21,060.3**	**100.0**	**4,401.9**	**100.0**	**25,462.2**	**100.0**
Average loan-to-value[(1)] of stock—indexed		**54.9%**		**55.4%**		**55.0%**
Average loan-to-value of new business		**69.8%**		**62.7%**		**68.0%**

(1) The average loan-to-value of stock and new business is balance weighted.

2014 (audited)	Residential mortgage loans		Residential buy-to-let mortgage loans		Total	
	£m	%	£m	%	£m	%
<50%	6,252.0	33.3	909.9	29.0	7,161.9	32.7
50%–<60%	4,649.9	24.8	978.3	31.2	5,628.2	25.7
60%–<70%	4,132.2	22.0	842.4	26.9	4,974.6	22.7
70%–<80%	2,464.8	13.1	396.0	12.6	2,860.8	13.1
80%–<90%	1,064.3	5.7	5.3	0.2	1,069.6	4.9
90%–<100%	180.9	1.0	2.4	0.1	183.3	0.8
>100%	15.4	0.1	1.3	—	16.7	0.1
Total	**18,759.5**	**100.0**	**3,135.6**	**100.0**	**21,895.1**	**100.0**
Average loan-to-value(1) of stock—indexed		55.8%		55.6%		55.7%
Average loan-to-value of new business		68.4%		61.3%		66.9%

(1) The average loan-to-value of stock and new business is balance weighted.

Average indexed LTVs on the book have decreased marginally by 0.7% as at 31 December 2015, reflecting the impact of house price movements reported between Q4 2014 and Q3 2015 for all UK regions.

The average LTV for new business has increased to 68.0% as at 31 December 2015 (2014: 66.9%). This has been partly driven by more than 3,500 new mortgages written under the government's Help to Buy schemes in 2015.

Details of the fair value of the property collateral held against retail secured loans are provided in the table below.

2015(1) (audited)	Residential mortgage loans		Residential buy-to-let mortgage loans		Total	
	£m	%	£m	%	£m	%
Neither past due nor impaired	20,836.9	100.0	4,379.8	100.0	25,216.7	100.0
—of which in receipt of forbearance	*238.6*	*100.0*	*8.8*	*100.0*	*247.4*	*100.0*
Past due and not impaired	145.2	100.0	15.0	100.0	160.2	100.0
Impaired	77.3	99.6	7.0	100.0	84.3	99.6
—of which in possession	*0.9*	*100.0*	*0.1*	*100.0*	*1.0*	*100.0*
Total	**21,059.4**	**100.0**	**4,401.8**	**100.0**	**25,461.2**	**100.0**

(1) Some segments may look fully collateralised due to immaterial balances in negative equity. Due to rounding these do not change the overall collateralised percentage shown.

Collateral held in relation to secured loans is capped at the amount outstanding on an individual loan basis. The percentages in the previous table represent the value of collateral, capped at loan amount, divided by the total loan amount in each category.

2014(1) (audited)	Residential mortgage loans		Residential buy-to-let mortgage loans		Total	
	£m	%	£m	%	£m	%
Neither past due nor impaired	18,506.6	100.0	3,110.2	100.0	21,616.8	100.0
—of which in receipt of forbearance	*241.7*	*100.0*	*7.2*	*100.0*	*248.9*	*100.0*
Past due and not impaired	182.6	100.0	17.6	100.0	200.2	100.0
Impaired	68.4	99.3	7.6	100.0	76.0	99.3
—of which in possession	*1.0*	*100.0*	*0.3*	*100.0*	*1.3*	*100.0*
Total	18,757.6	100.0	3,135.4	100.0	21,893.0	100.0

(1) Some segments may look fully collateralised due to immaterial balances in negative equity. Due to rounding these do not change the overall collateralised percentage shown.

The tables below show mortgages in negative equity. The value represents the excess between the mortgage balance and collateral value for mortgages where indexed LTV is greater than 100%.

The proportion of secured balances in negative equity has fallen below 0.1% at 31 December 2015 (2014: 0.1%). This relates to £9.9 million of asset balances in the mortgage portfolio that are exposed to negative equity (2014: £16.7 million). The amount of negative equity has decreased from £2.1 million at

31 December 2014 to £1.0 million as at 31 December 2015 as a result of positive house price movements observed in the portfolio.

2015 (audited)	Residential mortgage loans	Residential buy-to-let mortgage loans	Total
	£m	£m	£m
Neither past due nor impaired	**0.6**	**0.1**	**0.7**
—of which in receipt of forbearance	—	—	—
Past due and not impaired	—	—	—
Impaired	**0.3**	—	**0.3**
—of which in possession	—	—	—
Total	**0.9**	**0.1**	**1.0**

2014 (audited)	Residential mortgage loans	Residential buy-to-let mortgage loans	Total
	£m	£m	£m
Neither past due nor impaired	1.4	0.2	1.6
—of which in receipt of forbearance	—	—	—
Past due and not impaired	—	—	—
Impaired	0.5	—	0.5
—of which in possession	—	—	—
Total	1.9	0.2	2.1

Possessions

The Group works with customers who have difficulty paying their mortgages, and will only repossess a property when all other possibilities have been exhausted. Where accounts have been repossessed, the Group will obtain the best price that might reasonably be paid taking into account factors such as property and market conditions.

The Group uses external asset management specialists to realise the value as soon as practicable to settle indebtedness. Any surplus funds are returned to the borrower or are otherwise dealt with in accordance with appropriate insolvency regulations.

Possessions as a percentage of total book (number of properties)	2015		2014	
	Number	%	Number	%
Properties in possession	**12.0**	**0.01**	**18.0**	**0.01**
CML industry average[(1)]	**3,200.0**	**0.03**	**6,400.0**	**0.06**

(1) CML possession as at Q4 2015. The CML industry average includes banks with portfolios significantly larger than Virgin Money that drive up the industry average, so the percentage comparisons are more meaningful than the pure number comparisons.

Interest only mortgages

The Group provides interest only mortgages to customers, whereby payments made by the customer comprise interest for the term of the mortgage, with the customer responsible for repaying the principal outstanding at the end of the loan term. The Group's exposure to residential interest only mortgages for the year to 31 December 2015 has reduced, accounting for 33.1% of total secured balances, compared to 36.9% at 31 December 2014.

The table below provides details of balances which are on an interest only basis, analysed by maturity. This includes the interest only balances for loans on a part and part repayment basis.

2015 (audited)	Residential mortgage loans	Residential buy-to-let mortgage loans	Total
	£m	£m	£m
Term expired (still open)	**19.1**	**0.7**	**19.8**
Due within 2 years	**172.4**	**15.7**	**188.1**
Due after 2 years and before 5 years	**411.6**	**57.6**	**469.2**
Due after 5 years and before 10 years	**1,017.7**	**488.1**	**1,505.8**
Due after more than 10 years	**3,173.2**	**3,068.6**	**6,241.8**
Total	**4,794.0**	**3,630.7**	**8,424.7**
% of total secured loans and advances to customers	**22.8**	**82.5**	**33.1**

2014 (audited)	Residential mortgage loans	Residential buy-to-let mortgage loans	Total
	£m	£m	£m
Term expired (still open)	19.3	0.6	19.9
Due within 2 years	115.8	8.7	124.5
Due after 2 years and before 5 years	434.5	51.8	486.3
Due after 5 years and before 10 years	1,057.2	385.3	1,442.5
Due after more than 10 years	3,880.3	2,123.1	6,003.4
Total	**5,507.1**	**2,569.5**	**8,076.6**
% of total secured loans and advances to customers	**29.4**	**81.9**	**36.9**

Following a pilot exercise in 2014, a process is now in place to ensure that contact is made with customers who have an interest only mortgage scheduled to mature before the end of 2020. These customers are contacted each year to ask if their repayment strategy remains on track to repay the interest only mortgage loan in full at the end of the agreed term. If they are not on track, they are encouraged to make contact to discuss their options.

Interest only balances due to mature in the next two years represent 2.2% of total interest only balances, totalling £188.1 million at 31 December 2015. Treatment strategies exist to help customers who may not be able to repay the full amount of principal balance at maturity. Of residential interest only mortgages which have missed the payment of principal at the end of term, £19.8 million remain at 31 December 2015 (2014: £19.9 million).

All expired term balances are categorised as impaired loans, regardless of loss expectation.

The provisioning methodology for expired term mortgage loans reflects the latest performance on these accounts.

he Group offers interest only loans to applicants who have credible means to repay the mortgage loan at maturity.

The flow of new interest only residential business has remained low in 2015, representing 2.8% of residential completions. As a result, the proportion of residential interest only mortgages in the portfolio continues to reduce, moving from 24.7% to 19.1% during 2015.

The Group made enhancements to internal monitoring of the interest only portfolio to track closely movements in asset quality and better understand the composition of expired term balances. This management information is regularly reviewed to assess the effectiveness of the Group's interest only policy, contact strategies and to ensure the delivery of fair customer outcomes. Less than 0.1% of the secured portfolio relates to expired term loan balances, with the average balance of these loans around £49,000 and an average LTV of 22%.

Forbearance

2015 (audited)	Neither past due nor impaired		Past due not impaired		Impaired		Total	
	£m	%	£m	%	£m	%	£m	%
Secured								
Payment arrangement	**3.0**	**1.2**	**0.3**	**3.2**	**0.3**	**12.5**	**3.6**	**1.4**
Transfer to interest only	**17.5**	**7.1**	**3.3**	**34.0**	**0.8**	**33.3**	**21.6**	**8.3**
Term extension	**171.9**	**69.5**	**5.3**	**54.6**	**0.7**	**29.2**	**177.9**	**68.6**
Payment holiday	**55.0**	**22.2**	**0.8**	**8.2**	**0.6**	**25.0**	**56.4**	**21.7**
Total secured Forbearance	**247.4**	**100.0**	**9.7**	**100.0**	**2.4**	**100.0**	**259.5**	**100.0**
Unsecured								
Accounts where the customer has been approved on a repayment plan	**2.9**	**100.0**	**—**	**—**	**7.8**	**100.0**	**10.7**	**100.0**
Total Forbearance	**250.3**	**100.0**	**9.7**	**100.0**	**10.2**	**100.0**	**270.2**	**100.0**

The value of forbearance stock totalled £270.2 million at 31 December 2015, representing a 3.6% (£10.2 million) reduction on 31 December 2014.

2014 (audited)	Neither past due nor impaired		Past due not impaired		Impaired		Total	
	£m	%	£m	%	£m	%	£m	%
Secured								
Payment arrangement	2.8	1.1	0.4	2.4	0.1	4.8	3.3	1.2
Transfer to interest only	19.7	7.9	8.6	52.2	0.6	28.6	28.9	10.8
Term extension	162.5	65.3	4.0	24.2	0.9	42.8	167.4	62.6
Payment holiday	63.9	25.7	3.5	21.2	0.5	23.8	67.9	25.4
Total secured Forbearance	**248.9**	**100.0**	**16.5**	**100.0**	**2.1**	**100.0**	**267.5**	**100.0**
Unsecured(1)								
Accounts where the customer has been approved on a repayment plan	3.2	100.0			9.7	100.0	12.9	100.0
Total Forbearance	**252.1**	**100.0**	**16.5**	**100.0**	**11.8**	**100.0**	**280.4**	**100.0**

(1) The December 2014 forbearance balance was restated to reflect a change in the definition to include customers categorised as in hardship and on a payment plan or vulnerable.

Wholesale credit risk

(audited)	2015	2014
	£m	£m
Loans and advances to banks excluding Bank of England	**614.5**	720.5
Bank of England	**888.6**	851.3
Debt securities classified as loans and receivables	**1.1**	8.6
Debt securities classified as available-for-sale financial assets	**1,292.3**	1,539.6
Gross positive fair value of derivative contracts	**82.3**	101.2
Total	**2,878.8**	3,221.2

The Group's wholesale credit risk exposures reduced primarily to fund the growth in new loans and advances to customers.

At 31 December 2015 the single largest exposure to any single counterparty, which is not a sovereign or a supranational obligor, was £130.0 million (2014: £110.1 million). This exposure was to a large counterparty, with a credit rating of A. The table below shows the loans and advances to banks excluding the Bank of England.

(audited)	2015	2014
	£m	£m
AA+	**16.8**	19.9
AA–	**130.8**	144.4
A+	**205.5**	295.3
A	**174.3**	178.6
A–	**42.1**	39.6
BBB+	**45.0**	42.7
Total	**614.5**	**720.5**

The Group had cash balances with the Bank of England of £888.6 million and £851.3 million as at 31 December 2015 and 2014, respectively. These exposures were rated AA+ at both respective dates.

The table below shows debt securities classified as loans and receivables and debt securities classified as available-for-sale financial assets.

(audited)	2015		2014	
	Debt securities classified as loans and receivables	Debt securities classified as available-for-sale financial assets	Debt securities classified as loans and receivables	Debt securities classified as available-for-sale financial assets
	£m	£m	£m	£m
UK sovereign exposures	—	**409.5**	—	795.0
Non-domestic sovereign exposures	—	—	—	—
Supranational	—	**203.7**	—	310.7
Residential mortgage-backed securities	**1.1**	**59.4**	8.6	62.9
Covered bonds	—	**535.3**	—	265.7
Debt securities issued by banks	—	**84.4**	—	105.3
Other	—	—	—	—
Total	**1.1**	**1,292.3**	**8.6**	**1,539.6**

The table below shows the credit rating on debt securities classified as loans and receivables and debt securities classified as available-for-sale financial assets.

(audited)	2015	2014
	£m	£m
AAA	**798.4**	508.3
AA+	**434.9**	978.3
AA	—	20.9
AA–	**30.0**	—
A+	**29.0**	33.8
A	**1.1**	—
A–	—	6.9
Total	**1,293.4**	**1,548.2**

The changes to debt securities reflect a reduction from the high liquidity surplus held at year end 2014. Continued alignment of the Group's liquid asset portfolio to the evolving regulatory definition of high-quality liquid assets is reflected in the decrease in gilt holdings, increase in covered bonds and disposal of unsecured bank debt.

The credit rating of the debt securities remains high, with 95% having a rating of AA+ or better compared to 96% at 31 December 2014.

Derivative financial instruments

The Group reduces exposure to credit risk by using master netting agreements and by obtaining collateral in the form of cash or highly liquid securities. In respect of the Group's maximum credit risk relating to derivative assets of £82.3 million (2014: £101.2 million), cash collateral of £10.6 million (2014: £11.1 million) was held.

The Group measures exposure in over the counter (OTC) derivatives using the gross positive fair value of contracts outstanding with a counterparty, increased by potential future rises in fair value and reduced by gross negative fair value of contracts and collateral received.

While exposures are managed on a net basis, IAS 32 requires that they are represented on the balance sheet on a gross basis. Contracts with positive fair value are disclosed as assets in the balance sheet under 'derivative financial instruments'; those with negative fair value are disclosed as stated on the liabilities side under the same title.

Collateral received is shown as deposits by banks, with collateral posted shown as loans and advances to banks. The notes to the financial statements provide further information on collateral. The table below details OTC derivative exposures.

(audited)	**2015**	**2014**
	£m	**£m**
Gross positive fair value of derivative contracts	**82.3**	101.2
Netting with gross negative fair value of derivative contracts[1]	**(70.4)**	(90.0)
Potential future incremental exposure	**49.9**	49.4
Collateral received	**(10.6)**	(11.1)
Net OTC derivative exposures	**51.2**	**49.5**

(1) The use of netting allows positions on all bilateral transactions with any given counterparty to be offset.

The table below provides a summary of net OTC liabilities.

(audited)	**2015**	**2014**
	£m	**£m**
Gross negative fair value of derivative contracts	**(151.0)**	(223.1)
Netting with gross positive fair value of derivative contracts[1]	**70.4**	90.0
Collateral pledged (loans and advances to banks)	**76.7**	111.7
Net OTC derivative liability	**(3.9)**	(21.4)

(1) The use of netting allows positions on all bilateral transactions with any given counterparty to be offset.

The only netting agreements in place are in relation to derivative financial instruments and repurchase transactions. In respect of repurchase transactions, only the haircut between the asset pledged and deposit received is classed as an exposure given the balance sheet maintains the exposure to the underlying obligor.

The table below provides credit quality analysis of the gross OTC derivative exposures by credit rating of the counterparties.

(audited)	**2015**		**2014**	
	£m	**%**	**£m**	**%**
AA–	**22.1**	**26.9**	34.7	34.3
A+	**6.8**	**8.3**	9.6	9.5
A	**42.0**	**51.0**	42.2	41.7
A–	**6.4**	**7.7**	11.2	11.1
BBB+	**5.0**	**6.1**	3.5	3.4
Total	**82.3**	**100.0**	**101.2**	**100.0**

Market risk

Definition

Market risk is defined as the risk that the value of, or net income arising from, assets and liabilities changes as a result of interest rate or exchange rate movements. Market risk for the Group arises only as a natural consequence of carrying out and supporting core business activities. The Group does not trade or make markets. As a result interest rate risk is the only material market risk for the Group.

Market risk is assessed across the following classifications: interest rate mismatch risk, basis risk, pipeline risk, optionality risk and foreign currency risk.

Risk appetite

The Group has limited risk appetite for exposures to interest rate risk in the banking book (IRRBB), in terms of both potential changes to economic value, and changes to expected net interest income or earnings. This volatility is managed and reported through a suite of metrics supported by triggers, limits and policies.

Exposures

The Group's banking activities expose it to the risk of adverse movements in interest rates and exchange rates.

Interest rate mismatch risk in the Group's portfolio and in the Group's capital and funding activities arises from the different re-pricing characteristics of the Group's assets, liabilities (see loans and advances to customers on page 160) and off-balance sheet positions of the Group. Interest rate risk arises predominantly from the mismatch between interest rate sensitive assets and liabilities, the variation of volume of business written in response to changes in interest rate, optionality in customers' ability to complete or redeem their products, the investment term of capital and reserves, and the need to stabilise earnings in order to minimise income volatility.

- liabilities are either insensitive to interest rate movements, for example, interest free or very low interest customer deposits, or are sensitive to interest rate changes and bear rates which may be varied at the Group's discretion. There is a significant proportion of deposits with contractually fixed rates for their term to maturity;
- many assets are sensitive to interest rate movements. Some managed rate assets such as variable rate mortgages may be considered as a partial offset to the interest rate risk arising from the managed rate liabilities. A significant proportion of the Group's lending assets (mortgages) bear interest rates which are contractually fixed for periods of up to five years or longer;
- the Group establishes two types of hedge accounting relationships for interest rate risk: fair value hedges and cash flow hedges. The Group is exposed to fair value interest rate risk on fixed rate customer loans, fixed rate customer deposits and to cash flow interest rate risk on variable rate loans and deposits; and
- margin compression risk arises from the current low interest rate environment, which may restrict the ability to change interest rates applied to customers when interbank and central bank rates change.

Basis risk arises from possible changes in spreads, for example, where assets and liabilities reprice at the same time and the scale of rate movement differs.

Pipeline risk arises where new business volumes are higher or lower than forecast, requiring the business to unwind or execute additional hedging at rates which may differ to what was expected.

Optionality risk arises predominantly in retail activities, as customer balances amortise more quickly or slowly than anticipated due to economic conditions or customers' response to changes in economic conditions.

Foreign currency risk arises as a result of having assets, liabilities and derivative items denominated in currencies other than Sterling as a result of banking activities. This includes maintaining liquid assets and wholesale funding. The Group has minimal appetite for foreign currency risk. However, the Group does allow the purchase of liquid assets denominated in both U.S. Dollars and Euros within a well controlled limit framework.

Measurement

The Group uses scenario/stress based risk measures, for example, single factor stresses. These include interest rate re-pricing gaps, earnings sensitivity analysis and open foreign exchange positions.

During May 2015, the European Banking Authority published updated guidelines relating to the management of interest rate risk arising from non-trading activities. The Group expanded the IRRBB measurement framework and met regulatory guidelines in advance of the 1 January 2016 application date.

Interest rate risk exposure is monitored as follows:

- Capital at Risk (CaR) is considered for assets and liabilities in all interest rate risk re-pricing periods. This is expressed as the present value of the negative impact of a sensitivity test on the Group's capital position. Risk is measured considering both positive and negative shocks to interest rates. CaR quantifies the change in market value arising from an instantaneous parallel rise or fall in the yield curve, subject to a floor at 0% and relevant non-parallel yield curve stresses. CaR is controlled by a risk appetite limit and supporting metrics; and

- Earnings at Risk (EaR) is considered for assets and liabilities on the forecast balance sheet over a 12 month period. This measure is expressed as the adverse change to net interest income. EaR quantifies the impact to earnings over a rolling 12 month period of an instantaneous parallel rise or fall in the yield curve, subject to a floor at 0%. This measurement is enhanced with non-parallel stress scenarios (basis risk) and behavioural volume stresses (pipeline and optionality). EaR is controlled by a risk appetite limit and supporting metrics.

The Group has an integrated Asset and Liability Management system which allows it to measure and manage interest rate re-pricing profiles (including behavioural assumptions), perform stress testing and produce forecasts.

The following tables show the Group's sensitivities to an instantaneous parallel upward and downward shock to interest rates. The measure is simplified in that it assumes all interest rates for all maturities move at the same time and by the same amount.

Mitigation

As defined within the scope of the Group's IRRBB Policy, the Interest Rate Risk Transfer Pricing framework is used for all hedgeable interest rate risk. Treasury is responsible for managing risk and does this through natural offsets of matching assets and liabilities where possible.

Appropriate hedging activity of residual exposures is undertaken, subject to the authorisation and mandate of the Asset and Liability Committee, within the Board approved risk appetite. Certain residual interest rate risks may remain due to differences in basis and profile mismatches arising from customer behaviour. The impact of this is detailed in the tables on pages 178 and 179.

Monitoring

The Board Risk Committee regularly reviews market risk exposure as part of the wider risk management framework. Levels of exposures are compared to approved limits and triggers.

Capital at Risk

CaR as at 31 December 2015 increased from £26.3 million at 31 December 2014 to £32.2 million in a positive rate shock scenario. The increase in CaR arising under a positive rate shock is primarily due to the growth of fixed rate customer assets and liabilities, where customers may terminate their contract prior to the end of the fixed rate period. The level of CaR under a negative rate shock remains stable.

	2015		2014	
(unaudited)	**Positive rate shock**	**Negative rate shock(1)**	**Positive rate shock**	**Negative rate shock(1)**
	£m	**£m**	**£m**	**£m**
Interest rate mismatch risk	**(3.8)**	**3.1**	(5.7)	4.1
Basis risk	**—**	**—**	0.4	0.4
Pipeline risk	**8.9**	**4.7**	8.1	6.0
Optionality risk	**27.1**	**12.3**	23.5	10.7
Total interest rate risk—capital at risk	**32.2**	**20.1**	**26.3**	**21.2**

(1) Market rate (BBR, LIBOR and swaps) stresses are subject to a floor of 0%.

Earnings at Risk

EaR as at 31 December 2015 increased from £8.0 million at 31 December 2014 to £15.9 million in a positive rate shock scenario due to an increase in forecast contractually rate insensitive assets which do not reprice in an upward rate shock. EaR in a negative rate shock scenario has decreased by £9.2 million since 2014. The decline reflects revised forecast rate rises throughout the year; as a result, the stress severity reduced.

(unaudited)	2015		2014	
	Positive rate shock	Negative rate shock(1)	Positive rate shock	Negative rate shock(1)
	£m	£m	£m	£m
Interest rate mismatch risk	**4.0**	**2.9**	(1.8)	10.9
Basis risk	**(0.2)**	**0.1**	(0.4)	1.1
Pipeline risk	**3.8**	**1.7**	3.7	2.1
Optionality risk	**8.3**	**0.8**	6.5	0.6
Total interest rate risk—earnings at risk	**15.9**	**5.5**	**8.0**	**14.7**

(1) Market rate (BBR, LIBOR and swaps) stresses are subject to a floor of 0%.

The Capital and Earnings at Risk measures are based on a parallel stress to the yield curve for interest rate mismatch risk with complementary stress scenarios in other risk categories. The Group recognises that a parallel interest rate stress has inherent limitations and supplements this methodology with additional stress tests and balance sheet limits.

At 31 December 2015 the Group had negligible net foreign exchange risk positions. Potential exposures to changes in exchange rates are minimised by using cross-currency swaps and forward foreign exchange contracts. The table below shows assets and liabilities in foreign currency at sterling carrying values.

(audited)	2015		2014	
	US$ in £m	€ in £m	US$ in £m	€ in £m
Assets				
Loans and advances to banks	—	—	—	—
Available-for-sale financial assets	—	**3.3**	—	19.4
Other assets	**0.1**	**0.1**	0.1	—
Total assets	**0.1**	**3.4**	0.1	**19.4**
Liabilities				
Other Liabilities	**0.1**	**0.1**	—	—
Total liabilities	**0.1**	**0.1**	**—**	**—**
Notional value of derivatives affecting currency exposures	**—**	**—**	—	19.5
Net position	**—**	**3.3**	**0.1**	**(0.1)**

The following tables give an analysis of the re-pricing periods of assets and liabilities on the balance sheet. Mismatches in the re-pricing timing of assets, liabilities, and off-balance sheet positions create interest rate risk quantified in CaR and EaR.

2015[(1)] (audited)	**Within 3 months**	**After 3 months and within 6 months**	**After 6 months and within 1 year**	**After 1 year and within 5 years**	**After 5 years**	**Non interest bearing instruments**	**Total**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Assets							
Cash and balances at central banks	**835.5**	—	—	—	—	**53.1**	**888.6**
Loans and receivables:							
Loans and advances to banks	**610.0**	—	—	—	—	**4.5**	**614.5**
Loans and advances to customers	**7,201.3**	**1,710.6**	**3,132.4**	**14,407.5**	**516.9**	**140.3**	**27,109.0**
Debt securities	**1.2**	—	—	—	—	**(0.1)**	**1.1**
Available-for-sale financial assets	**373.2**	**4.7**	**59.0**	**177.9**	**612.7**	**69.4**	**1,296.9**
Other assets	—	—	—	—	—	**318.9**	**318.9**
Total assets	**9,021.2**	**1,715.3**	**3,191.4**	**14,585.4**	**1,129.6**	**586.1**	**30,229.0**
Liabilities							
Deposits from banks	**1,298.7**	—	—	—	—	—	**1,298.7**
Customer deposits	**14,679.4**	**1,661.6**	**3,443.6**	**5,348.6**	—	**11.7**	**25,144.9**
Debt securities in issue	**1,745.9**	—	—	**300.0**	—	**(6.5)**	**2,039.4**
Other liabilities	—	—	—	—	—	**405.7**	**405.7**
Equity	—	—	—	**160.0**	—	**1,180.3**	**1,340.3**
Total liabilities and equity	**17,724.0**	**1,661.6**	**3,443.6**	**5,808.6**	—	**1,591.2**	**30,229.0**
Notional values of derivatives affecting interest rate sensitivity	**7,698.6**	**199.8**	**591.2**	**(7,103.3)**	**(1,386.3)**	—	—
Total interest rate sensitivity gap	**(1,004.2)**	**253.5**	**339.0**	**1,673.5**	**(256.7)**	**(1,005.1)**	—
Cumulative interest rate sensitivity gap	**(1,004.2)**	**(750.7)**	**(411.7)**	**1,261.8**	**1,005.1**	—	—

(1) Items are allocated to time bands in the table above by reference to the earlier of the next contractual interest rate re-pricing date and the residual maturity date.

2014[(1)] (audited)	**Within 3 months**	**After 3 months and within 6 months**	**After 6 months and within 1 year**	**After 1 year and within 5 years**	**After 5 years**	**Non interest bearing instruments**	**Total**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Assets							
Cash and balances at central banks	803.7	—	—	—	—	47.6	851.3
Loans and receivables:							
Loans and advances to banks	717.4	—	—	—	—	3.1	720.5
Loans and advances to customers	6,842.1	1,247.2	2,522.1	12,004.4	324.1	153.2	23,093.1
Debt securities	11.1	—	—	—	—	(2.5)	8.6
Available-for-sale financial assets	230.1	—	41.7	311.8	841.7	114.3	1,539.6
Other assets	—	—	—	—	—	323.7	323.7
Total assets	**8,604.4**	**1,247.2**	**2,563.8**	**12,316.2**	**1,165.8**	**639.4**	**26,536.8**
Liabilities							
Deposits from banks	846.7	—	—	—	—	—	846.7
Customer deposits	14,381.2	1,108.4	1,827.4	5,025.0	2.0	21.7	22,365.7
Debt securities in issue	1,594.1	—	—	—	—	—	1,594.1
Other liabilities	—	—	—	—	—	486.5	486.5
Equity	—	—	—	160.0	—	1,083.8	1,243.8
Total liabilities and equity	**16,822.0**	**1,108.4**	**1,827.4**	**5,185.0**	**2.0**	**1,592.0**	**26,536.8**
Notional values of derivatives affecting interest rate sensitivity	7,721.4	145.9	(517.7)	(5,799.3)	(1,548.1)	(2.2)	—
Total interest rate sensitivity gap	**(496.2)**	**284.7**	**218.7**	**1,331.9**	**(384.3)**	**(954.8)**	**—**
Cumulative interest rate sensitivity gap	(496.2)	(211.5)	7.2	1,339.1	954.8	—	—

(1) Items are allocated to time bands in the table above by reference to the earlier of the next contractual interest rate re-pricing date and the residual maturity date.

The interest rate re-pricing table shown above reflects the re-pricing of assets and liabilities without adjustments to the re-pricing profile that reflect future pricing assumptions or taking into account expected future business that the Group hedges ahead of becoming contractually bound. The Group manages interest rate risk taking these factors into account. Therefore, the increased gap profile shown above does not directly translate to the CaR and EaR term mismatch quantification.

Operational risk

Definition

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, including legal risk.

The aim of operational risk management is to manage operational risks in line with defined appetite and to protect both customers and the Group while delivering sustainable growth. The Group's Operational Risk Framework is the method by which operational risks are managed in terms of setting risk appetite, evaluating key exposures, measuring, mitigating, and monitoring risks on an ongoing basis, as set out below.

Risk appetite

The Group's operational risk appetite is designed to safeguard the interests of customers, internal and external stakeholders, and shareholders.

Exposures

The principal operational risks to the Group are:

- IT systems and resilience risk arising from failure to develop, deliver and maintain effective IT solutions;
- information security risk arising from information leakage, loss or theft;
- external fraud arising from an act of deception or omission;
- cyber risk arising from malicious attacks on the Group via technology, networks and systems;
- service disruption;
- failure of a third party corporate partner or strategic supplier; and
- normal business operational risk including transaction processing, information capture and implementation of change.

Measurement

A variety of measures are used such as scoring of potential risks, considering impact and likelihood, assessing the effectiveness of controls, monitoring of events and losses by size, functional area and internal risk categories.

Operational risk exposure and actual losses are used by the Group to calculate the appropriate holding of operational risk capital. The Group calculates Pillar 1 operational risk capital requirements using the Standardised Approach, in line with the Basel Committee guidance.

Mitigation

The Group's control environment is regularly reviewed. Reporting on material risks is discussed monthly by senior management. Risks are managed through a range of strategies—avoidance, mitigation, transfer (including insurance), and acceptance. Contingency plans are maintained for a range of potential scenarios with regular disaster recovery exercises.

Mitigating actions for the principal risks include:

- investment in IT to ensure continued availability, security and resilience of infrastructure;
- investment in information security capability to protect customers and the Group;
- investing in protection of customer information, including access to key systems and the security, durability and accessibility of critical records;
- a risk-based approach to mitigate the financial crime risks the Group faces, reflecting the current and emerging financial crime risks within the market. Through Group-wide policies and operational control frameworks, the Group has developed a comprehensive financial crime operating model. The Group's fraud awareness programme is a key component of the financial crime control environment; and

- operational resilience measures and recovery planning to ensure an appropriate and consistent approach to the management of continuity risks, including potential interruptions from a range of internal and external incidents or threats.

Monitoring

Monitoring and reporting of operational risk is undertaken at Board and Executive committees, in accordance with delegated authorities which are regularly reviewed and refreshed. Risk exposure is discussed at the monthly Operational Risk, Conduct Risk and Compliance Committee, and matters are escalated to the Chief Risk Officer, the Risk Management Committee and the Board Risk Committee, where appropriate. A combination of systems, monthly reports, oversight and challenge from the Risk Function, Internal Audit and assurance teams ensures that key risks are regularly presented and debated by executive management.

The Group maintains a formal approach to operational risk event escalation. Material events are identified, captured and escalated. Root causes of events are determined and action plans put in place to ensure an optimum level of control. This ensures the Group keeps customers and the business safe, reduces costs, and improves efficiency.

Key operational risks are appropriately insured and the insurance programme is monitored and reviewed regularly, with recommendations being made to executive management prior to each renewal. Insurers are monitored on an ongoing basis to minimise counterparty risk. A process is in place to manage insurer rating changes.

Conduct risk and compliance

Definition

Conduct risk and compliance is defined as the risk that the Group's operating model, culture or actions result in unfair outcomes for customers, and the risk of regulatory sanction, material financial loss or reputational damage if the Group fails to design and implement operational processes, systems and controls and maintain compliance with all applicable regulatory requirements.

Risk appetite

The Group has no appetite for regulatory breaches and no tolerance for failing to deliver fair customer outcomes arising from activities, whether through product design, sales or after sales processes. The Group has policies, processes and standards which provide the framework for the business and colleagues to operate in accordance with the laws and regulations which apply to the Group's activities.

Exposures

Conduct risk could affect all aspects of the Group's operations, all types of customers and the Group's stakeholders. The Group faces limited conduct risk in relation to products and services, sales processes and complaint handling.

A series of change programmes drives new legislation and regulation into day-to-day operational and business practices across the Group.

The Group is unburdened with legacy conduct risk issues like PPI, investments or derivatives mis-selling; LIBOR manipulation; or distressed asset portfolios.

Measurement

Risk appetite metrics are regularly reviewed and monitored and include assessments of control and material regulatory rule breaches, complaints and whistleblowing.

Metrics are presented at relevant governance forums for review, challenge and action.

Mitigation

The Group takes a range of mitigating actions with respect to conduct risk and compliance. They include:

- putting the customer at the heart of business planning and strategy;

- using a governance framework that ensures product design and sales processes offer customers value for money, meet the needs of the target market, and deliver fair outcomes to customers, including vulnerable customers;
- using metrics to identify where the Group may be operating outside the risk appetite;
- focusing on recruitment and training and how the Group manages colleagues' performance with clear customer accountabilities;
- creating awareness and providing training to colleagues on the needs of vulnerable customers;
- regulatory horizon scanning;
- using oversight and assurance themed reviews to assess compliance with rules, regulations and policies;
- continuing investment in the Group's IT systems to meet regulatory commitments; and
- escalating material risks and issues to committees that challenge the business on their management.

Monitoring

A robust assurance and quality monitoring regime is in place to test the performance of customer critical activities. Customer metrics are proactively used when reviewing business performance and feedback loops have been established to learn from issues identified.

The Risk Function reports on conduct risk and compliance exposure. The report forms the basis of challenge to the business at the monthly Operational Risk, Conduct Risk and Compliance Committee. This committee will escalate matters to the Chief Risk Officer, the Risk Management Committee or the Board Risk Committee, as appropriate.

Concentration risk[1]

Definition

Concentration risk is defined as the exposure of the Group to credit concentrations in relation to retail and wholesale portfolios, products, obligors and counterparty levels.

Risk appetite

The Group has limited appetite for concentrated exposures by region, loan size, loan type and country.

Concentration risk appetite is reported through a comprehensive suite of metrics.

Exposures

The principal source of concentration risk is from loans and advances to customers in relation to geography, loan size and loan type concentrations in the mortgage portfolio; and from cash, debt securities and derivatives in relation to individual counterparty and country of exposure. The Group has no significant concentrations of risk in the credit card portfolio.

Measurement

Credit concentration risk is measured through the application of limits relating to each concentration category.

Mitigation

Credit risk management includes portfolio controls on product lines and risk segments to reflect risk appetite and individual limit guidelines. Credit policy is aligned to the Group's risk appetite and restricts exposure to more vulnerable sectors and segments. Exposures are monitored to prevent an excessive concentration of risk. The Group's larger exposures are reported in accordance with regulatory reporting requirements.

Monitoring

Monthly reporting on concentration risk exposures is made to the Board.

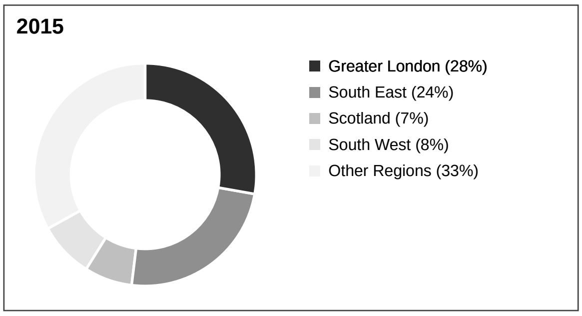
[1] All risk class components of financial risk are outlined on page 149. Concentration risk is the most significant component of financial risk and therefore has been disclosed in detail.

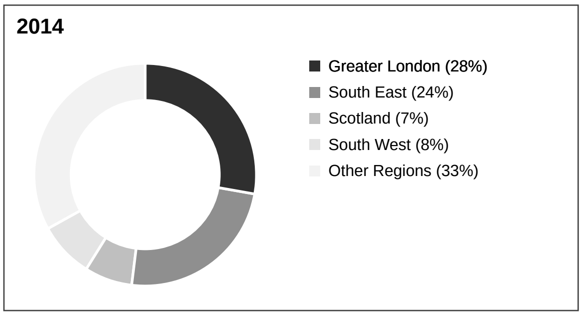
Secured credit

There has been significant focus on house price inflation since the end of 2013 with London and the South East experiencing significantly higher levels of house price growth than the rest of the UK. Whilst demand for London property may be influenced by the international market, concerns over an asset bubble forming in these two regions are based on the rate of growth relative to other regions, a potential divergence in supply and demand for property, and customer affordability being stretched. The Group's policy broadly restricts LTV for higher value loans, resulting in the lower average new lending LTVs observed in London (63%) and the South East (68%) compared to other regions (72%). The Group made changes to its lending policy in 2014 in response to this risk by introducing income multiple and higher debt-to-income ratios caps for all residential mortgages loans. While the policy is applied at a national level, it predominantly affects London and the South East.

The table below shows the geographical concentration of the mortgage portfolio.

(audited)	2015		2014	
	£m	%	£m	%
East Anglia	**605.9**	**2.5**	517.8	2.4
East Midlands	**1,287.8**	**5.1**	1,071.6	4.9
North	**957.0**	**3.8**	919.2	4.2
Yorkshire & Humberside	**1,413.0**	**5.5**	1,232.0	5.6
North West	**1,890.7**	**7.4**	1,652.1	7.5
West Midlands	**1,302.3**	**5.1**	1,078.2	4.9
South West	**1,936.2**	**7.6**	1,696.3	7.7
South East	**6,139.4**	**24.1**	5,178.8	23.7
Greater London	**7,230.0**	**28.4**	6,037.0	27.6
Wales	**597.4**	**2.3**	547.0	2.5
Scotland	**1,685.5**	**6.6**	1,616.3	7.4
Northern Ireland	**416.5**	**1.6**	347.9	1.6
Other	**0.5**	**—**	0.9	—
Total	**25,462.2**	**100.0**	**21,895.1**	**100.0**



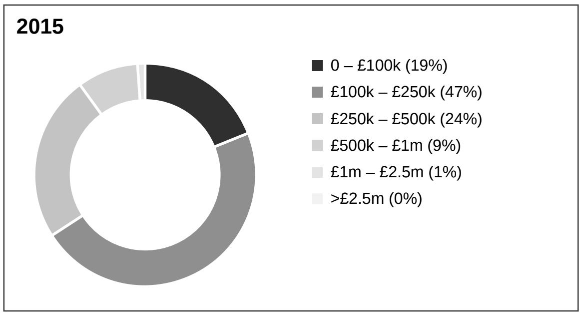


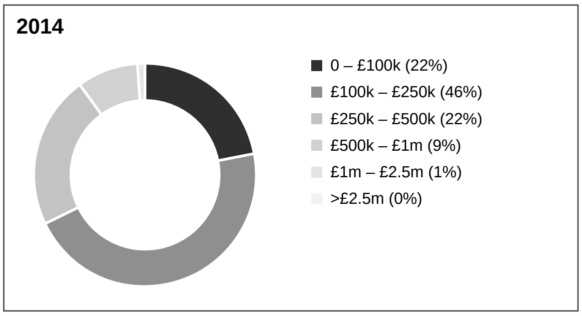
The geographical split of the portfolio remains broadly stable.

The table below shows retail secured credit concentrations by loan size.

(audited)	2015		2014	
	£m	%	£m	%
0–£100k	**4,941.5**	**19.4**	4,722.5	21.5
£100k–£250k	**11,878.2**	**46.6**	10,023.9	45.8
£250k–£500k	**6,078.0**	**23.9**	4,851.3	22.2
£500k–£1m	**2,334.3**	**9.2**	2,068.1	9.4
£1m–£2.5m	**211.3**	**0.8**	210.1	1.0
>£2.5m	**18.9**	**0.1**	19.2	0.1
Total	**25,462.2**	**100.0**	**21,895.1**	**100.0**

As at 31 December 2015, 0.9% (2014: 1.1%) of mortgage balances consisted of loans in excess of £1 million.





The proportion of loans with balances of up to £250,000 increased by £2.1 billion in 2015. This represents 58% of the total secured loans portfolio growth of £3.6 billion.

The table below shows retail secured credit average LTV by loan size.

2015 (audited)	Residential mortgage Loans	Residential buy-to-let mortgage loans	Total
	%	%	
0–£100k	**42.9**	**57.9**	**47.9**
£100k–£250k	**58.9**	**56.5**	**58.5**
£250k–£500k	**56.5**	**49.5**	**55.9**
£500k–£1m	**51.6**	**43.9**	**51.0**
£1m–£2.5m	**46.5**	**35.9**	**44.9**
>£2.5m	**43.8**	**—**	**43.8**
Total	**54.9**	**55.4**	**55.0**

2014 (audited)	Residential mortgage Loans	Residential buy-to-let mortgage loans	Total
	%	%	
0–£100k	45.0	57.8	48.4
£100k–£250k	59.9	56.3	59.5
£250k–£500k	57.2	51.3	56.7
£500k–£1m	53.4	46.1	52.9
£1m–£2.5m	50.8	40.3	49.1
>£2.5m	44.8	—	44.8
Total	**55.8**	**55.6**	**55.7**

The Group's policy broadly restricts LTV for higher value loans. The average LTV for each loan band demonstrates that, excluding loans under £100,000, higher value loans have lower LTVs. The average indexed LTV across the loan size bands has decreased reflecting continued house price growth in 2015.

Page 153 details policy changes for income multiples and higher debt to income levels. These were designed to improve the resilience of the portfolio to any reversal of house price inflation gains that were seen since 2014, or future interest rate rises.

Loan type

The residential mortgage loan portfolio comprises three principal loan repayment types:

- capital repayment loans amortise monthly through customer repayments which comprise an interest payment and contribution to the principal loan balance;
- part and part loans provide customers with the flexibility to choose to pay a proportion of the loan on a capital repayment basis and a proportion on interest only, with the interest only element repaid from an acceptable repayment vehicle; and
- interest only loans allow borrowers to pay only the interest on the loan each month, with the capital to be repaid in full at the end of the loan period from an acceptable repayment vehicle. For residential mortgage

customers, the Group continues to apply strict affordability criteria and restricts applicant loan-to-value. For buy-to-let customers, interest only mortgages continue to be the predominant repayment method, with the majority of customers looking to the sale of the mortgaged property as the ultimate loan repayment vehicle. These loans are also subject to stringent lending standards.

The tables below show retail secured credit concentrations by loan type.

2015 (audited)	Residential mortgage loans		Residential buy-to-let mortgage loans		Total	
	£m	%	£m	%	£m	%
Capital repayment	**15,800.7**	**75.0**	**761.0**	**17.3**	**16,561.7**	**65.0**
Part and part	**1,235.4**	**5.9**	**26.5**	**0.6**	**1,261.9**	**5.0**
Interest only	**4,024.2**	**19.1**	**3,614.4**	**82.1**	**7,638.6**	**30.0**
Total	**21,060.3**	**100.0**	**4,401.9**	**100.0**	**25,462.2**	**100.0**

2014 (audited)	Residential mortgage loans		Residential buy-to-let mortgage loans		Total	
	£m	%	£m	%	£m	%
Capital repayment	12,712.5	67.7	556.9	17.8	13,269.4	60.6
Part and part	1,419.9	7.6	23.9	0.8	1,443.8	6.6
Interest only	4,627.1	24.7	2,554.8	81.4	7,181.9	32.8
Total	**18,759.5**	**100.0**	**3,135.6**	**100.0**	**21,895.1**	**100.0**

Interest only residential new lending has remained low at 2.8% of total residential mortgage completions for 2015. As a result, the proportion of residential interest only loans has decreased from 24.7% to 19.1%.

Wholesale

Concentration risk is managed for both individual counterparties and for country of exposure. The Group does not set a limit to exposures to the Bank of England and the UK Sovereign. The table below shows exposures by country.

(audited)	2015	2014
	£m	£m
Australia	**63.2**	88.3
Canada	**108.9**	151.1
France	**67.7**	84.0
UK	**2,234.9**	2,373.7
Germany	**10.9**	6.6
Netherlands	**73.8**	118.8
Norway	**24.0**	44.8
Sweden	**20.0**	—
USA	**71.7**	43.2
Supranational	**203.7**	310.7
Total	**2,878.8**	**3,221.2**

The Group's wholesale credit risk exposures reduced primarily to fund the growth in new loans and advances to customers.

The Group's wholesale credit risk exposure outside the UK remains well diversified.

Funding and liquidity risk

Definition

Funding risk is defined as the inability to raise and maintain sufficient funding in quality and quantity to support the delivery of the business plan. Sound funding risk management reduces the likelihood of liquidity risks occurring through minimising refinancing concentration.

Liquidity risk is defined as the inability to accommodate liability maturities and withdrawals, fund asset growth and otherwise meet contractual obligations to make payments as they fall due.

Risk appetite

The Group has an appetite to maintain sufficient liquidity resources which are adequate, in both amount and quality, to ensure that it is able to meet its financial obligations and regulatory requirements. Balance sheet limits and metrics shape the funding strategy to ensure growth is delivered through stable and sustainable sources, managing refinancing, tenor and concentration risks.

Exposures

Liquidity exposure represents the amount of potential stressed outflows in any future period less expected inflows. Liquidity is considered from both an internal and a regulatory perspective.

Measurement

A series of measures is used across the Group to monitor both short and long-term liquidity including ratios, cash outflow triggers, wholesale and retail funding maturity profile, early warning indicators and stress test survival period triggers. Liquidity risk appetite covers a range of metrics considered key to maintaining a strong liquidity and funding position and is regularly reported to the Board Risk Committee and the Board. Strict criteria and limits are in place to ensure highly liquid marketable securities are available as part of the portfolio of liquid assets.

Details of contractual maturities for assets and liabilities form an important source of information for the management of liquidity risk.

In order to reflect more accurately the expected behaviour of the Group's assets and liabilities, measurement and modelling of the behavioural aspects of each is calculated.

Mitigation

The Group mitigates the risk of a liquidity mismatch in excess of risk appetite by managing the liquidity profile of the balance sheet through short-term liquidity management and over the life of the funding plan. Short-term liquidity management is considered from two perspectives: business as usual and liquidity under stressed conditions, both of which relate to funding within one year. The Group measures risk appetite and liquidity position as the quantum of liquid assets available in excess of the minimum requirements set by total stress outflows.

Longer term funding is used to manage the Group's strategic liquidity profile which is determined by the Group's balance sheet structure. Longer term is defined as having an original maturity of more than one year.

The most material component of the Group's funding and liquidity position is the customer deposit base, and is supplemented by wholesale funding providing a source of stable funding for balance sheet growth. A substantial proportion of the retail deposit base is made up of customers' savings accounts which, although mostly repayable on demand, have traditionally provided a stable source of funding. Funding concentration by counterparty is not considered significant for the Group. Where concentrations do exist for example, refinancing at maturity, these are managed within the appropriate internal risk appetite.

The Group operates a Funds Transfer Pricing (FTP) mechanism which:

- drives customer pricing and supports the overall Group balance sheet strategy; and
- is consistent with regulatory requirements.

FTP makes use of behavioural maturity profiles, taking account of expected customer loan prepayments and the stability of customer deposits. Such behavioural maturity assumptions are subject to formal governance and reviewed periodically.

The ability to deploy assets quickly, either through the repo market or through outright sale, is also an important source of liquidity for the Group. In addition to central bank reserves, the Group holds sizeable balances of high-quality marketable debt securities which can be sold to provide, or used to secure, additional cash inflows should the need arise from either market counterparties or central bank facilities (Bank of England).

Monitoring

Liquidity is actively monitored by the Treasury and Risk Functions. Reporting is conducted through the Group's committee structure, in particular the Asset and Liability Committee and the Board Risk Committee. In a stress situation the level of monitoring and reporting is increased commensurate with the nature of the stress event. Liquidity policies and procedures are subject to independent internal oversight.

Daily monitoring and control processes are in place to address internal and regulatory liquidity requirements. The Group monitors a range of market and internal early warning indicators on a daily basis for early signs of liquidity risk in the market or specific to the Group. These are a mixture of quantitative and qualitative measures including daily variation of customer balances, cash outflows, changes in primary liquidity portfolio, credit default swap spreads and changing funding costs.

In addition, the monitoring framework has two other important components:

- firstly, the volume and quality of the Group's liquid asset portfolio is defined through a series of stress tests across a range of time horizons and stress conditions. The Group ensures a liquidity surplus is held during normal market conditions above liquidity stress outflow requirements. Stress cash outflow assumptions have been established for individual liquidity risk drivers across idiosyncratic and market wide stresses.

  Internal and regulatory liquidity requirements are quantified on a daily basis, with holdings assessed against a full suite of liquidity stresses weekly.

  As at 31 December 2015, the results of stress testing of liquidity outflows were £3.1 billion (2014: £2.8 billion). This is significantly below the level of liquidity held by the Group. Risk drivers of this liquidity stress outflow are detailed in the following table. The Group is predominantly retail funded. As a result the largest potential source of liquidity stress is the outflow of retail customer deposits.

  The key risk driver assumptions applied to the scenarios are:

Liquidity risk driver	Modelling assumption
Retail Funding	Severe unexpected withdrawals of retail deposits, the scale of which is based on the experience during the financial crisis with adjustments taking into account changes in depositor protection, the Group's liability profile and customer behaviour. No additional deposit inflows are assumed.
Wholesale funding	Limited opportunity to refinance wholesale contractual maturities with the exception of repo funding by the Bank of England or market participants using central bank eligible collateral.
Off-balance sheet	Cash outflows continue as a result of off-balance sheet commitments such as mortgage pipeline, undrawn credit card facilities and collateral commitments.
Marketable asset risk	Assets held for liquidity purposes experience deterioration in market availability and resulting value.

  The scenarios and the assumptions are reviewed at least annually to ensure that they continue to be relevant to the nature of the business. The Group's liquidity risk appetite is calibrated against a number of stressed metrics. The funding plan is also stressed against a range of macroeconomic scenarios; and

- secondly, the Group maintains a Contingency Funding Plan which is designed to provide an early warning indicator for liquidity concerns. As a result, mitigating actions can be taken to avoid a more serious situation developing. Contingency Funding Plan invocation and escalation processes are based on analysis of five major quantitative and qualitative components. They comprise an assessment of early warning indicators, prudential and regulatory liquidity risk limits and triggers, stress testing results, event and systemic indicators and market intelligence.

  The introduction of the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio as part of CRD IV are intended to raise the resilience of banks to potential liquidity shocks and provide the basis for a harmonised approach to liquidity risk management. The LCR became the Pillar 1 standard for liquidity in the UK from 1 October 2015. As at 31 December, the Group had an LCR of 202.1% based on the

PRA's guidance for calculation. The Group manages LCR within an internal risk limit above the European and UK regulatory requirements.

Funding and liquidity management in 2015

The Group is predominantly funded through customer deposits. During 2015, the Group maintained a strong presence in the retail savings market, increasing total customer deposits by £2,779 million. The focus of retail funding was fixed rate ISAs, growing 68.9% since December 2014.

Wholesale funding is used to support balance sheet growth, lengthen the tenor of funding and diversify sources of funding. The Group has continued to diversify its sources of wholesale funding, issuing an inaugural Medium Term Note, raising funds through the well-established Residential Mortgage Backed Securities (RMBS) Gosforth programme and through additional drawings from the BoE Funding for Lending Scheme (FLS) facility. The volume of Term Repo has increased by £440 million through the use of repurchase agreements to fund lending growth. The volume of encumbered assets has increased as a result of additional FLS, Term Repo and RMBS issuance.

Group funding sources

The Group's loan-to-deposit ratio has increased to 107.5% compared with 102.8% at 31 December 2014, driven by increased retail lending activities supported by growth in secured wholesale funding and a reduction in surplus liquidity. The table below shows funding position.

(audited)	**2015**	**2014**
	£m	**£m**
Loans and advances to customers	**27,109.0**	23,093.1
Loans and advances to banks	**614.5**	720.5
Debt securities classified as loans and receivables	**1.1**	8.6
Available-for-sale financial assets (encumbered)	**—**	321.7
Cash and balances at central banks (encumbered)	**160.5**	38.0
Funded assets	**27,885.1**	24,181.9
Other assets	**318.9**	323.7
Total assets (excluding liquid assets)	**28,204.0**	24,505.6
On balance sheet primary liquidity assets		
Cash and balances at central banks—primary	**728.1**	813.3
Available-for-sale financial assets (unencumbered)	**1,296.9**	1,217.9
Total assets	**30,299.0**	26,536.8
Less: Other liabilities	**(429.5)**	(497.9)
Funding requirement	**29,799.5**	26,038.9
Funded by		
Customer deposits	**25,144.9**	22,365.7
Wholesale funding	**3,314.3**	2,429.4
Total equity	**1,340.3**	1,243.8
Total funding	**29,799.5**	**26,038.9**

Asset origination was funded partly by an increase in wholesale funding. The table below shows the sources of wholesale funding.

(audited)	**2015**	**2014**
	£m	**£m**
Debt securities in issue	**2,039.4**	1,594.1
Term repo	**1,274.9**	835.3
Total on-balance sheet sources of funds	**3,314.3**	2,429.4
FLS drawings	**2,960.0**	2,260.0
Total	**6,274.3**	**4,689.4**

The tables below show residual maturity of the wholesale funding book.

2015 (audited)	Within 3 months	3–12 months	1–5 years	After 5 years	Total
	£m	£m	£m	£m	£m
Debt securities in issue	**—**	**—**	**297.5**	**1,741.9**	**2,039.4**
Term repo	**749.9**	**525.0**	**—**	**—**	**1,274.9**
Total on-balance sheet sources of Funds	**749.9**	**525.0**	**297.5**	**1,741.9**	**3,314.3**
FLS drawings	**—**	**510.0**	**2,450.0**	**—**	**2,960.0**
Total	**749.9**	**1,035.0**	**2,747.5**	**1,741.9**	**6,274.3**

2014 (audited)	Within 3 months	3–12 months	1–5 years	After 5 years	Total
	£m	£m	£m	£m	£m
Debt securities in issue	—	—	—	1,594.1	1,594.1
Term repo	272.3	563.0	—	—	835.3
Total on-balance sheet sources of Funds	272.3	563.0	—	1,594.1	2,429.4
FLS drawings	—	—	2,260.0	—	2,260.0
Total	**272.3**	**563.0**	**2,260.0**	**1,594.1**	**4,689.4**

The increase in FLS drawings is offset by the continued pay down of the Gosforth RMBS programme, leaving the average tenor of wholesale funding stable.

Encumbered assets

The Group's assets can be used to support funding collateral requirements for central bank operations or third party re-purchase transactions. Assets that have been set aside for such purposes are classified as 'encumbered and pledged assets' and cannot be used for other purposes. The tables below show asset encumbrance.

	Encumbered assets		Unencumbered assets		
2015 (audited)	Pledged as collateral	Other(1)	Available as collateral(2)	Other(3)	Total
	£m	£m	£m	£m	£m
Cash and balances at central banks(4)	**160.5**	**—**	**—**	**728.1**	**888.6**
Debt securities classified as loans and receivables	**—**	**—**	**1.1**	**—**	**1.1**
Available-for-sale financial assets	**—**	**—**	**1,292.3**	**4.6**	**1,296.9**
Derivative financial assets	**—**	**—**	**—**	**82.3**	**82.3**
Loans and advances to banks	**—**	**478.6**	**—**	**135.9**	**614.5**
Loans and advances to customers(5)	**7,524.1**	**—**	**3,153.5**	**16,431.4**	**27,109.0**
Other assets	**—**	**—**	**—**	**236.6**	**236.6**
Total Assets	**7,684.6**	**478.6**	**4,446.9**	**17,618.9**	**30,229.0**
Treasury bills raised through FLS held off balance sheet(6)	**786.0**	**—**	**2,174.0**	**—**	**2,960.0**
Total Assets plus off balance sheet FLS	**8,470.6**	**478.6**	**6,620.9**	**17,618.9**	**33,189.0**

(1) Other encumbered assets are assets that cannot be used for secured funding due to legal or other reasons. These include cash reserves supporting secured funding structures.

(2) Unencumbered assets which are classified as 'available as collateral' are readily available to secure funding or to meet collateral requirements. Loans and advances to customers are classified as 'available as collateral' only if they are already in such a form that they can be used immediately to raise funding.

(3) Other unencumbered assets are assets which are not subject to any restrictions and are not readily available for use.

(4) Encumbered cash and balances at central banks includes the minimum reserve collaterisation requirement for the BACS payment system, introduced in September 2015.

(5) Loans and advances to customers consist of collateral pledged to the Bank of England and securitised mortgage pools.

(6) These include Treasury Bills received by the Group through FLS which are not recognised on the balance sheet. These are classified as unencumbered when the Group is permitted to re-pledge.

	Encumbered assets		Unencumbered assets		
2014 (audited)	**Pledged as collateral**	**Other[(1)]**	**Available as collateral[(2)]**	**Other[(3)]**	**Total**
	£m	**£m**	**£m**	**£m**	**£m**
Cash and balances at central banks[(4)]	38.0	—	—	813.3	851.3
Debt securities classified as loans and receivables	—	—	8.6	—	8.6
Available-for-sale financial assets	321.7	—	1,217.9	—	1,539.6
Derivative financial assets	—	—	—	101.2	101.2
Loans and advances to banks	—	569.8	—	150.7	720.5
Loans and advances to customers[(5)]	6,609.4	—	2,075.0	14,408.7	23,093.1
Other assets	—	—	—	222.5	222.5
Total Assets	**6,969.1**	**569.8**	**3,301.5**	**15,696.4**	**26,536.8**
Treasury bills raised through FLS held off balance sheet[(6)]	—	—	2,260.0	—	2,260.0
Total Assets plus off balance sheet FLS	**6,969.1**	**569.8**	**5,561.5**	**15,696.4**	**28,796.8**

(1) Other encumbered assets are assets that cannot be used for secured funding due to legal or other reasons. These include cash reserves supporting secured funding structures.

(2) Unencumbered assets which are classified as 'available as collateral' are readily available to secure funding or to meet collateral requirements. Loans and advances to customers are classified as 'available as collateral' only if they are already in such a form that they can be used immediately to raise funding.

(3) Other unencumbered assets are assets which are not subject to any restrictions and are not readily available for use.

(4) Encumbered cash and balances at central banks includes the minimum reserve collaterisation requirement for the BACS payment system, introduced in September 2015.

(5) Loans and advances to customers consist of collateral pledged to the Bank of England and securitised mortgage pools.

(6) These include Treasury Bills received by the Group through FLS which are not recognised on the balance sheet. These are classified as unencumbered when the Group is permitted to re-pledge.

The Group's total level of asset encumbrance increased to 27.0% compared with 26.2% at 31 December 2014. Encumbrance of assets predominantly arises from the use of the BoE FLS liquidity facility and from the Gosforth RMBS programme. The Group manages the volume of available unencumbered collateral to meet requirements arising from current and future secured funding transactions. During 2015, the Group's unencumbered loans and advances to customers increased by £3,101 million as a result of using wholesale funding to support increased lending.

The Group maintains a portfolio of liquid assets in accordance with risk appetite. Liquid assets are held predominantly in high-quality unencumbered securities issued by the UK Government or supranationals and deposits with central banks. The portfolio mix is aligned to the liquidity coverage requirement defined in European liquidity regulatory standards. Other liquidity resources represent additional unencumbered liquid assets held over and above high-quality liquid assets. These are intended to cover more extreme stress events and provide flexibility for liquidity management. The table below shows composition of the liquidity portfolio.

(unaudited)	2015	2015 Average	2014	2014 Average
	£m	£m	£m	£m
Level 1				
Cash and balances at central banks	**846.3**	**796.4**	813.3	1,120.9
UK Government securities	**409.5**	**392.6**	586.2	637.8
Other HQLA level 1 eligible	**25.4**	**15.8**	—	33.9
Supranational securities	**203.7**	**294.6**	310.7	350.1
Treasury bills raised through FLS	**2,174.0**	**2,150.6**	2,260.0	1,598.5
Covered bonds (Level 1 eligible)(1)	**498.2**	**248.2**	—	—
Total level 1	**4,157.1**	**3,898.2**	**3,970.2**	**3,741.2**
Level 2a				
Covered bonds (Level 2a eligible)(1)	**22.1**	**133.5**	225.7	127.9
Total level 2a	**22.1**	**133.5**	**225.7**	**127.9**
Level 2b				
Eligible RMBS	**59.4**	**44.7**	40.0	42.1
Total level 2b	**59.4**	**44.7**	**40.0**	**42.1**
High quality liquid assets (Level 1 + 2a + 2b)	**4,238.6**	**4,076.4**	4,235.9	3,911.2
Other liquidity resources				
Covered bonds	**15.0**	**2.3**	—	—
Non-eligible RMBS	—	**3.0**	8.6	8.8
Certificates of deposit	**59.0**	**4.5**	—	43.8
Floating rate notes	—	—	—	11.1
Fixed rate bonds	—	**17.0**	55.3	120.3
Money market loans	**54.0**	**30.9**	—	—
Total other liquidity resources	**128.0**	**57.7**	**63.9**	**184.0**
Self-issued RMBS	**326.7**	**197.6**	**92.8**	**433.4**
Total liquidity	**4,693.3**	**4,331.7**	**4,392.6**	**4,528.6**

(1) During 2015, the Group reclassified covered bonds to align with the European Commission's delegated act with regard to the liquidity coverage requirement. The legislation prescribes a liquidity classification based on several criteria, including the credit quality and indicators of liquidity performance under stress conditions of the instrument.

The Group holds sufficient liquidity to meet all internal and regulatory liquidity requirements.

The tables below analyse assets and liabilities of the Group into relevant maturity groupings based on the remaining contractual period at the balance sheet date. The Group's assets and liabilities may be repaid or otherwise mature earlier or later than implied by their contractual terms, and readers are therefore advised to use caution when using this data to evaluate the Group's liquidity position. In particular, amounts in respect of customer deposits are usually contractually payable on demand or at short notice. In practice, these deposits are not usually withdrawn on their contractual maturity.

2015 (audited)	Within 3 months	3–12 months	1–5 years	After 5 years	Total
	£m	£m	£m	£m	£m
Assets					
Cash and balances at central banks	**846.9**	**—**	**—**	**41.7**	**888.6**
Derivative financial instruments	**16.1**	**13.3**	**47.4**	**5.5**	**82.3**
Loans and receivables:					
Loans and advances to banks	**614.5**	**—**	**—**	**—**	**614.5**
Loans and advances to customers	**1,778.0**	**572.5**	**3,334.6**	**21,423.9**	**27,109.0**
Debt securities	**—**	**—**	**—**	**1.1**	**1.1**
Available-for-sale financial assets	**47.5**	**4.7**	**424.4**	**820.3**	**1,296.9**
Other assets	**47.5**	**20.2**	**14.8**	**154.1**	**236.6**
Total assets	**3,350.5**	**610.7**	**3,821.2**	**22,446.6**	**30,229.0**
Liabilities					
Deposits from banks	**773.7**	**525.0**	**—**	**—**	**1,298.7**
Customer deposits	**20,776.5**	**2,630.2**	**1,738.2**	**—**	**25,144.9**
Derivative financial instruments	**5.9**	**12.1**	**103.2**	**34.8**	**156.0**
Debt securities in issue	**—**	**—**	**297.5**	**1,741.9**	**2,039.4**
Other liabilities	**158.8**	**46.9**	**39.5**	**4.5**	**249.7**
Total liabilities	**21,714.9**	**3,214.2**	**2,178.4**	**1,781.2**	**28,888.7**
Net liquidity (gap)/surplus	**(18,364.4)**	**(2,603.5)**	**1,642.8**	**20,665.4**	**1,340.3**

2014 (audited)	Within 3 months	3–12 months	1–5 years	After 5 years	Total
	£m	£m	£m	£m	£m
Assets					
Cash and balances at central banks	813.3	—	—	38.0	851.3
Derivative financial instruments	6.7	12.8	70.7	11.0	101.2
Loans and receivables:					
Loans and advances to banks	720.5	—	—	—	720.5
Loans and advances to customers	1,264.8	468.6	2,859.7	18,500.0	23,093.1
Debt securities	—	—	—	8.6	8.6
Available-for-sale financial assets	20.1	122.2	406.0	991.3	1,539.6
Other assets	41.2	28.1	34.6	118.6	222.5
Total assets	**2,866.6**	**631.7**	**3,371.0**	**19,667.5**	**26,536.8**
Liabilities					
Deposits from banks	283.7	563.0	—	—	846.7
Customer deposits	18,041.0	2,356.4	1,967.4	0.9	22,365.7
Derivative financial instruments	6.3	6.8	133.1	82.0	228.2
Debt securities in issue	—	—	—	1,594.1	1,594.1
Other liabilities	191.7	42.5	19.3	4.8	258.3
Total liabilities	**18,522.7**	**2,968.7**	**2,119.8**	**1,681.8**	**25,293.0**
Net liquidity (gap)/surplus	(15,656.1)	(2,337.0)	1,251.2	17,985.7	1,243.8

Cashflow profile

The table below divides the Group's non-derivative cash outflows into relevant maturity groupings based on the remaining period between the balance sheet date and the contractual maturity date. The amounts disclosed are the contractual undiscounted cash flows. These differ from balance sheet values due to the effects of discounting on certain balance sheet items and due to the inclusion of contractual future interest flows.

2015 (audited)	Within 3 months	3–6 months	6–12 months	1–5 years	Over 5 years	Total
	£m	£m	£m	£m	£m	£m
Deposits from banks	**775.8**	**526.3**	—	—	—	**1,302.1**
Customer deposits	**21,228.6**	**895.0**	**1,604.4**	**1,962.0**	—	**25,690.0**
Debt securities in issue	**152.3**	**236.7**	**208.3**	**1,550.4**	—	**2,147.7**
Total	**22,156.7**	**1,658.0**	**1,812.7**	**3,512.4**	—	**29,139.8**

2014 (audited)	Within 3 months	3–6 months	6–12 months	1–5 years	Over 5 years	Total
	£m	£m	£m	£m	£m	£m
Deposits from banks	284.4	564.9	—	—	—	849.3
Customer deposits	18,151.5	1,372.4	1,140.9	2,204.6	1.0	22,870.4
Debt securities in issue	185.3	128.7	223.5	1,123.4	—	1,660.9
Total	**18,621.2**	**2,066.0**	**1,364.4**	**3,328.0**	**1.0**	**25,380.6**

Fixed rate ISAs have been the main source of retail funding throughout 2015. As the table reflects deposits on a contractual basis, these are disclosed in the 'within 3 months' category, resulting in a shortening of the Group's contractual cashflow profile of customer deposits.

The tables below divide the undiscounted derivative cash outflows into relevant maturity groupings based on the remaining period between the balance sheet date and the contractual maturity date. Cash flows for the floating legs of derivative transactions are calculated based on market indications of future interest rates. As a result, totals in these tables are not intended to be identical to tables on OTC derivatives or the notes to the financial statements by definition.

2015 (audited)	Within 3 months	3–6 months	6–12 months	1–5 years	Over 5 years	Total
	£m	£m	£m	£m	£m	£m
Settled on a net basis						
Derivatives in economic and not accounting hedges	**(1.1)**	**0.2**	**(0.6)**	**(13.5)**	**(0.9)**	**(15.9)**
Derivatives in accounting hedge relationships	**(30.9)**	**(25.1)**	**(35.8)**	**(41.6)**	**(3.2)**	**(136.6)**
	(32.0)	**(24.9)**	**(36.4)**	**(55.1)**	**(4.1)**	**(152.5)**
Settled on a gross basis						
Outflows	—	—	—	—	—	—
Inflows	—	—	—	—	—	—
Derivatives in accounting hedge relationships	—	—	—	—	—	—
Total	**(32.0)**	**(24.9)**	**(36.4)**	**(55.1)**	**(4.1)**	**(152.5)**

2014 (audited)	Within 3 months	3–6 months	6–12 months	1–5 years	Over 5 years	Total
	£m	£m	£m	£m	£m	£m
Settled on a net basis						
Derivatives in economic and not accounting hedges	(2.8)	(2.2)	(5.5)	(9.4)	(2.5)	(22.4)
Derivatives in accounting hedge relationships	(31.6)	(22.9)	(45.8)	(91.2)	(12.6)	(204.1)
	(34.4)	**(25.1)**	**(51.3)**	**(100.6)**	**(15.1)**	**(226.5)**
Settled on a gross basis						
Outflows	—	—	—	—	—	—
Inflows	—	—	—	—	—	—
Derivatives in accounting hedge relationships	—	—	—	—	—	—
Total	**(34.4)**	**(25.1)**	**(51.3)**	**(100.6)**	**(15.1)**	**(226.5)**

External credit ratings

Virgin Money Holdings (UK) plc does not have an external credit rating. Disclosures below relate to its subsidiary, Virgin Money plc. Virgin Money plc's short and long-term credit ratings as at 31 December 2015 are as follows.

	Long term	Short term	Outlook	Date of last rating action	Rating action type
Fitch	BBB+	F2	Positive	19 November 2015	Affirmed

In November 2015 the rating agency Fitch revised Virgin Money plc's outlook to Positive from Stable and affirmed its long-term rating at BBB+.

The table below sets out the amount of additional collateral the Company would need to provide in the event of a one and two notch downgrade by external credit ratings agencies.

	Cumulative adjustment for a one-notch downgrade	Cumulative adjustment For a two-notch downgrade
	£m	£m
2015	—	10.0
2014	—	10.0

SECTION D:
HISTORICAL FINANCIAL INFORMATION RELATING TO THE VIRGIN MONEY GROUP FOR THE SIX MONTH PERIODS ENDED 30 JUNE 2018 AND 30 JUNE 2017

RISK MANAGEMENT REPORT

As a UK retail bank we are focused on serving domestic customers. We are subject to risks arising from macro-economic conditions in the UK, geopolitical uncertainty, market conditions and new structural and regulatory changes which will come into force over the next few years. Our ongoing focus on maintaining a strong retail deposit franchise, building an SME deposit offering, and growing high-quality lending portfolios is supported by clearly defined risk appetite and a robust approach to both financial and non-financial risk management.

The Board-approved risk appetite reflects our tolerance for risk in pursuit of our strategic objectives. It is designed to achieve an appropriate balance between risk and reward. Risk appetite is embedded in the business through delegation of authority from the Board to the Executive. Our risk management approach is fully aligned with Board risk appetite, regulatory requirements and industry good practice.

PRINCIPAL RISKS AND UNCERTAINTIES

The principal risks faced by the Group are summarised below. Except where noted, there has been no significant change to the description of these risks or key mitigating actions disclosed in the Group's 2017 Annual Report and Accounts (pages 36 to 39), with any quantitative disclosures updated below.

Credit risk

Credit risk is the risk of loss resulting from a borrower or counterparty failing to pay amounts due. We provide residential and buy-to-let mortgages and credit cards to customers across the UK. There is a risk that any adverse changes in the macro-economic environment and/or the credit quality or behaviour of borrowers results in additional impairment losses, thereby reducing profitability.

Wholesale exposures arise through operational exposures, our liquid asset portfolio and the use of derivative instruments to manage interest rate risk.

Market risk

Market risk is the risk that unfavourable market movements lead to a reduction in earnings or value. We do not trade or make markets. Interest rate risk is the only material category of market risk for the Group.

Operational risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, including legal risk. The management of third party relationships, cybercrime and information security remains a key focus for the Group. During 2018, the Group will become a direct member of all relevant UK inter-bank payment systems.

Conduct risk and compliance

Conduct risk and compliance is defined as the risk that the Group's operating model, culture or actions result in unfair outcomes for customers. This could give rise to regulatory sanction, material financial loss or reputational damage if the Group fails to design and implement operational processes, systems and controls and maintain compliance with all applicable regulatory requirements.

Strategic and financial risk

Strategic risk is the risk of significant loss or damage arising from business decisions that impact the long-term interests of stakeholders or from an inability to adapt to external developments.

Financial risk is focused primarily on credit concentration risk, which is managed for retail and wholesale credit exposures at portfolio, product and counterparty levels.

Financial performance can be impacted by adverse changes in customer behaviour. Customer behaviour is monitored monthly and reviewed quarterly at cohort, product and portfolio levels.

Funding and liquidity risk

Funding risk represents the inability to raise and maintain sufficient funding in quality and quantity to support the delivery of the business plan.

Liquidity risk represents the inability to accommodate liability maturities and withdrawals, fund asset growth, and otherwise meet contractual obligations to make payments as they fall due.

Capital risk

Capital risk is defined as the risk that the Group has a sub-optimal amount or quality of capital or that capital is deployed inefficiently across the Group.

CREDIT RISK MANAGEMENT

Overview

The Group's credit risk exposures are categorised as retail (secured and unsecured) and wholesale. As at 30 June 2018, the total credit risk exposures of the Group totalled £43.5 billion, comprising secured loans and advances to customers of £34.1 billion (78.3%), unsecured loans and advances to customers of £3.2 billion (7.4%) and wholesale exposures of £6.2 billion (14.3%).

Adoption of IFRS 9

The Group adopted IFRS 9 '*Financial Instruments*' on 1 January 2018, which supersedes IAS 39 '*Financial Instruments: Recognition and Measurement*'. This new accounting standard has three key areas of change: impairment, classification and measurement, and hedge accounting.

Impairment

The impairment requirements of IFRS 9 affect the Group's retail and wholesale portfolios and introduce an expected credit loss (ECL) assessment, resulting in earlier recognition of credit losses.

ECL is calculated as the product of Probability of Default, Exposure at Default and Loss Given Default for each account, which are defined as:

- Probability of Default (PD) is an estimate of the likelihood of the account defaulting over either 12 months or the lifetime of the account.
- Exposure at Default (EAD) is the amount the Group expects the customer account to represent at the point of default.
- Loss Given Default (LGD) is the amount of loss that will be incurred in the event of default.

IFRS 9 also requires that multiple forward-looking macro-economic scenarios are incorporated into the ECL calculation.

A three stage categorisation is used for assessing impairment under IFRS 9. This is outlined in the table below.

Credit risk categorisation	Expected credit loss calculation period	Description
Stage 1	12 months	A loan that is not credit-impaired on initial recognition and has not experienced a significant increase in credit risk.
Stage 2	Lifetime	If a significant increase in credit risk has occurred since initial recognition, the loan is moved to stage 2, but is not yet deemed to be credit-impaired.
Stage 3	Lifetime	If the loan is credit-impaired it is moved to stage 3. All expired term, fraud and operational risk loans are treated as credit-impaired.

Further information regarding IFRS 9, including transition disclosures, can be found in note 19 to the condensed consolidated half-year financial statements.

The illustrative reconciliation of the IAS 39 retail impairment allowance at 31 December 2017 to the IFRS 9 retail ECL at 1 January 2018 is shown in the table below.

	£m
At 31 December 2017—IAS 39 incurred loss provision	59.4
Removal of latent risk and other calibration differences	(14.0)
12 month ECL	3.9
Lifetime ECL	42.1
Undrawn balances	11.6
Multiple economic scenarios	1.2
At 1 January 2018—IFRS 9 expected credit loss	**104.2**

The reconciling items in the table above represent:

Latent risk and other calibration differences: Under IFRS 9, an ECL is recognised for every financial asset, on either a 12 month or lifetime basis. This reconciling item removes the provision held under IAS 39 for losses which had been incurred, but not specifically identified at the reporting date, and adjustments arising from other calibration differences under IFRS 9.

12 month ECL: IFRS 9 recognises a 12 month ECL on all performing loans classified as stage 1. Under IAS 39, an impairment provision would only have been recognised against these accounts to the extent there were observable indicators of impairment.

Lifetime ECL: IFRS 9 recognises a lifetime ECL on all loans that have experienced a significant increase in credit risk. Under IAS 39, an impairment provision would only have been recognised against these accounts to the extent there were observable indicators of impairment.

Undrawn balances: IFRS 9 requires an impairment allowance to be recognised on undrawn balances, where IAS 39 did not. For credit cards, the impact of undrawn exposure on ECL is captured as part of the EAD estimate, and recognised within the ECL calculation.

Multiple economic scenarios: IFRS 9 requires that multiple forward-looking macro-economic scenarios are incorporated into the ECL calculation. Details of the macro-economic scenarios used at 1 January 2018 and 30 June 2018 can be found in note 19 to the condensed consolidated half-year financial statements.

The following table explains the changes in the loss allowance between 1 January 2018 and 30 June 2018.

	£m
At 1 January 2018	104.2
Advances written off	(21.5)
Charge to the income statement	30.4
At 30 June 2018	**113.1**

Further information can be found in note 6 to the condensed consolidated half-year financial statements on page 49.

Classification and measurement

The classification and measurement requirements of IFRS 9 require financial assets to be classified into one of three measurement categories: fair value through other comprehensive income, fair value through profit or loss and amortised cost. Classification is based on the objectives of the entity's underlying business model for managing its financial assets and the contractual cash flow characteristics of the instrument.

Unless otherwise stated, the comparatives presented are the balance sheet position under IFRS 9 at 1 January 2018, and under IAS 39 at 31 December 2017.

Loans and advances to customers

The Group's mortgage portfolio is secured on residential and buy-to-let properties and represented 91.3% of total loans and advances to customers at 30 June 2018. Residential lending grew by 0.5% (£137.4 million) during the first half of 2018 and credit quality remained strong. Buy-to-let loans grew by 4.1% (£259.6 million) to £6.6 billion. This is a contained section of the portfolio that represents 19.4% of total secured loans (1 January 2018 and 31 December 2017: 18.9%).

The Group's credit card portfolio represented 8.7% of total loans and advances to customers at 30 June 2018 (1 January 2018 and 31 December 2017: 8.4%). Unsecured credit card lending increased by £169.3 million during the first six months of 2018 to £3.2 billion and the quality of new business remained strong. New lending was well within the approved policy, lending and concentration limits.

	At 30 Jun 2018	At 1 Jan 2018	At 31 Dec 2017
	£m	£m	£m
Secured residential loans and advances not subject to securitisation	**22,342.1**	21,878.7	21,878.7
Secured residential loans and advances subject to securitisation	**5,112.5**	5,438.5	5,438.5
	27,454.6	27,317.2	27,317.2
Secured residential buy-to-let loans and advances not subject to securitisation	**6,626.9**	6,367.3	6,367.3
Total loans and advances secured on residential property	**34,081.5**	33,684.5	33,684.5
Impairment allowance—secured	**(12.8)**	(12.1)	(12.1)
Total loans and advances—secured	**34,068.7**	33,672.4	33,672.4
Credit cards	**3,240.6**	3,071.3	3,071.3
Overdrafts	**0.1**	0.1	0.1
Unsecured loans and advances not subject to securitisation	**3,240.7**	3,071.4	3,071.4
Impairment allowance—unsecured	**(100.3)**	(92.1)	(47.3)
Total loans and advances—unsecured	**3,140.4**	2,979.3	3,024.1
Total loans and advances excluding portfolio hedging	**37,209.1**	36,651.7	36,696.5

Gross retail credit risk exposures by IFRS 9 stage allocation

Information regarding the Group's retail credit risk exposures at 30 June 2018 and 1 January 2018, including corresponding impairment allowances and coverage ratios, can be found in the tables below. Information regarding the 31 December 2017 position on an IAS 39 basis can be found in the 2017 Annual Report and Accounts which is available on the Group's website.

At 30 Jun 2018	Stage 1	Stage 2	Stage 3	Total
Gross exposure (£m)				
Residential mortgage loans	**25,798.8**	**1,484.9**	**170.9**	**27,454.6**
Residential buy-to-let mortgage loans	**6,415.9**	**194.4**	**16.6**	**6,626.9**
Total secured	**32,214.7**	**1,679.3**	**187.5**	**34,081.5**
Credit cards	**2,869.5**	**337.2**	**33.9**	**3,240.6**
Overdrafts	—	**0.1**	—	**0.1**
Total unsecured	**2,869.5**	**337.3**	**33.9**	**3,240.7**
Total	**35,084.2**	**2,016.6**	**221.4**	**37,322.2**
Impairment allowance (£m)				
Residential mortgage loans	**2.8**	**5.2**	**3.6**	**11.6**
Residential buy-to-let mortgage loans	**0.1**	**0.4**	**0.7**	**1.2**
Total secured	**2.9**	**5.6**	**4.3**	**12.8**
Credit cards	**24.8**	**56.0**	**19.4**	**100.2**
Overdrafts	—	**0.1**	—	**0.1**
Total unsecured	**24.8**	**56.1**	**19.4**	**100.3**
Total	**27.7**	**61.7**	**23.7**	**113.1**
Coverage ratio (%)				
Residential mortgage loans	**<0.1%**	**0.4%**	**2.1%**	**<0.1%**
Residential buy-to-let mortgage loans	**<0.1%**	**0.2%**	**4.2%**	**<0.1%**
Total secured	**<0.1%**	**0.3%**	**2.3%**	**<0.1%**
Credit cards	**0.9%**	**16.6%**	**57.2%**	**3.1%**
Overdrafts	—	**100.0%**	—	**100.0%**
Total unsecured	**0.9%**	**16.6%**	**57.2%**	**3.1%**
Total	**<0.1%**	**3.1%**	**10.7%**	**0.3%**

At 1 Jan 2018	Stage 1	Stage 2	Stage 3	Total
Gross exposure (£m)				
Residential mortgage loans	25,869.6	1,300.1	147.5	27,317.2
Residential buy-to-let mortgage loans	6,167.8	183.4	16.1	6,367.3
Total secured	32,037.4	1,483.5	163.6	33,684.5
Credit cards	2,741.6	300.3	29.4	3,071.3
Overdrafts	—	0.1	—	0.1
Total unsecured	2,741.6	300.4	29.4	3,071.4
Total	34,779.0	1,783.9	193.0	36,755.9
Impairment allowance (£m)				
Residential mortgage loans	3.2	4.5	3.2	10.9
Residential buy-to-let mortgage loans	0.1	0.3	0.8	1.2
Total secured	3.3	4.8	4.0	12.1
Credit cards	23.3	51.5	17.2	92.0
Overdrafts	—	0.1	—	0.1
Total unsecured	23.3	51.6	17.2	92.1
Total	26.6	56.4	21.2	104.2
Coverage ratio (%)				
Residential mortgage loans	<0.1%	0.3%	2.2%	<0.1%
Residential buy-to-let mortgage loans	<0.1%	0.2%	5.0%	<0.1%
Total secured	<0.1%	0.3%	2.4%	<0.1%
Credit cards	0.8%	17.1%	58.5%	3.0%
Overdrafts	—	100.0%	—	100.0%
Total unsecured	0.8%	17.2%	58.5%	3.0%
Total	<0.1%	3.2%	11.0%	0.3%

Credit-impaired assets and impairment allowances

Total credit-impaired assets increased by £28.4 million in the first half of 2018, and the proportion of credit-impaired assets as a percentage of total loans and advances to customers remained low at 0.6% as at 30 June 2018 (1 January 2018: 0.5%).

Secured credit-impaired loans as a proportion of total secured loans have increased marginally to 0.6% (1 January 2018: 0.5%), with balances increasing by £23.9 million to £187.5 million as at 30 June 2018. This is due to a reduction in interest only expired terms being offset by an increase in fraud balances. The fraud balances account for less than 0.2% of the portfolio, have an average LTV of 64.4%, and are managed at an account level. Provisioning for fraud reflects the expected credit loss associated with each individual account.

Secured impairment allowances increased from £12.1 million to £12.8 million during the first six months of 2018. House Price Index (HPI) reductions in some regions of the UK and book growth were partially offset by favourable arrears performance.

Unsecured credit-impaired loans as a proportion of total unsecured loans has remained stable at 1.0% (1 January 2018: 1.0%), with balances increasing by £4.5 million to £33.9 million as at 30 June 2018. This is primarily due to expected seasoning of the portfolio.

In line with the growth in new lending, unsecured impairment allowances increased by £8.2 million during the first six months of the year.

Assets classified as stage 2

The tables below present stage 2 loans and advances to customers by number of days past due at 30 June 2018 and 1 January 2018.

At 30 Jun 2018	Not past due	1–30 days past due	Over 30 days past due	Total
	£m	£m	£m	£m
Residential mortgage loans	**1,319.3**	**110.3**	**55.3**	**1,484.9**
Residential buy-to-let mortgage loans	**178.0**	**9.9**	**6.5**	**194.4**
Total secured	**1,497.3**	**120.2**	**61.8**	**1,679.3**
Credit cards	**329.3**	**4.5**	**3.4**	**337.2**
Overdrafts	**0.1**	—	—	**0.1**
Total unsecured	**329.4**	**4.5**	**3.4**	**337.3**
Total	**1,826.7**	**124.7**	**65.2**	**2,016.6**

At 1 Jan 2018	Not past due	1–30 days past due	Over 30 days past due	Total
	£m	£m	£m	£m
Residential mortgage loans	1,119.0	121.5	59.6	1,300.1
Residential buy-to-let mortgage loans	167.7	9.1	6.6	183.4
Total secured	1,286.7	130.6	66.2	1,483.5
Credit cards	292.9	4.5	2.9	300.3
Overdrafts	0.1	—	—	0.1
Total unsecured	293.0	4.5	2.9	300.4
Total	1,579.7	135.1	69.1	1,783.9

Stage 2 loans as a proportion of total loans and advances to customers have increased to 5.4% (1 January 2018: 4.9%), with balances increasing by £232.7 million to £2,016.6 million as at 30 June 2018. In assessing whether an account is classified as stage 2, the Group considers a series of quantitative, qualitative and backstop criteria. As a consequence, certain fully performing loans will be captured in stage 2 through the Group's internal debt management processes. These accounts are closely monitored.

In relation to mortgages, the movement is primarily due to an increase in accounts that, while fully performing, have experienced PD deterioration since origination. The majority of these accounts are mature interest only accounts. As the remaining term of the mortgage reduces, the PD increases, irrespective of credit quality, due to increased likelihood of default. The average LTV of these accounts is 45.3% and the resultant expected credit loss is low. The average lifetime PD for secured accounts classified as stage 2 is 7.0%.

In relation to credit cards, the movement is primarily due to an increase in accounts subject to internal account management activity, which is reflective of expected seasoning of the portfolio.

The Group held 15 repossessed properties as at 30 June 2018 (31 December 2017: ten).

Collateral held as security

Period end and weighted average LTVs across the retail mortgage portfolios are shown in the table below.

At 30 Jun 2018	Residential mortgage loans		Residential buy-to-let mortgage loans		Total	
	£m	%	£m	%	£m	%
<50%	**9,635.4**	**35.1**	**2,200.8**	**33.2**	**11,836.2**	**34.8**
50%–<60%	**5,179.2**	**18.9**	**1,926.6**	**29.1**	**7,105.8**	**20.9**
60%–<70%	**4,635.7**	**16.9**	**1,548.4**	**23.4**	**6,184.1**	**18.1**
70%–<80%	**4,211.1**	**15.3**	**942.9**	**14.2**	**5,154.0**	**15.1**
80%–<90%	**3,008.2**	**11.0**	**6.5**	**0.1**	**3,014.7**	**8.8**
90%–<100%	**778.3**	**2.8**	**1.3**	**—**	**779.6**	**2.3**
>100%	**6.7**	**—**	**0.4**	**—**	**7.1**	**—**
Total	**27,454.6**	**100.0**	**6,626.9**	**100.0**	**34,081.5**	**100.0**
Average loan-to-value[1] of stock—indexed		**57.6%**		**55.1%**		**57.1%**
Average loan-to-value of new business[2]		**71.9%**		**56.2%**		**68.8%**

(1) The average loan-to-value of stock and new business is balance weighted.

(2) New business includes lending since 1 January 2018.

At 31 Dec 2017	Residential mortgage loans		Residential buy-to-let mortgage loans		Total	
	£m	%	£m	%	£m	%
<50%	10,249.6	37.6	2,293.5	36.1	12,543.1	37.2
50%–<60%	5,362.9	19.6	1,851.5	29.1	7,214.4	21.4
60%–<70%	4,508.4	16.5	1,441.4	22.6	5,949.8	17.7
70%–<80%	4,022.9	14.7	778.1	12.2	4,801.0	14.3
80%–<90%	2,725.7	10.0	1.9	—	2,727.6	8.1
90%–<100%	444.6	1.6	0.6	—	445.2	1.3
>100%	3.1	—	0.3	—	3.4	—
Total	27,317.2	100.0	6,367.3	100.0	33,684.5	100.0
Average loan-to-value[1] of stock—indexed		56.1%		54.1%		55.8%
Average loan-to-value of new business[2]		70.0%		59.7%		68.1%

(1) The average loan-to-value of stock and new business is balance weighted.

(2) New business includes lending since 1 January 2017.

The average indexed LTV of the overall mortgage portfolio increased marginally by 1.3 percentage points as at 30 June 2018, reflecting new business growth and negative HPI movements observed in some regions during the first six months of the year. The average indexed LTV is well within the current Group portfolio risk appetite limit of 70%.

Forbearance

The value of forbearance stock totalled £202.1 million at 30 June 2018, representing a 14.6% (£25.7 million) increase during the first six months of the year.

Secured

At 30 June 2018, £185.8 million (1 January 2018: £161.2 million) of retail secured loans and advances were subject to forbearance. The increase is primarily due to a series of definitional changes following a review of forbearance activity and the data capture process. These changes have been applied from 1 January 2018. Secured loans with a payment arrangement in place increased due to the definition now capturing accounts in both overpayment and underpayment arrangements.

Secured forbearance as a percentage of stock is below 0.6% of the portfolio. Loans which are forborne are grouped with other assets with similar risk characteristics and assessed collectively for impairment. The loans are not considered as credit-impaired unless they meet the Group's definition of a credit-impaired asset.

Unsecured

At 30 June 2018, total retail unsecured loans and advances benefiting from forbearance totalled £16.3 million (1 January 2018: £15.2 million).

A breakdown of secured and unsecured forbearance is shown below.

At 30 Jun 2018	**Total**		**Of which in Stage 3**	
	£m	**%**	**£m**	**%**
Secured				
Payment arrangement	**35.1**	**18.9**	**21.6**	**81.8**
Transfer to interest only	**29.7**	**16.0**	**1.3**	**4.9**
Term extension	**49.8**	**26.8**	**2.9**	**11.0**
Payment holiday	**71.2**	**38.3**	**0.6**	**2.3**
Total secured forbearance	**185.8**	**100.0**	**26.4**	**100.0**
Unsecured				
Accounts where the customer has been approved on a payment plan	**16.3**	**100.0**	**12.2**	**100.0**
Total forbearance	**202.1**	**100.0**	**38.6**	**100.0**

At 1 Jan 2018	**Total**		**Of which in Stage 3**	
	£m	**%**	**£m**	**%**
Secured				
Payment arrangement	2.0	1.2	1.0	7.6
Transfer to interest only	30.9	19.2	1.1	8.3
Term extension	64.3	39.9	10.3	78.0
Payment holiday	64.0	39.7	0.8	6.1
Total secured forbearance	161.2	100.0	13.2	100.0
Unsecured				
Accounts where the customer has been approved on a payment plan	15.2	100.0	11.4	100.0
Total forbearance	176.4	100.0	24.6	100.0

Wholesale credit risk

Wholesale credit risk exposures increased by £2.1 billion during the first six months of the year to £6.2 billion at 30 June 2018, primarily due to increased deposits at the Bank of England. This reflects the replacement of off-balance sheet liquidity from the Bank of England's Funding for Lending Scheme (FLS) with on-balance sheet liquidity. The table below shows the wholesale credit risk exposures of the Group.

	At 30 Jun 2018	**At 1 Jan 2018**	**At 31 Dec 2017**
	£m	**£m**	**£m**
Loans and advances to banks excluding central banks	**309.0**	359.2	359.4
Cash and balances at central banks	**4,164.2**	2,579.0	2,579.0
Debt securities classified as available-for-sale financial assets	—	—	1,048.7
Debt securities classified as fair value through other comprehensive income	**1,635.8**	1,048.7	—
Gross positive fair value of derivative contracts	**74.3**	78.8	78.8
Other assets[1]	**0.1**	0.3	0.3
Total	**6,183.4**	4,066.0	4,066.2

(1) Other assets relates to debt securities at amortised cost (previously debt securities classified as loans and receivables under IAS 39.)

The Group has increased its holdings of high-quality wholesale assets during the period including supranational, covered bond and RMBS investments. Wholesale credit risk exposures are assessed by reference to credit rating. There were no wholesale credit exposures classified as credit-impaired at 30 June 2018, 1 January 2018 or 31 December 2017.

An impairment allowance of £0.2 million as at 30 June 2018 (1 January 2018: £0.2 million; 31 December 2017: £nil) is recognised in relation to loans and advances to banks.

Full disclosure of the Group's portfolio of liquid assets can be found on page 30.

FUNDING AND LIQUIDITY MANAGEMENT

Overview

The Group is funded predominantly through retail customer deposits. During the first six months of 2018, the Group maintained a strong presence in the retail savings market. Total customer deposits increased by £637.2 million in the first half of 2018 and represented 72.6% of the Group's funding at 30 June 2018. The Group's retail funding demonstrated stability throughout the first six months of 2018 with fixed rate ISA origination driving new product growth. Retention performance was in line with expectation. Refinancing risk concentrations are controlled within portfolio risk appetite limits.

The Group adopts a prudent wholesale funding strategy which meets a series of balance sheet metrics which limit concentration and refinancing risk exposures. The Bank of England's Term Funding Scheme (TFS) closed in February 2018. Prior to its closure, the Group made further drawings of £2.2 billion to repay all remaining FLS funding, taking total TFS drawings to £6.4 billion as at 30 June 2018. Repayment of the TFS lending is scheduled to be completed in a controlled manner, ahead of the contractual maturity date. The Group completed its inaugural MREL-eligible Medium Term Note issuance of £350 million in April 2018. This represents 0.8% of total funding as at 30 June 2018.

Group funding sources

The Group's loan-to-deposit ratio decreased to 118.3% during the first half of 2018 from 119.1% at 31 December 2017.

The table below shows the Group's funding position.

	At 30 Jun 2018	At 1 Jan 2018	At 31 Dec 2017
	£m	£m	£m
Loans and advances to customers	**37,176.0**	36,695.4	36,740.2
Loans and advances to banks	**309.0**	359.2	359.4
Available-for-sale financial assets (encumbered)	—	—	149.4
Financial instruments classified as fair value through other comprehensive income (encumbered)	**362.9**	149.4	—
Cash and balances at central banks (encumbered)	**251.2**	215.7	215.7
Funded assets	**38,099.1**	37,419.7	37,464.7
Other assets	**407.6**	388.8	377.4
Total assets (excluding liquid assets)	**38,506.7**	37,808.5	37,842.1
On balance sheet primary liquid assets			
Cash and balances at central banks—primary	**3,913.0**	2,363.3	2,363.3
Available-for-sale financial assets (unencumbered)	—	—	902.4
Financial instruments classified as fair value through other comprehensive income (unencumbered)	**1,275.4**	901.4	—
Equity investments classified as fair value through profit or loss (unencumbered)	**1.0**	1.0	—
Total assets	**43,696.1**	41,074.2	41,107.8
Less: Other liabilities	**(376.1)**	(371.6)	(371.6)
Funding requirement	**43,320.0**	40,702.6	40,736.2
Funded by			
Customer deposits	**31,445.6**	30,808.4	30,808.4
Wholesale funding	**10,013.2**	8,102.9	8,102.9
Total equity	**1,861.2**	1,791.3	1,824.9
Total funding	**43,320.0**	40,702.6	40,736.2

Analysis of total wholesale funding by residual maturity

At 30 Jun 2018	Within 3 months £m	3–12 months £m	1–5 years £m	After 5 years £m	Total £m
Debt securities in issue	—	—	**304.8**	**2,634.4**	**2,939.2**
Liabilities in respect of securities sold under repurchase agreements	**312.0**	**375.0**	—	—	**687.0**
Secured loans	—	—	**6,387.0**	—	**6,387.0**
Total on-balance sheet sources of funds	**312.0**	**375.0**	**6,691.8**	**2,634.4**	**10,013.2**
Treasury bills raised through FLS	—	—	—	—	—
Total	**312.0**	**375.0**	**6,691.8**	**2,634.4**	**10,013.2**

At 31 Dec 2017	Within 3 months £m	3–12 months £m	1–5 years £m	After 5 years £m	Total £m
Debt securities in issue	—	—	302.8	2,434.1	2,736.9
Liabilities in respect of securities sold under repurchase agreements	5.0	850.0	275.0	—	1,130.0
Secured loans	—	—	4,236.0	—	4,236.0
Total on-balance sheet sources of funds	5.0	850.0	4,813.8	2,434.1	8,102.9
Treasury bills raised through FLS	—	1,098.5	935.0	—	2,033.5
Total	5.0	1,948.5	5,748.8	2,434.1	10,136.4

Secured loans relate to the Group's drawings from the Bank of England's TFS. The increase is due to additional drawings during the first six months of the year to repay remaining FLS funding. The Group manages funding concentration risk arising from wholesale maturities through Board-approved risk appetite which limits the amount of funding refinancing over a 90-day period and requires the early accumulation of liquidity ahead of refinancing events.

Encumbered assets

The Group's assets are used to support collateral requirements for central bank operations, third party repurchase agreements, swap transactions, securitisation and balances at central banks. Assets set aside for such purposes are classified as 'encumbered and pledged assets' and cannot be used for other purposes. The tables below show the total asset encumbrance position of the Group at 30 June 2018, 1 January 2018 and 31 December 2017.

	Encumbered assets		Unencumbered assets		
At 30 Jun 2018	Pledged as collateral(1) £m	Other(2) £m	Available as collateral(3) £m	Other(4) £m	Total £m
Cash and balances at central banks	—	**251.2**	—	**3,913.0**	**4,164.2**
Financial instruments classified as fair value through other comprehensive income	**220.0**	**142.9**	**1,272.9**	**2.5**	**1,638.3**
Equity investments classified as fair value through profit or loss	—	—	—	**1.0**	**1.0**
Derivative financial assets	—	—	—	**74.3**	**74.3**
Loans and advances to banks	**77.3**	**168.9**	—	**62.8**	**309.0**
Loans and advances to customers	**12,548.1**	—	**5,380.3**	**19,247.6**	**37,176.0**
Other assets	**3.9**	—	**0.1**	**329.3**	**333.3**
Total assets	**12,849.3**	**563.0**	**6,653.3**	**23,630.5**	**43,696.1**
Treasury bills raised through FLS held off balance sheet(5)	—	—	—	—	—
Total assets plus off-balance sheet Treasury bills raised through FLS	**12,849.3**	**563.0**	**6,653.3**	**23,630.5**	**43,696.1**

At 1 Jan 2018	Encumbered assets		Unencumbered assets		
	Pledged as collateral(1)	Other(2)	Available as collateral(3)	Other(4)	Total
	£m	£m	£m	£m	£m
Cash and balances at central banks	—	215.7	—	2,363.3	2,579.0
Financial instruments classified as fair value through other comprehensive income	—	—	—	1.0	1.0
Equity investments classified as fair value through profit or loss	—	149.4	899.3	2.1	1,050.8
Derivative financial assets	—	—	—	78.8	78.8
Loans and advances to banks	93.0	201.1	—	65.1	359.2
Loans and advances to customers	13,109.4	—	4,670.3	18,915.7	36,695.4
Other assets	8.5	—	0.3	301.2	310.0
Total assets	13,210.9	566.2	5,569.9	21,727.2	41,074.2
Treasury bills raised through FLS held off balance sheet(5)	182.9	—	1,850.6	—	2,033.5
Total assets plus off balance sheet FLS	13,393.8	566.2	7,420.5	21,727.2	43,107.7

At 31 Dec 2017	Encumbered assets		Unencumbered assets		
	Pledged as collateral(1)	Other(2)	Available as collateral(3)	Other(4)	Total
	£m	£m	£m	£m	£m
Cash and balances at central banks	—	215.7	—	2,363.3	2,579.0
Available-for-sale financial assets	—	149.4	899.3	3.1	1,051.8
Derivative financial assets	—	—	—	78.8	78.8
Loans and advances to banks	93.0	201.1	—	65.3	359.4
Loans and advances to customers	13,109.4	—	4,670.3	18,960.5	36,740.2
Other assets	8.5	—	0.3	289.8	298.6
Total assets	13,210.9	566.2	5,569.9	21,760.8	41,107.8
Treasury bills raised through FLS held off balance sheet(5)	182.9	—	1,850.6	—	2,033.5
Total assets plus off balance sheet FLS	13,393.8	566.2	7,420.5	21,760.8	43,141.3

(1) Encumbered assets pledged as collateral include amounts to OTC derivative counterparties of £77.3 million (2017: £93.0 million) and amounts in respect of centrally cleared derivatives of £3.9 million (2017: £8.5 million). Encumbered loans and advances to customers of £12,548.1 million (2017: £13,109.4 million) consist of securitised mortgages and other loan pools positioned with the Bank of England that have been pledged as collateral for funding and liquidity transactions. At 30 June 2018, £8,283.9 million (2017: £6,219.8 million) of loan pools have been pledged as collateral in respect of secured loans and repo agreements.

(2) Other encumbered assets are assets that cannot be used for secured funding due to legal or other reasons. These comprise the mandatory reserve and the minimum requirement for the BACS payment system of £251.2 million (2017: £215.7 million) and cash reserves supporting secured funding structures of £168.9 million (2017: £201.1 million).

(3) Unencumbered assets which are classified as 'Available for collateral' are readily available to secure funding or to meet collateral requirements. Loans and advances to customers are classified as 'Available for collateral' only if they are already in such a form that they can be used immediately to raise funding.

(4) Other unencumbered assets are assets which are not subject to any restrictions and are not readily available for use.

(5) These amounts represent Treasury bills received by the Group through FLS, which are not recognised on the balance sheet. The Group is permitted to re-pledge these securities to generate on-balance sheet financial assets, such as cash, or to fund lending. These items are classified as encumbered where the Group has used them in re-purchase transactions or unencumbered when it has not.

The Group's total level of asset encumbrance reduced by £547.7 million to 30.7% at 30 June 2018 (1 January 2018 and 31 December 2017: 32.4%). This was primarily driven by asset growth, partially supported by unsecured wholesale funding activity in the first six months of the year. The Group manages the volume of available unencumbered collateral to meet requirements arising from current and future secured funding transactions.

Liquid asset portfolio

The Group maintains a portfolio of liquid assets, predominantly in high-quality unencumbered securities issued by the UK Government or supranational institutions and deposits with the Bank of England. The portfolio mix is aligned to the liquidity coverage requirement defined by the EBA in European liquidity regulatory standards. Other liquidity resources represent additional unencumbered liquid assets held over and above High Quality Liquid Assets (HQLA). These are intended to cover more extreme stress events and provide flexibility for liquidity management.

The table below shows the composition of the Group's liquidity portfolio.

	At 30 Jun 2018	2018 Average	At 31 Dec 2017	2017 Average
	£m	£m	£m	£m
Level 1				
Cash and balances at central banks	**4,075.7**	**4,040.8**	2,525.9	1,923.0
UK Government securities	**202.2**	**123.8**	207.3	221.8
Other HQLA level 1 eligible	**28.3**	**12.1**	—	—
Supranational securities	**395.6**	**330.0**	234.1	178.0
Treasury bills raised through FLS	—	**486.1**	1,850.6	2,219.7
Covered bonds (Level 1 eligible)	**470.3**	**425.2**	374.7	378.8
Total level 1	**5,172.1**	**5,418.0**	5,192.6	4,921.3
Level 2a				
Covered bonds (Level 2a eligible)	**29.8**	**22.3**	21.7	22.2
Total level 2a	**29.8**	**22.3**	21.7	22.2
Level 2b				
Eligible RMBS	**136.2**	**101.7**	50.1	52.6
Total level 2b	**136.2**	**101.7**	50.1	52.6
High quality liquid assets (Level 1 + 2a + 2b)	**5,338.1**	**5,542.0**	5,264.4	4,996.1
Other liquidity resources				
Non-eligible RMBS	**10.5**	**11.1**	11.4	8.6
Certificates of deposit	—	—	—	40.8
Floating rate notes	—	—	—	6.3
Money market loans	**15.0**	**18.3**	13.8	13.3
Total other liquidity resources	**25.5**	**29.4**	25.2	69.0
Self-issued RMBS	**839.7**	**825.4**	601.7	958.2
Total liquidity	**6,203.3**	**6,396.8**	5,891.3	6,023.3

During the first half of 2018, the Group maintained a strong funding and liquidity position in excess of risk appetite and the short-term liquidity stress metric, the Liquidity Coverage Ratio (LCR). The Group's LCR as at 30 June 2018 was 175.6%, representing a material surplus above the UK regulatory minimum requirement of 100%. The LCR reduced from 203.1% at 31 December 2017 due to the increased mortgage lending pipeline. The Group monitors the Net Stable Funding Ratio (NSFR) based on its own interpretations of current guidance available on CRD IV NSFR reporting.

CAPITAL MANAGEMENT

Overview

During 2018, the Group made a submission to the PRA seeking approval for improvements to its mortgage risk-weight models. These improvements have been approved and, as a result, the common equity tier 1 (CET 1) capital ratio for the Group increased by 2.5 percentage points to 16.3% as at 30 June 2018.

The Group also received notification from the PRA of its revised Pillar 2A capital requirement, which includes both fixed and variable elements, and took effect from 5 July 2018. Had it applied at 30 June 2018, it would have equated to an estimated Pillar 2A capital add-on of 5.4%.

The leverage ratio for the Group (based on the Basel III definition of January 2014, and the revised CRD IV definition of October 2014) is 3.8%. The Group is not required to comply with the UK leverage ratio framework until core retail deposits exceed the £50 billion threshold. However, during 2016, the EBA recommended a 3.0% minimum regulatory requirement should apply from January 2018. This has not yet been written into regulation but the Group maintains prudent risk appetite for leverage, above the expected EBA requirement.

Regulation

CRD IV introduced new capital limits and buffers for banks, and includes a combined buffer requirement which is the sum of the capital conservation buffer and the countercyclical buffer. The capital conservation buffer has been set at 2.5% with a transitional period between 1 January 2016 and 31 December 2018. During 2018, the transitional buffer is set at 1.875%, increasing to 2.5% on 1 January 2019.

The Bank of England increased the countercyclical buffer from 0.0% to 0.5% in June 2018, with a further increase to 1.0% due in November 2018. The Group reviews the capital structure on an on-going basis to ensure it is well placed to react to prevailing economic and regulatory conditions.

Ring-fencing is scheduled to be implemented by 1 January 2019. The Bank of England requires all banks with core deposits over £25 billion to ring-fence their core activities. The Group's application to form its ring-fenced group has been submitted to the PRA for approval.

The framework for a systemic risk buffer (SRB) for ring-fenced banks will be applied to individual institutions by the Bank of England and will be introduced from 2019. Current guidance states that firms with balance sheet assets less than £175 billion will have an SRB of 0%.

Minimum Requirements for Own Funds and Eligible Liabilities (MREL) were applicable from 1 January 2016 on a transitional basis, with full implementation required by 1 January 2022. From 1 January 2020 until 31 December 2021 the Group will be required to hold 18% of risk-weighted assets, in the form of MREL. From 1 January 2022, the Group will be subject to an end state MREL of two times Pillar 1 and Pillar 2A capital. The Group is working towards implementation of these requirements and has reflected them in the strategic planning process.

IFRS 9 came into force from 1 January 2018 and, in parallel, CRD IV has introduced transitional capital arrangements. These arrangements allow both the initial impact of the increase in the impairment allowance under IFRS 9, and the impact of subsequent increases, to be phased in over five years. The five year transitional period allows a percentage of the IFRS 9 adjustment to be added back each year. In 2018, 95% of the impact of IFRS 9 is added back as a transitional adjustment.

The table below shows the Group's capital resources.

	At 30 Jun 2018	At 31 Dec 2017
	£m	**£m**
Share capital and share premium account	**654.6**	654.6
Other equity instruments	**384.1**	384.1
Other reserves	**(11.9)**	(18.1)
Retained earnings	**834.4**	804.3
Total equity per balance sheet	**1,861.2**	1,824.9
Regulatory capital adjustments		
Deconsolidation of non-regulated companies	**(0.4)**	(0.3)
Foreseeable distributions on Additional Tier 1 securities	**(3.8)**	(3.8)
Foreseeable distribution on ordinary shares	**(13.9)**	(18.1)
Other equity instruments	**(384.1)**	(384.1)
Cash flow hedge reserve	**17.0**	22.7
Additional valuation adjustment	**(1.8)**	(1.2)
Intangible assets	**(158.5)**	(128.4)
Excess of expected loss over impairment allowance	**(40.1)**	(46.9)
Deferred tax on brought forward tax losses	**—**	(0.6)
IFRS 9 transitional adjustments	**38.7**	—
Total regulatory capital adjustments	**(546.9)**	(560.7)
Common Equity Tier 1 capital	**1,314.3**	1,264.2
Additional Tier 1 securities	**384.1**	384.1
Total Tier 1 capital	**1,698.4**	1,648.3
Tier 2 capital		
General credit risk adjustments	**—**	14.3
Excess of impairments over expected losses	**1.5**	—
IFRS 9 transitional adjustments	**(1.1)**	—
Total Tier 2 capital	**0.4**	14.3
Total own funds	**1,698.8**	1,662.6
Common Equity Tier 1 ratio	**16.3%**	13.8%
Tier 1 ratio	**21.1%**	18.0%
Total capital ratio	**21.1%**	18.1%

As required by Article 26(2) of the Capital Requirements Regulation, a deduction has been made for foreseeable dividends on 2018 profit. Capital ratios include verified profit for H1 2018.

Were the IFRS 9 transitional capital arrangements not applied, the table below shows the fully loaded position as at 30 June 2018.

	At 30 Jun 2018
	£m
Common Equity Tier 1 capital	**1,275.6**
Total Tier 1 capital	**1,659.7**
Total own funds	**1,661.2**
Common Equity Tier 1 ratio	**15.9%**
Tier 1 ratio	**20.7%**
Total capital ratio	**20.7%**

Movements in Common Equity Tier 1 Capital

	2018
	£m
At 31 Dec 2017	**1,264.2**
Changes on adoption of IFRS 9	**(33.6)**
Movement in retained earnings	**63.7**
Additional valuation adjustment	**(0.6)**
Movement in revaluation reserve	**0.5**
Distributions on ordinary shares paid during the year	**18.1**
Distributions on ordinary shares accrued during the year	**(13.9)**
AT1 coupons accrued at previous year end	**3.8**
AT1 coupons accrued at this year end	**(3.8)**
Movement in reserves of non-regulated companies	**(0.1)**
Movement in intangible assets	**(30.1)**
Movement in excess of expected loss over impairment	**6.8**
Movement in deferred tax on tax losses carried forward	**0.6**
IFRS 9 transitional adjustments	**38.7**
At 30 Jun 2018	**1,314.3**

The main drivers for the increase in capital resources are the increase in retained earnings, net of distributions and increased intangible assets.

Risk-weighted assets

	At 30 Jun 2018	At 31 Dec 2017
	£m	£m
Retail mortgages	**4,394.3**	5,790.5
Retail unsecured lending	**2,389.4**	2,282.9
Treasury	**170.5**	134.8
Other assets	**227.0**	204.3
Credit valuation adjustments	**10.8**	10.4
Operational risk	**867.3**	755.7
Total risk-weighted assets	**8,059.3**	9,178.6

Were the IFRS 9 transitional capital arrangements not applied, total risk-weighted assets would be £8,029.3 million as at 30 June 2018.

Movement in risk-weighted assets

	IRB mortgage	Standardised lending	Other standardised assets	Credit valuation adjustment	Operational risks	Total
	£m	£m	£m	£m	£m	£m
RWAs at 31 Dec 2017	**5,790.5**	**2,282.9**	**339.1**	**10.4**	**755.7**	**9,178.6**
Book growth	**249.2**	**122.4**	—	—	—	**371.6**
Other movements	**(1,645.4)**	**(15.9)**	**58.4**	**0.4**	**111.6**	**(1,490.9)**
RWAs at 30 Jun 2018	**4,394.3**	**2,389.4**	**397.5**	**10.8**	**867.3**	**8,059.3**

The table above shows the movement in risk-weighted assets during the period to 30 June 2018. During 2018, the Group carried out a re-segmentation of the mortgage AIRB models, resulting in a £1.6 billion reduction in mortgage risk-weighted assets.

For credit cards, growth in risk-weighted assets was largely in line with growth in customer balances as unsecured risk-weighted assets are calculated using the standardised approach.

Other movements includes an increase due to growth in the Group's deferred tax asset as a consequence of the implementation of IFRS 9. In addition, there was an increase in exposure to wholesale assets following replacement of off-balance sheet FLS treasury bills with on-balance sheet liquidity.

There was an additional increase in operational risk-weighted assets of £111.6 million. This increase was in line with the standardised approach for the calculation of operational risk, where the growth in average income over the past three years is recognised in higher levels of operational risk-weighted assets.

Leverage ratio

The leverage ratio is risk insensitive, requiring capital to be held against total on and off-balance sheet exposures, including undrawn credit facilities.

The Group's leverage ratio as at 30 June 2018 was 3.8% (31 December 2017: 3.9%).

	At 30 Jun 2018	At 31 Dec 2017
	£m	£m
Common Equity Tier 1 capital	**1,314.3**	1,264.2
Additional Tier 1 capital	**384.1**	384.1
Tier 1 capital	**1,698.4**	1,648.3
Exposures measure		
Statutory balance sheet assets	**43,696.1**	41,107.8
Deconsolidation adjustments	**(0.5)**	(0.4)
Derivative adjustments	**70.7**	14.1
Securities Financing Transactions (SFT) adjustments	**122.5**	364.3
Off-balance sheet items	**862.8**	776.8
Regulatory deductions and other adjustments	**(183.4)**	(154.4)
IFRS 9 adjustments	**38.7**	—
Total exposures	**44,606.9**	42,108.2
Leverage ratio	**3.8%**	3.9%

Were the IFRS 9 transitional capital arrangements not applied, the fully loaded leverage ratio as at 30 June 2018 would be 3.7%.

Exposure values associated with derivatives and securities financing transactions have been reported in compliance with CRD IV rules. For the purposes of the leverage ratio, the derivative measure has been adjusted for regulatory netting rules, potential future exposures and cash collateral.

Off-balance sheet items are made up of undrawn credit facilities. Credit conversion factors have been applied to these items to convert them to an on-balance sheet equivalent in compliance with the CRD IV rules.

Other regulatory adjustments consist of adjustments that have been applied to Tier 1 capital which are also applied to the leverage ratio exposure measure. This ensures consistency between Tier 1 capital and the total exposures component of the ratio.

CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS (UNAUDITED)

CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS (UNAUDITED) (continued)

CONDENSED CONSOLIDATED INCOME STATEMENT

	Note	Half-year to 30 Jun 2018	Half-year to 30 Jun 2017	Half-year to 31 Dec 2017
		£ million	£ million	£ million
Interest and similar income		**518.4**	465.4	492.6
Interest and similar expense		**(215.3)**	(176.9)	(186.5)
Net interest income	3	**303.1**	288.5	306.1
Net fee and commission income		**17.0**	14.4	15.2
Other operating income		**19.9**	24.3	17.5
Fair value gains/(losses) on financial instruments		**0.2**	1.3	(4.6)
Other income		**37.1**	40.0	28.1
Total income		**340.2**	328.5	334.2
Operating expenses	4	**(182.6)**	(182.5)	(173.4)
Profit before tax from operating activities		**157.6**	146.0	160.8
Impairment charge	6	**(30.4)**	(22.2)	(22.0)
Profit before tax		**127.2**	123.8	138.8
Taxation	7	**(33.7)**	(33.3)	(37.2)
Profit for the period		**93.5**	90.5	101.6
Profit attributable to equity owners		**93.5**	90.5	101.6
Profit for the period		**93.5**	90.5	101.6
Basic earnings per share (pence)	8	**18.3**	17.7	20.2
Diluted earnings per share (pence)	8	**18.1**	17.5	20.0

The accompanying notes are an integral part of these condensed consolidated half-year financial statements.

CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS (UNAUDITED) (continued)

CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

	Half-year to 30 Jun 2018[1]	Half-year to 30 Jun 2017	Half-year to 31 Dec 2017
	£ million	£ million	£ million
Profit for the period	**93.5**	90.5	101.6
Other comprehensive income/(expense)			
Items that may subsequently be reclassified to profit or loss:			
Movements in revaluation reserve in respect of available-for-sale financial assets:			
Change in fair value	—	12.0	2.1
Income statement transfers in respect of disposals	—	(10.4)	(3.1)
Taxation	—	(0.4)	0.3
	—	1.2	(0.7)
Movements in revaluation reserve for debt instruments at fair value through other comprehensive income:			
Change in fair value	**3.4**	—	—
Income statement transfers in respect of disposals	**(3.3)**	—	—
Taxation	**0.2**	—	—
	0.3	—	—
Movements in cash flow hedging reserve:			
Effective portion of changes in fair value taken to other comprehensive income	**3.5**	2.1	(3.3)
Net income statement transfers	**4.3**	6.6	6.0
Taxation	**(2.1)**	(2.4)	(0.2)
	5.7	6.3	2.5
Items that will not be reclassified to profit or loss:			
Movements in revaluation reserve for equity investments designated at fair value through other comprehensive income:			
Change in fair value	**0.3**	—	—
Taxation	**(0.1)**	—	—
	0.2	—	—
Other comprehensive income for the period, net of tax	**6.2**	7.5	1.8
Total comprehensive income for the period	**99.7**	98.0	103.4
Total comprehensive income attributable to equity shareholders	**99.7**	98.0	103.4

(1) Under IFRS 9 'Financial Instruments', debt investments previously classified in the available-for-sale category were reclassified to the new fair value through other comprehensive income category at 1 January 2018 (see note 19).

The accompanying notes are an integral part of these condensed consolidated half-year financial statements.

CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS (UNAUDITED) (continued)

CONDENSED CONSOLIDATED BALANCE SHEET

	Note	At 30 Jun 2018	At 31 Dec 2017
		£ million	£ million
Assets			
Cash and balances at central banks		**4,164.2**	2,579.0
Derivative financial instruments		**74.3**	78.8
Loans and advances to banks		**309.0**	359.4
Loans and advances to customers	11	**37,176.0**	36,740.2
Financial instruments at fair value through other comprehensive income(1)		**1,638.3**	—
Equity investments at fair value through profit or loss		**1.0**	—
Available-for-sale financial assets(1)		—	1,051.8
Intangible assets	12	**158.5**	128.4
Tangible fixed assets		**73.0**	74.5
Deferred tax assets		**21.7**	11.5
Other assets		**60.4**	84.2
Disposal group assets held for sale	10	**19.7**	—
Total assets		**43,696.1**	41,107.8

(1) Under IFRS 9 'Financial Instruments', debt investments previously classified in the available-for-sale category were reclassified to the new fair value through other comprehensive income category at 1 January 2018 (see note 19).

CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS (UNAUDITED) (Continued)

CONDENSED CONSOLIDATED BALANCE SHEET (Continued)

Equity and liabilities	Note	At 30 Jun 2018	At 31 Dec 2017
		£ million	£ million
Liabilities			
Deposits from banks		**7,083.4**	5,379.0
Customer deposits	13	**31,445.6**	30,808.4
Derivative financial instruments		**49.2**	93.5
Debt securities in issue	14	**2,939.2**	2,736.9
Current tax liabilities		**28.6**	23.6
Other liabilities		**285.9**	241.5
Disposal group liabilities held for sale	10	**3.0**	—
Total liabilities		**41,834.9**	39,282.9
Equity			
Share capital and share premium		**654.6**	654.6
Other equity instruments		**384.1**	384.1
Other reserves		**(11.9)**	(18.1)
Retained earnings		**834.4**	804.3
Total equity		**1,861.2**	1,824.9
Total liabilities and equity		**43,696.1**	41,107.8

The accompanying notes are an integral part of these condensed consolidated half-year financial statements.

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

Attributable to equity holders

	Share capital and share premium	Other equity instruments	Other reserves	Retained earnings	Total equity
	£ million	£ million	£ million	£ million	£ million
Balance at 1 January 2018	**654.6**	**384.1**	**(18.1)**	**804.3**	**1,824.9**
Changes on adoption of IFRS 9 (see note 19)	—	—	—	**(33.6)**	**(33.6)**
Restated balance at 1 January 2018	**654.6**	**384.1**	**(18.1)**	**770.7**	**1,791.3**
Comprehensive income					
Profit for the period	—	—	—	**93.5**	**93.5**
Other comprehensive income					
Net movement in revaluation reserve in respect of financial assets held at fair value through other comprehensive income	—	—	**0.5**	—	**0.5**
Net movement in cash flow hedge reserve	—	—	**5.7**	—	**5.7**
Total other comprehensive income	—	—	**6.2**	—	**6.2**
Total comprehensive income for the period	—	—	**6.2**	**93.5**	**99.7**
Transactions with equity holders					
Dividends paid to ordinary shareholders	—	—	—	**(18.2)**	**(18.2)**
Distribution to Additional Tier 1 security holders	—	—	—	**(16.4)**	**(16.4)**
Tax attributable to Additional Tier 1 securities	—	—	—	**3.9**	**3.9**
Purchase of own shares	—	—	—	**(4.3)**	**(4.3)**
Share based payments—charge for the period (net of tax)	—	—	—	**5.2**	**5.2**
Total transactions with equity holders	—	—	—	**(29.8)**	**(29.8)**
Balance at 30 June 2018	**654.6**	**384.1**	**(11.9)**	**834.4**	**1,861.2**

CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS (UNAUDITED) (Continued)

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (Continued)

Attributable to equity holders

	Share capital and share premium	Other equity instruments	Other reserves	Retained earnings	Total equity
	£ million	£ million	£ million	£ million	£ million
Balance at 1 January 2017	654.6	384.1	(27.4)	659.2	1,670.5
Comprehensive income					
Profit for the period	—	—	—	90.5	90.5
Other comprehensive income					
Net movement in revaluation reserve in respect of available-for-sale financial assets	—	—	1.2	—	1.2
Net movement in cash flow hedge reserve	—	—	6.3	—	6.3
Total other comprehensive income	—	—	7.5	—	7.5
Total comprehensive income for the period	—	—	7.5	90.5	98.0
Transactions with equity holders					
Dividends paid to ordinary shareholders	—	—	—	(15.5)	(15.5)
Distribution to Additional Tier 1 security holders	—	—	—	(16.4)	(16.4)
Tax attributable to Additional Tier 1 securities	—	—	—	4.0	4.0
Purchase of own shares	—	—	—	(7.7)	(7.7)
Share based payments—charge for the period (net of tax)	—	—	—	5.1	5.1
Total transactions with equity holders	—	—	—	(30.5)	(30.5)
Balance at 30 June 2017	654.6	384.1	(19.9)	719.2	1,738.0

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (Continued)

Attributable to equity holders

	Share capital and share premium	Other equity instruments	Other reserves	Retained earnings	Total equity
	£ million	£ million	£ million	£ million	£ million
Balance at 1 July 2017	654.6	384.1	(19.9)	719.2	1,738.0
Comprehensive income					
Profit for the period	—	—	—	101.6	101.6
Other comprehensive income					
Net movement in revaluation reserve in respect of available-for-sale financial assets	—	—	(0.7)	—	(0.7)
Net movement in cash flow hedge reserve	—	—	2.5	—	2.5
Total other comprehensive income	—	—	1.8	—	1.8
Total comprehensive income for the period	—	—	1.8	101.6	103.4
Transactions with equity holders					
Dividends paid to ordinary shareholders	—	—	—	(8.4)	(8.4)
Distribution to Additional Tier 1 security holders	—	—	—	(16.3)	(16.3)
Tax attributable to Additional Tier 1 securities	—	—	—	4.4	4.4
Purchase of own shares	—	—	—	(0.8)	(0.8)
Share based payments—charge for the period (net of tax)	—	—	—	4.8	4.8
Other distributions	—	—	—	(0.2)	(0.2)
Total transactions with equity holders	—	—	—	(16.5)	(16.5)
Balance at 31 December 2017	654.6	384.1	(18.1)	804.3	1,824.9

CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS (UNAUDITED) (Continued)

CONDENSED CONSOLIDATED CASH FLOW STATEMENT

	Half-year to 30 Jun 2018	Half-year to 30 Jun 2017	Half-year to 31 Dec 2017
	£ million	£ million	£ million
Profit before taxation	**127.2**	123.8	138.8
Adjustments for:			
Changes in operating assets	**(525.7)**	(2,309.5)	(2,048.3)
Changes in operating liabilities	**2,373.6**	5,511.7	294.9
Non-cash and other items	**45.7**	34.5	13.7
Tax paid	**(23.9)**	(16.6)	(28.5)
Net cash provided by/(used in) operating activities	**1,996.9**	3,343.9	(1,629.4)
Cash flows from investing activities			
Purchase of securities	**(852.3)**	(374.7)	(166.8)
Proceeds from sale and redemption of securities	**248.1**	185.7	311.4
Purchase and investment in intangible assets	**(41.5)**	(34.6)	(39.7)
Purchase of tangible fixed assets	**(2.6)**	(1.7)	(4.1)
Net cash (used in)/provided by investing activities	**(648.3)**	(225.3)	100.8
Cash flows from financing activities			
Dividends paid to ordinary shareholders	**(18.2)**	(15.5)	(8.4)
Distributions to Additional Tier 1 security holders	**(16.4)**	(16.4)	(16.3)
Other distributions	—	—	(0.2)
Net proceeds from issue of debt securities	**548.1**	—	746.2
Repayments of debt securities in issue	**(352.5)**	(302.7)	(305.6)
Purchase of own shares	**(4.3)**	(7.7)	(0.8)
Net cash provided by/(used in) financing activities	**156.7**	(342.3)	414.9
Change in cash and cash equivalents	**1,505.3**	2,776.3	(1,113.7)
Cash and cash equivalents at beginning of period	**3,034.8**	1,372.2	4,148.5
Cash and cash equivalents at end of period[(1)]	**4,540.1**	4,148.5	3,034.8

(1) The composition of cash and cash equivalents is consistent with the basis applied in the 2017 Annual Report and Accounts.

NOTES TO THE CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS (UNAUDITED)

Note 1: Basis of preparation

1.1 Basis of preparation and going concern

The condensed consolidated half-year financial statements of Virgin Money Holdings (UK) plc and its subsidiaries (the Group) for the six months ended 30 June 2018 were authorised for issue in accordance with a resolution of the Directors on 25 July 2018.

These condensed consolidated half-year financial statements for the six months ended 30 June 2018 have been prepared in accordance with the Disclosure and Transparency Rules of the Financial Conduct Authority (FCA) and IAS 34 '*Interim Financial Reporting'* as adopted by the European Union (EU). They do not include all the information required by International Financial Reporting Standards (IFRS) in full annual financial statements and should be read in conjunction with the Annual Report and Accounts for the year ended 31 December 2017. Copies of the 2017 Annual Report and Accounts are available on the Group's website.

The comparative financial information for the year ended 31 December 2017 does not constitute statutory accounts as defined in section 434 of the Companies Act 2006. A copy of the statutory accounts for that year has been delivered to the Registrar of Companies. The auditors' report on those accounts was not qualified, did not include a reference to any matters to which the auditors drew attention by way of emphasis without qualifying the report and did not contain statements under section 498(2) or (3) of the Companies Act 2006.

The Directors have reviewed the strategic plan which shows the financial position, cash flow, liquidity and capital forecasts for the Group. The Directors are confident that the Group will have sufficient resources to meet its liabilities as they fall due and continue to operate for a period of at least 12 months from the date of approval of the condensed consolidated half-year financial statements. Accordingly the Directors believe that it remains appropriate to prepare the condensed consolidated half-year financial statements on a going concern basis.

1.2 Accounting policies

The accounting policies and methods of computation are consistent with those applied in the 2017 Annual Report and Accounts (pages 207 to 216) with the exception of new accounting policies in respect of IFRS 9 *'Financial Instruments'* and IFRS 15 *'Revenue',* which were both adopted on 1 January 2018.

IFRS 9 replaces IAS 39 *'Financial Instruments: Recognition and Measurement'*. This new accounting standard has three core areas of change: Classification and Measurement; Hedge Accounting; and Impairment. The most significant impacts on the Group are from the changes to impairment. Details of the new accounting policies applied and the impact of transition to IFRS 9 can be found in note 19.

IFRS 15 replaces IAS 18 *'Revenue*' and IAS 11 '*Construction contracts*' as a comprehensive standard for revenue recognition. Financial instruments and other contractual rights or obligations within the scope of IFRS 9 are excluded from the scope of this standard. IFRS 15 has not had a significant impact on the Group, as a substantial proportion of the Group's income is generated from financial instruments.

1.3 Future accounting developments

A number of IFRS pronouncements of new accounting standards and amendments to accounting standards have been issued by the IASB that are not yet effective and therefore have not been applied in preparing these condensed consolidated half-year financial statements. Those which may have a significant impact on the Group in future periods are consistent with those disclosed in the 2017 Annual Report and Accounts (page 250).

1.4 Presentation of information

Presentation of risk disclosures

IAS 34 '*Interim Financial Statements'* requires certain disclosures outlined in IFRS 7 '*Financial Instruments: Disclosure'*. These include disclosures concerning the nature and extent of risks relating to financial instruments and have been included within the Risk Management Report.

1.5 Critical estimates and judgements

The preparation of financial statements in conformity with IFRS requires Management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Estimates and judgements are based on Management's knowledge and historical experience. Due to the inherent uncertainty in making estimates, actual results in future periods may include amounts which differ from those estimates.

The following updates are provided on critical estimates and judgements, which should be read in conjunction with the 2017 Annual Report and Accounts (pages 216 and 217).

a) Effective interest rates

Effective interest rate (EIR) accounting for unsecured lending remains an area of critical judgement and estimate for the Group. Management model expected future cash flows over the estimated customer life, restricted to a maximum of seven years, which is supported by observed experience. Income recognition can differ significantly from actual cash receipts over that period. The selection of expected life for modelling purposes also has a material bearing on the EIR rate used for each cohort. A shorter modelling period results in a lower rate for income recognition.

As at 30 June 2018 the EIR method gave rise to an adjustment of £192.6 million (31 December 2017: £159.8 million) to the balance sheet value of unsecured loans. This adjustment represented 6.1% (31 December 2017: 5.3%) of the balance sheet carrying value of unsecured loans.

In the calculation of EIR, Management uses estimates and assumptions of future customer behaviour. These include the estimation of utilisation of available credit, transaction and repayment activity and the retention of the customer balance after the end of a promotional period.

As at 30 June 2018 a full and in depth analysis of all customer behaviours was undertaken, which included the 49,000 customers who have come off their zero per cent promotion period during the first half of the year. The customer behaviours and future cash flow assumptions, in respect of the seven year modelling period used within the EIR calculations, have been updated across the portfolio to reflect these latest observed data points. This resulted in a net reduction to total income of £(7.8) million. £(5.4) million of the total represents income previously recognised and £(2.4) million represents the present value of income not yet earned.

In relation to future sensitivities, should Management's current estimation of future cash flows be inaccurate to the extent that the original effective interest rates on unsecured lending cohorts were all reduced by 0.1%, the present value adjustment to interest income would be approximately £(12.3) million as at 30 June 2018 (31 December 2017: £(10.2) million).

The level of repayment immediately post-promotional period is a key estimate in the EIR calculation. Management have undertaken a sensitivity on post-promotion payment rates for all cohorts which are still within their promotional periods as at 30 June 2018. For these cohorts, should the payment rate be 10% higher than forecast for the six months following end of promotion, Management estimate this would result in a negative present value adjustment to interest income of approximately £(24.3) million as at 30 June 2018 (31 December 2017: £(30.8) million). In such an adjustment, £(10.9) million (31 December 2017: £(11.5) million) would relate to write-off of income previously recognised in the income statement, with £(13.4) million (31 December 2017: £(19.3) million) representing an adjustment to reflect a lower level of interest income expected in future accounting periods.

b) Capitalisation of intangible assets

Management judgement is required in assessing intangible assets for impairment, including those not yet in use at the reporting date. As part of that judgement, Management have considered the outlook for the Group and the current intention to deliver the Group's stated strategic objectives. On this basis Management are satisfied with the carrying value of intangible assets at 30 June 2018.

In the event of a future change in ownership, there may be changes that affect the Group's current strategic objectives. Management acknowledge such a change in circumstance may give rise to a requirement to review this judgement at a future date.

c) Impairment of loans and receivables

Impairment of loans and receivables is now accounted for under IFRS 9 *'Financial Instruments'*. Details of the new critical estimates and judgements made under IFRS 9 can be found in note 19.

d) Disposal Group

On 20 March 2018 the Group announced that it had agreed in principle to enter into a new strategic joint venture for the provision of asset management services with Aberdeen Standard Investments. The transaction is expected to result in the deconsolidation of the Group's wholly owned subsidiary, Virgin Money Unit Trust Managers Limited, which will be recognised as a joint venture under the new arrangement. Management have concluded that it is highly probable the sale will occur within the next 12 months. As a result the assets and liabilities of Virgin Money Unit Trust Managers Limited, which is not a separate major line of business, have been classified as a disposal group (see note 10) in accordance with IFRS 5 '*Non-current assets held for sale and discontinued operations'*.

Note 2: Segmental analysis and reconciliation to underlying basis

The Group falls within the scope of IFRS 8 *'Operating Segments'*. The Group's chief operating decision maker (which has been determined to be the Executive Committee) assesses performance and makes decisions based on the performance of the Group as a whole. The Group has therefore determined that it has one reportable operating segment and is therefore not required to produce additional segmental disclosure.

The Group operates in a single geographic segment, being the UK, and the Group is not reliant on a single customer.

Reconciliation of statutory results to underlying basis

The underlying basis is the basis on which financial information is presented to the chief operating decision maker which excludes certain items included in the statutory results. The tables below reconcile the statutory results to the underlying basis.

		Adjusted for		
Half-year to 30 June 2018	**Statutory results**	**Strategic items**	**Fair value losses on financial instruments**	**Underlying basis**
	£m	**£m**	**£m**	**£m**
Net interest income	**303.1**	—	—	**303.1**
Other income	**37.1**	—	**2.8**	**39.9**
Total income	**340.2**	—	**2.8**	**343.0**
Operating expenses	**(182.6)**	**11.6**	—	**(171.0)**
Profit before tax from operating activities	**157.6**	**11.6**	**2.8**	**172.0**
Impairment	**(30.4)**	—	—	**(30.4)**
Profit before tax	**127.2**	**11.6**	**2.8**	**141.6**

		Adjusted for			
Half-year to 30 June 2017	**Statutory results**	**IPO share based payments**	**Strategic items**	**Fair value gains on financial instruments**	**Underlying basis**
	£m	**£m**	**£m**	**£m**	**£m**
Net interest income	288.5	—	—	—	288.5
Other income	40.0	—	—	(1.3)	38.7
Total income	328.5	—	—	(1.3)	327.2
Operating expenses	(182.5)	0.6	5.5	—	(176.4)
Profit before tax from operating activities	146.0	0.6	5.5	(1.3)	150.8
Impairment	(22.2)	—	—	—	(22.2)
Profit before tax	123.8	0.6	5.5	(1.3)	128.6

Half-year to 31 December 2017	Statutory results	Adjusted for: IPO share based payments	Strategic items	Fair value losses on financial instruments	Underlying basis
	£m	£m	£m	£m	£m
Net interest income	306.1	—	—	—	306.1
Other income	28.1	—	—	4.6	32.7
Total income	334.2	—	—	4.6	338.8
Operating expenses	(173.4)	0.3	1.0	—	(172.1)
Profit before tax from operating activities	160.8	0.3	1.0	4.6	166.7
Impairment	(22.0)	—	—	—	(22.0)
Profit before tax	138.8	0.3	1.0	4.6	144.7

Note 3: Net interest income

	Half-year to 30 Jun 2018	Half-year to 30 Jun 2017	Half-year to 31 Dec 2017
	£m	£m	£m
Interest and similar income:			
Loans and advances to customers	**502.2**	460.6	484.6
Loans and advances to banks	**0.8**	0.4	0.5
Available-for-sale financial assets	—	2.6	3.0
Financial instruments at fair value through other comprehensive income	**4.9**	—	—
Cash and balances at central banks	**10.5**	1.8	4.5
Total interest and similar income	**518.4**	465.4	492.6
Interest and similar expense:			
Deposits from banks	**(19.3)**	(5.7)	(10.8)
Customer deposits	**(174.6)**	(152.9)	(157.9)
Debt securities in issue	**(20.9)**	(15.4)	(15.6)
Other	**(0.5)**	(2.9)	(2.2)
Total interest and similar expense	**(215.3)**	(176.9)	(186.5)
Net interest income	**303.1**	288.5	306.1

Note 4: Operating expenses

	Half-year to 30 Jun 2018	Half-year to 30 Jun 2017	Half-year to 31 Dec 2017
	£m	£m	£m
Staff costs:			
Wages and salaries	**86.1**	75.3	86.6
Social security costs	**7.6**	7.5	8.0
Other pension costs	**5.7**	5.4	5.5
Employee share schemes	**5.2**	5.1	4.8
	104.6	93.3	104.9
Premises and equipment:			
Hire of equipment	**2.3**	2.3	2.3
Rent and rates	**7.8**	7.4	7.0
Other property costs	**5.8**	5.8	5.2
	15.9	15.5	14.5
Other expenses:			
Marketing costs	**10.8**	10.3	11.5
Telecommunications and IT	**8.9**	9.6	8.9
Professional fees	**12.8**	9.5	13.6
Other	**14.1**	24.5	4.6
	46.6	53.9	38.6
Depreciation, amortisation and impairment:			
Depreciation of tangible fixed assets	**4.1**	4.3	4.4
Amortisation of intangible assets	**11.4**	10.7	11.0
Impairment of intangible assets	**—**	4.8	—
	15.5	19.8	15.4
Total operating expenses	**182.6**	182.5	173.4

Note 5: Share based payments

All share based payment charges relate to equity settled schemes. Details of the existing share plans can be found in note 7 of the 2017 Annual Report and Accounts.

In the six months to 30 June 2018 the Group granted new awards under the Deferred Bonus Share Plan and the Long Term Incentive Plan.

Note 6: Allowance for impairment losses on loans and advances to customers

The following table explains the changes in the loss allowance between the beginning and the end of the period:

	Half-year to 30 Jun 2018	Half-year to 30 Jun 2017	Half-year to 31 Dec 2017
	£m	£m	£m
Opening allowance at 31 December	**59.4**	50.1	55.7
Changes on adoption of IFRS 9 at 1 January 2018 (see note 19)	**44.8**	—	—
Restated opening balance at 1 January	**104.2**	50.1	55.7
Advances written off	**(21.5)**	(16.6)	(18.3)
Charge to the income statement	**30.4**	22.2	22.0
Closing allowance	**113.1**	55.7	59.4
In respect of:			
Secured loans	**12.8**	11.7	12.1
Unsecured loans	**100.3**	44.0	47.3
Total closing allowance	**113.1**	55.7	59.4

A loss allowance of £0.2 million (30 June 2017 and 31 December 2017: £nil) is recognised in relation to loans and advances to banks.

Note 7: Taxation

Analysis of the tax charge for the period:

	Half-year to 30 Jun 2018	Half-year to 30 Jun 2017	Half-year to 31 Dec 2017
	£m	£m	£m
Profit before tax	**127.2**	123.8	138.8
Tax charge at standard tax rate of 19.00% (30 June 2017: 19.25%, 31 December 2017: 19.25%)	**(24.2)**	(23.8)	(26.7)
Factors affecting tax charge:			
Disallowed items	**(0.8)**	(0.8)	(0.2)
Bank corporation tax surcharge	**(8.5)**	(8.4)	(10.5)
UK corporation tax rate changes	**(0.2)**	(0.1)	(0.3)
Deferred tax charge in respect of share schemes	**0.1**	—	—
Adjustments in respect of prior periods	—	(0.1)	0.4
Other	**(0.1)**	(0.1)	0.1
Total tax charge	**(33.7)**	(33.3)	(37.2)

The main rate of corporation tax reduced from 20% to 19% on 1 April 2017, and will reduce further to 17% on 1 April 2020 in accordance with the Finance Act 2016.

In accordance with IAS 34 '*Interim Financial Reporting*', the Group's tax charge for the half-year to 30 June 2018 is based on the best estimate of the weighted-average annual corporation tax rate expected for the full financial year. The tax effects of one-off items are not included in the weighted-average annual corporation tax rate, but are recognised in the relevant period.

Note 8: Earnings per share

	Half-year to 30 Jun 2018	Half-year to 30 Jun 2017	Half-year to 31 Dec 2017
	£m	**£m**	**£m**
Profit attributable to equity owners—basic and diluted	**93.5**	90.5	101.6
Distributions to Additional Tier 1 security holders (net of tax)	**(12.5)**	(12.4)	(12.4)
Profit attributable to equity shareholders for the purposes of basic and diluted EPS	**81.0**	78.1	89.2

	30 Jun 2018 Number of shares	30 Jun 2017 Number of shares	31 Dec 2017 Number of shares
	(million)	**(million)**	**(million)**
Weighted-average number of ordinary shares in issue—basic	**442.7**	442.2	442.5
Adjustment for share options and awards	**3.9**	4.2	4.2
Weighted-average number of ordinary shares in issue—diluted	**446.6**	446.4	446.7
Basic earnings per share (pence)	**18.3**	17.7	20.2
Diluted earnings per share (pence)	**18.1**	17.5	20.0

Basic earnings per share has been calculated after deducting 2.5 million (30 June 2017: 2.8 million; 31 December 2017: 2.8 million) ordinary shares representing the weighted-average of the Group's holdings of own shares in respect of employee share schemes.

Of the total number of employee share options and share awards at 30 June 2018 none were anti-dilutive (30 June and 31 December 2017: nil).

Note 9: Dividends

An interim dividend for 2018 of 2.3 pence per ordinary share, amounting to £10.2 million, was declared on 25 July 2018 and will be paid on 21 September 2018 to shareholders on the share register at close of business on 10 August 2018.

An interim dividend for 2017 of 1.9 pence per ordinary share, amounting to £8.4 million, was paid in September 2017. A final dividend in respect of the year ended 31 December 2017 of 4.1 pence per ordinary share, amounting to £18.2 million, was paid in May 2018.

Note 10: Disposal group assets and liabilities held for sale

On 20 March 2018 the Group announced that it had agreed in principle to enter into a new strategic joint venture for the provision of asset management services with Aberdeen Standard Investments (ASI). For accounting purposes, the transaction is expected to result in the deconsolidation of the Group's wholly owned subsidiary, Virgin Money Unit Trust Managers Limited, which will be recognised as a joint venture under the new arrangement.

The transaction is expected to complete within the next 12 months. In accordance with the accounting requirements, the assets and liabilities of Virgin Money Unit Trust Managers Limited, which is not a separate major business line, have been presented as a disposal group following the announcement.

	At 30 Jun 2018
	£m
Assets	
Loans and advances to banks	**12.4**
Other assets	**7.3**
Total assets	**19.7**
Liabilities	
Current tax liabilities	**1.7**
Other liabilities	**1.3**
Total liabilities	**3.0**

Note 11: Loans and advances to customers

	At 30 Jun 2018	At 31 Dec 2017
	£m	**£m**
Secured residential loans and advances not subject to securitisation	**22,342.1**	21,878.7
Secured residential loans and advances subject to securitisation	**5,112.5**	5,438.5
	27,454.6	27,317.2
Secured residential buy-to-let loans and advances not subject to securitisation	**6,626.9**	6,367.3
Total loans and advances to customers secured on residential property	**34,081.5**	33,684.5
Unsecured loans and advances not subject to securitisation	**3,240.7**	3,071.4
Total loans and advances to customers before allowance for impairment losses	**37,322.2**	36,755.9
Impairment allowance (refer note 6)	**(113.1)**	(59.4)
Total loans and advances to customers excluding portfolio hedging	**37,209.1**	36,696.5
Fair value of portfolio hedging	**(33.1)**	43.7
Total loans and advances to customers	**37,176.0**	36,740.2

Note 12: Intangible assets

	Core deposit intangible	Software	Banking platforms	Total
	£m	**£m**	**£m**	**£m**
Cost:				
At 1 January 2018	4.8	144.9	59.8	209.5
Additions	—	**21.1**	**20.4**	**41.5**
Disposals	**(4.8)**	—	—	**(4.8)**
At 30 June 2018	—	**166.0**	**80.2**	**246.2**
Accumulated amortisation and impairment:				
At 1 January 2018	4.8	66.2	10.1	81.1
Charge for the period	—	**9.9**	**1.5**	**11.4**
Disposals	**(4.8)**	—	—	**(4.8)**
At 30 June 2018	—	**76.1**	**11.6**	**87.7**
Balance sheet amount at 30 June 2018	—	**89.9**	**68.6**	**158.5**
Balance sheet amount at 31 December 2017	—	78.7	49.7	128.4

During the year, the core deposit intangible was removed from the asset register. This asset was recognised in respect of the intrinsic value of the retail savings book when the Group acquired Northern Rock plc in 2012. All of these accounts have now matured, and the full benefit to the Group has been realised.

Note 13: Customer deposits

	At 30 Jun 2018	At 31 Dec 2017
	£m	**£m**
Savings and investment accounts	**31,005.6**	30,393.0
Personal current accounts	**440.0**	415.4
Total customer deposits	**31,445.6**	30,808.4

Note 14: Debt securities in issue

	Securitisation programmes	Medium Term Notes	Total
	£m	£m	£m
At 1 January 2018	2,434.1	302.8	2,736.9
Repayments	**(352.5)**	—	**(352.5)**
Issues	**199.5**	**348.6**	**548.1**
Revaluation	**4.9**	—	**4.9**
Other movements	**1.5**	**0.3**	**1.8**
At 30 June 2018	**2,287.5**	**651.7**	**2,939.2**

Other movements comprise amortisation of issuance costs and hedge accounting adjustments.

Securitisation programmes

In January 2018, the Group raised £199.5 million from a private sale of previously retained Residential Mortgage Backed Securities in the Gosforth 2017-1 transaction.

Medium Term Notes

In April 2018, the Group issued callable Medium Term Notes with a nominal value of £350.0 million at a coupon of 3.375% per annum, repayable on 24 April 2026. They were issued as part of the Group's £3 billion Global Medium Term Note programme and qualify for Minimum Requirements for Own Funds and Eligible Liabilities (MREL).

Note 15: Contingent liabilities and commitments

Contingent liabilities

The Board was not aware of any significant contingent liabilities as at 30 June 2018 (31 December 2017: none).

The Company is, from time to time and in the normal course of business, subject to a variety of legal or regulatory claims, actions or proceedings. When such circumstances arise, the Board considers the likelihood of a material outflow of economic resources and provides for its best estimate of costs where an outflow of economic resources is considered probable. While there can be no assurances, the Directors believe, based on information currently available to them, that the likelihood of material outflows from such matters is remote.

The Board does not expect the ultimate resolution of any other threatened or actual legal proceedings to have a significant adverse effect on the financial position of the Group.

Loan commitments

Contractual amounts to which the Group is committed for extension of credit to customers.

	At 30 Jun 2018	At 31 Dec 2017
	£m	£m
Not later than 1 year	**6,835.8**	5,815.9
Later than 1 year and not later than 5 years	**85.2**	97.1
Later than 5 years	**257.5**	280.5
Total loan commitments	**7,178.5**	6,193.5

Note 16: Fair value of financial assets and financial liabilities

Fair value of financial assets and liabilities recognised at cost

The following table summarises the fair values of those financial assets and liabilities not presented on the Group's balance sheet at their fair value, by the level in the fair value hierarchy into which each fair value measurement is categorised. The accounting policy in the 31 December 2017 Annual Report and Accounts sets out the key principles for estimating the fair values of financial instruments.

	Level 1	Level 2	Level 3	Total fair value	Total carrying value
	£m	£m	£m	£m	£m
At 30 June 2018					
Cash and balances at central banks	—	**4,164.2**	—	**4,164.2**	**4,164.2**
Loans and advances to banks	—	**309.0**	—	**309.0**	**309.0**
Loans and advances to customers	—	—	**37,442.6**	**37,442.6**	**37,176.0**
Other assets	**0.1**	**37.2**	—	**37.3**	**37.3**
Disposal group assets	—	**19.5**	—	**19.5**	**19.5**
Total financial assets	**0.1**	**4,529.9**	**37,442.6**	**41,972.6**	**41,706.0**
Deposits from banks	—	**7,083.4**	—	**7,083.4**	**7,083.4**
Customer deposits	—	**31,433.7**	—	**31,433.7**	**31,445.6**
Debt securities in issue	**2,946.0**	—	—	**2,946.0**	**2,939.2**
Other liabilities	—	**266.8**	—	**266.8**	**266.8**
Disposal group liabilities	—	**1.3**	—	**1.3**	**1.3**
Total financial liabilities	**2,946.0**	**38,785.2**	—	**41,731.2**	**41,736.3**

	Level 1	Level 2	Level 3	Total fair value	Total carrying value
	£m	£m	£m	£m	£m
At 31 December 2017					
Cash and balances at central banks	—	2,579.0	—	2,579.0	2,579.0
Loans and advances to banks	—	359.4	—	359.4	359.4
Loans and advances to customers	—	—	36,951.6	36,951.6	36,740.2
Available-for-sale financial assets	—	—	0.3	0.3	0.3
Other assets	0.3	55.0	—	55.3	55.3
Total financial assets	0.3	2,993.4	36,951.9	39,945.6	39,734.2
Deposits from banks	—	5,379.0	—	5,379.0	5,379.0
Customer deposits	—	30,800.5	—	30,800.5	30,808.4
Debt securities in issue	2,748.3	—	—	2,748.3	2,736.9
Other liabilities	—	215.1	—	215.1	215.1
Total financial liabilities	2,748.3	36,394.6	—	39,142.9	39,139.4

Fair value hierarchy

The tables above summarise the carrying value and fair value of assets and liabilities held on the balance sheet. There are three levels to the hierarchy as follows:

Level 1—Quoted prices (unadjusted) in active markets for identical assets and liabilities.

Level 2—Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, whether directly (i.e. as prices) or indirectly (i.e. derived from prices).

Level 3—Inputs for the asset or liability that are not based on observable market data (unobservable inputs).

There is no significant change to what was disclosed in the 31 December 2017 Annual Report and Accounts in respect of the valuation methodology (techniques and inputs) applied for calculations of fair values in the tables above.

Fair value of financial assets and liabilities recognised at fair value

The following table summarises the fair values of those financial assets and liabilities recognised at fair value, by the level in the fair value hierarchy into which each fair value measurement is categorised. The accounting policy in the 31 December 2017 Annual Report and Accounts sets out the key principles for estimating the fair values of financial instruments.

30 June 2018	Level 1	Level 2	Level 3	Total
	£m	£m	£m	£m
Financial assets				
Derivative financial instruments	—	**74.3**	—	**74.3**
Financial instruments at fair value through other comprehensive income	**1,635.8**	—	**2.5**	**1,638.3**
Equity investments at fair value through profit or loss	—	—	**1.0**	**1.0**
Financial liabilities				
Derivative financial instruments	—	**49.2**	—	**49.2**

31 December 2017	Level 1	Level 2	Level 3	Total
	£m	£m	£m	£m
Financial assets				
Derivative financial instruments	—	78.8	—	78.8
Available-for-sale financial assets	1,048.7	—	2.8	1,051.5
Financial liabilities				
Derivative financial instruments	—	93.5	—	93.5

Level 1 Valuations

The fair value of debt securities recognised at fair value through other comprehensive income are derived from unadjusted quoted prices in an active market.

Level 2 Valuations

The fair values of derivative instruments are calculated by discounted cash flow models using yield curves that are based on observable market data or are based on valuations obtained from counterparties.

Level 3 Valuations

Level 3 financial assets represent the Group's best estimates of the value of certain equity investments in unlisted companies and of unlisted preferred stock. The valuations take into account relevant information on the individual investments, with discounts applied to reflect their illiquid nature and, in respect of the preferred stock, risks of reduction in conversion rights. The discounts applied are the most significant unobservable valuation inputs.

Note 17: Related party transactions

Full details of the Group's related party transactions for the year to 31 December 2017 can be found in note 35 of the 2017 Annual Report and Accounts.

Related party transactions for the half-year to 30 June 2018 are similar in nature to those for the year to 31 December 2017. There are no other changes to related party transactions that have had a material effect on the financial position or performance of the Group.

Note 18: Events after the balance sheet date

There have been no significant events between 30 June 2018 and the date of approval of the condensed consolidated half-year financial statements which would require a change to or additional disclosure in the financial statements apart from the declaration of the interim dividend as disclosed in note 9.

Note 19: Transition to IFRS 9 'Financial Instruments'

On 1 January 2018 the Group adopted IFRS 9 *'Financial Instruments'* which replaces IAS 39 *'Financial Instruments: Recognition and Measurement'*. This new accounting standard has three core areas of change: Classification and Measurement; Hedge Accounting; and Impairment. The most significant impacts on the Group are from the changes to impairment.

(a) Transitional disclosures and impact

In relation to classification and measurement, the primary impact of IFRS 9 is the reclassification of debt investments in the available-for-sale (AFS) category to the new fair value through other comprehensive income (FVOCI) category. Management also have an option to classify non-trading equity investments as fair value through profit or loss (FVPL) or irrevocably designate them as FVOCI, on an investment by investment basis.

The material retail financial asset portfolios (primarily secured and unsecured loans) retain their classification as amortised cost, so there is no change in the classification and measurement of these financial assets. The classification requirements for financial liabilities are unchanged on adoption of IFRS 9.

The following table sets out the reclassification impacts of transitioning from IAS 39 to IFRS 9 on 1 January 2018:

	IAS 39		IFRS 9	
Financial assets	**Measurement category**	**Carrying amount**	**Measurement category**	**Carrying amount**
		£m		**£m**
Cash and balances at central banks	Loans and receivables (amortised cost)	2,579.0	Amortised cost	2,579.0
Derivative financial instruments	FVPL (Hedging instrument)	78.8	FVPL (mandatory)	78.8
Loans and advances to banks	Loans and receivables (amortised cost)	359.4	Amortised cost	359.2
Loans and advances to customers	Loans and receivables (amortised cost)	36,740.2	Amortised cost	36,695.4
			FVOCI	1,048.7
Available for sale financial assets	Available for sale	1,051.8	FVOCI (designated)[(1)]	2.1
			FVPL	1.0

(1) Management has the option to designate non-trading equity investments as FVOCI on an investment by investment basis.

The following table sets out the one-off balance sheet reclassification and remeasurement impacts of transitioning from IAS 39 to IFRS 9 on 1 January 2018 and for comparison purposes the ongoing impact of IFRS 9 at 30 June 2018:

Financial assets	IAS 39 At 1 Jan 2018	Reclassification	Remeasurement	IFRS 9 At 1 Jan 2018	IAS 39 At 30 Jun 2018	Reclassification	Remeasurement	IFRS 9 At 30 Jun 2018
	£m	£m	£m	£m	£m	£m	£m	£m
Cash and balances at central banks	2,579.0	—	—	2,579.0	**4,164.2**	—	—	**4,164.2**
Derivative financial instruments	78.8	—	—	78.8	**74.3**	—	—	**74.3**
Loans and advances to banks	359.4	—	(0.2)	359.2	**309.2**	—	**(0.2)**	**309.0**
Loans and advances to customers	36,740.2	—	(44.8)	36,695.4	**37,225.5**	—	**(49.5)**	**37,176.0**
Financial instruments at fair value through other comprehensive income	—	1,050.8	—	1,050.8	—	**1,638.3**	—	**1,638.3**
Available-for-sale financial assets	1,051.8	(1,051.8)	—	—	**1,639.3**	**(1,639.3)**	—	—
Equity investments at fair value through profit or loss	—	1.0	—	1.0	—	**1.0**	—	**1.0**
Deferred tax assets	11.5	—	11.4	22.9	**10.8**	—	**10.9**	**21.7**
Other assets	287.1	—	—	287.1	**311.6**	—	—	**311.6**
Total assets	41,107.8	—	(33.6)	41,074.2	**43,734.9**	—	**(38.8)**	**43,696.1**
Total liabilities	39,282.9	—	—	39,282.9	**41,836.1**	—	**(1.2)**	**41,834.9**
Total equity	1,824.9	—	(33.6)	1,791.3	**1,898.8**	—	**(37.6)**	**1,861.2**

Profit before tax for the six months ending 30 June 2018 would have been £4.7 million higher on an IAS 39 basis (£3.5 million higher on an after tax basis) as a result of earlier recognition of credit losses under an IFRS 9 approach compared with IAS 39.

The table below shows the allocation of the Group's loans and advances to customers by stage at 30 June 2018:

30 June 2018	Stage 1	Stage 2	Stage 3	Total
	£m	£m	£m	£m
Gross Exposure				
Residential mortgage loans	**25,798.8**	**1,484.9**	**170.9**	**27,454.6**
Residential buy-to-let mortgage loans	**6,415.9**	**194.4**	**16.6**	**6,626.9**
Credit cards	**2,869.5**	**337.2**	**33.9**	**3,240.6**
Overdrafts	—	**0.1**	—	**0.1**
Total	**35,084.2**	**2,016.6**	**221.4**	**37,322.2**
Impairment allowance				
Residential mortgage loans	**2.8**	**5.2**	**3.6**	**11.6**
Residential buy-to-let mortgage loans	**0.1**	**0.4**	**0.7**	**1.2**
Credit cards	**24.8**	**56.0**	**19.4**	**100.2**
Overdrafts	—	**0.1**	—	**0.1**
Total	**27.7**	**61.7**	**23.7**	**113.1**

The allocation of the Group's loans and advances to customers by stage at 1 January 2018 was:

1 January 2018	Stage 1	Stage 2	Stage 3	Total
	£m	£m	£m	£m
Gross Exposure				
Residential mortgage loans	25,869.6	1,300.1	147.5	27,317.2
Residential buy-to-let mortgage loans	6,167.8	183.4	16.1	6,367.3
Credit cards	2,741.6	300.3	29.4	3,071.3
Overdrafts	—	0.1	—	0.1
Total	34,779.0	1,783.9	193.0	36,755.9
Impairment allowance				
Residential mortgage loans	3.2	4.5	3.2	10.9
Residential buy-to-let mortgage loans	0.1	0.3	0.8	1.2
Credit cards	23.3	51.5	17.2	92.0
Overdrafts	—	0.1	—	0.1
Total	26.6	56.4	21.2	104.2

In addition an impairment allowance of £0.2 million was recognised in relation to loans and advances to banks at both 1 January and 30 June 2018. All loans and advances to bank balances are classified as stage 1.

(b) Accounting policies

Classification and measurement

Under IFRS 9 financial assets are classified into one of three measurement categories:

- amortised cost;
- fair value through other comprehensive income (FVOCI); or
- fair value through profit or loss (FVPL).

Classification is based on the objectives of the Group's business model for managing its financial assets and the contractual cash flow characteristics of the instruments. IFRS 9 retains most of the existing classification and measurement requirements for financial liabilities from IAS 39.

The business model reflects how the Group manages the assets in order to generate cash flows. One of the following business models is identified for each financial instrument depending on how the risks are managed, past experience with the financial asset and how performance is measured and reported:

- hold to collect: it is intended to collect the contractual cash flows from the assets (Amortised cost classification);
- hold to collect and to sell: it is intended to collect both the contractual cash flows and cash flows arising from the sale of the asset (FVOCI classification); or
- hold to sell: it is intended to sell the financial asset in the short to medium term, or the asset is designated FVPL to minimise an accounting mismatch (FVPL classification).

Where the business model is 'held to collect' or 'held to collect and sell' the Group assesses whether the financial instruments' cash flows represent solely payments of principal and interest (the 'SPPI test'). In making this assessment, the Group considers whether the contractual cash flows are consistent with a basic lending arrangement i.e. interest includes only consideration for the time value of money, credit risk, other basic lending risks and a profit margin that is consistent with a basic lending arrangement. Where the contractual terms introduce exposure to risk or volatility that are inconsistent with a basic lending arrangement, the related financial asset is classified and measured at fair value through profit or loss.

Financial assets with previously separable embedded derivatives are considered in their entirety when determining whether their cash flows are solely payment of principal and interest.

The Group reclassifies debt investments only when its business model for managing those assets changes. Such changes are expected to be very infrequent and none occurred during the period.

The accounting requirements of the three measurement categories are as follows:

Amortised cost

Financial assets at amortised cost are initially recognised at fair value, including direct and incremental transaction costs. Subsequent measurement is at amortised cost using the effective interest rate method. The Group's secured and unsecured loan portfolios are classified as amortised cost.

The carrying amount of these assets is adjusted by any expected credit loss allowance. Interest income is included in 'Interest income' using the effective interest rate method.

Fair value through other comprehensive income (FVOCI)

Financial assets at FVOCI are initially measured at fair value, including direct and incremental transaction costs. Subsequent measurement is at fair value, with changes in fair value being recognised in other comprehensive income, with the exception of impairment gains or losses, interest income and foreign exchange gains and losses on the instruments amortised cost which are recognised in profit or loss. Interest income from these financial assets is included in 'interest income' using the effective interest rate method. The Group's investments in debt securities are classified as FVOCI.

On derecognition of a financial asset, the cumulative gain or loss previously recognised in OCI is reclassified from equity to profit or loss and recognised in 'Fair value gains/losses on financial instruments'.

Fair value through profit or loss (FVPL)

Assets that do not meet the criteria for amortised cost or FVOCI are measured at FVPL on initial recognition and at each reporting date.

Any gain or loss on an asset that is subsequently measured at FVPL, and is not part of a hedging relationship, is recognised in profit or loss and presented in the profit or loss statement within 'Fair value gains/losses on financial instruments'.

Interest income from these financial assets is included separately in 'Net Interest Income'.

Equity instruments

Equity instruments are instruments that do not contain a contractual obligation to pay and that evidence a residual interest in the issuer's net assets (e.g. basic ordinary shares).

The Group measures all equity investments at fair value through profit or loss, except where Management has elected, at initial recognition, to irrevocably designate the non-trading equity investment at FVOCI. When this election is used, fair value gains and losses are recognised in OCI and are not subsequently reclassified to profit or loss, including on disposal. Impairment losses are not reported separately from other changes in fair value. Dividends continue to be recognised in profit or loss as 'Other income' when the Group's right to receive payments is established.

Gains or losses on equity investments at FVPL are included in the 'Fair value gains/losses on financial instruments' line in the Income Statement.

Fair value measurement

The measurement of fair value has not changed as a result of adopting IFRS 9. Fair value measurement is determined by IFRS 13 *'Fair Value Measurement'* and the accounting policy for determining fair value can be found in the 2017 Annual Report and Accounts.

Expected Credit Loss (Impairment)

The Group assesses all financial assets and off-balance sheet commitments for impairment at each reporting date. For the Group, this is primarily loans and advances to customers and undrawn lending commitments. Under IFRS 9 a 'three-stage' model for calculating Expected Credit Losses (ECL) is used, and is based on changes in credit quality since initial recognition as summarised below:

- Stage 1—A financial instrument that is not credit-impaired on initial recognition and has not significantly increased in credit risk;

- Stage 2—If a significant increase in credit risk has occurred since initial recognition, the financial instrument is moved to stage 2 but is not yet deemed to be credit-impaired; and
- Stage 3—If the financial instrument is credit-impaired, the financial instrument is then moved to stage 3.

ECL is measured on either a 12 month or lifetime basis depending on whether a significant increase in credit risk (SICR) has occurred since initial recognition or whether an asset is considered to be credit-impaired. 12 month ECL is recognised on stage 1 accounts and lifetime ECL is recognised on stage 2 and 3 accounts. Interest income is recognised on the gross carrying value of stage 1 and 2 assets and the net carrying value of stage 3 assets.

ECL is calculated using a Probability of Default (PD), which reflects the likelihood of a borrower defaulting over either the next 12 months or the lifetime of the account, and includes forward-looking economic information in this estimation. The Exposure at Default (EAD) and Loss Given Default (LGD) for each account are also calculated to estimate actual loss at the point of default. These assumptions incorporate expected contractual payments, utilisation of available credit limits, collateral values and forced sale discounts. The LGD component incorporates forward-looking economic variables (e.g. house price inflation).

These variables (PD, LGD and EAD) are projected for each future month and for each individual exposure or collective segment. Segmentation is used in the determination of these variables where accounts have similar characteristics and are expected to behave in uniform ways. This allows for an ECL to be calculated for each account for each future month, which is then discounted back to the reporting date to create a total ECL at account level. The discount rate used in the ECL calculation is the original effective interest rate or an approximation thereof.

Hedge Accounting

The hedge accounting requirements of IFRS 9 are more closely aligned with risk management practices than the current IAS 39 requirements and follow a principles-based approach. However, there is an option in IFRS 9 to maintain existing IAS 39 hedge accounting rules until the IASB completes its project on macro hedging. This option has been provided because the macro hedging project is still in the consultation phase, with a second discussion paper due to be issued by the International Accounting Standards Board (IASB) in 2019.

Management have analysed the benefits of adopting IFRS 9 hedge accounting but currently the preferred approach is to continue applying IAS 39 hedge accounting in its entirety. As a result there is no change from the 2017 Annual Report and Accounts accounting policy. The revised disclosure requirements of IFRS 7 '*Financial Instruments: Disclosures*' in relation to hedge accounting will be applied.

(c) Critical judgements and estimates

IFRS 9 requires Management to make estimates and judgements in its application that affect the allowance for expected credit loss. Estimates and judgements are based on Management's knowledge and historical experience. The nature of the calculation of ECL and the various estimates included means that Management recognise the potential for possible volatility in the level of ECL in the coming periods. The critical estimates and judgements made are:

Significant increase in credit risk (SICR) assessment

A significant increase in credit risk is not a defined term, and is determined by Management, based on their experience and judgement. In assessing whether the credit risk has significantly increased the Group has identified a series of quantitative, qualitative and backstop criteria (30 days past due as set by IFRS 9) which take into account forward-looking macroeconomic factors. These are referred to as the staging criteria.

The staging criteria have been extensively tested to ensure the characteristics of the portfolio are correctly reflected and accounts appropriately flow through the stages prior to default, without either a prolonged duration in stage 2 or introducing significant volatility by moving unnecessarily between the stages. For unsecured exposures, a cure period of two months has been applied to reduce volatility between stages. This means that an account remains in stage 2 for a period of two months after it ceases to meet any stage 2 criteria.

The staging criteria take into account the following:

- Quantitative criteria—if an account's current lifetime PD is greater than a multiple of origination lifetime PD then the credit risk of the account is considered to have increased significantly;

- Qualitative criteria—if an account enters forbearance or demonstrates other indicators of financial difficulty, not yet caught by an increase in PD, then the credit risk of the account is considered to have increased significantly; and
- Backstop—if the account is 30 days past due it will automatically transition to Stage 2.

The staging criteria are monitored and revisited in advance of each reporting date.

Definition of default

The definition of default is used to determine both the PD and the transition to stage 3 (all accounts which have defaulted are recognised in stage 3).

For the retail portfolios, the Group defines a financial instrument as in default, when it meets one or more of the following criteria:

- The customer is more than 90 days past due on their contractual payments;
- The customer meets unlikeliness to pay criteria, which indicates the customer is in significant financial difficulty; or
- The account term has expired, but the account has not been fully paid down or refinanced (secured lending).

A secured loan can transition (cure) back to stage 2 when it has not met any of the default criteria for six consecutive months. For unsecured loans, an account cannot cure from stage 3 as the account is blocked from future use once the customer enters default.

For secured exposures, the definition of default for regulatory expected loss capital purposes is 180 days past due. However for accounting purposes Management have elected not to rebut the 90 days past due presumption under IFRS 9 for both secured and unsecured loan portfolios.

Probability of default (PD)

PD is a key component in the calculation of ECL and the transition from stage 1 to stage 2. It is an estimate of the likelihood of default over either 12 months or the lifetime of the account. Management have used historical data, assumptions and expectations of future conditions to model PD over time for the secured and unsecured portfolios. An origination PD is required for each account. Where origination PDs were not available at the origination date, the origination PD was approximated, based on available account level data.

Exposure at default (EAD)

EAD is the amount that the Group expects the exposure to be at the point of default. For secured loans, this is a highly predictable amount based on the contractual payment profile and historic behaviours. For unsecured loans, the estimated balance utilisation at default is determined based on the characteristics of the account, including arrears status, consumer credit index of the account, and the current utilisation of the account (including whether the card is inactive).

Loss given default (LGD)

LGD is the amount of loss that will be incurred in the event of default. It represents the actual cash flows expected to be recovered for an individual account, and takes in to account collateral values and other cash recovered (e.g. through debt sale arrangements).

Expected life

The calculation of ECL is over the contractual life of the account, or the period over which the account exposes the Group to credit risk. For secured loans, this is the contractual period of the mortgage. For unsecured loans, the lifetime is the behavioural life of the credit card, which is the period over which the Group is exposed to credit risk.

Origination dates

The origination date of an exposure is the contractual origination date. The origination date is when the origination PD is determined, which will be referenced at each reporting period when determining if there has been a significant increase in credit risk.

For newly originated accounts, the origination PD is recorded on the contractual origination date. For acquired portfolios, Management have considered the facts around the purchase of each portfolio to determine the origination date to be applied.

Macro-economic scenarios

Unbiased macro-economic scenarios covering multiple potential outcomes are required by IFRS 9 to be incorporated into the ECL calculation.

Macro-economic variables impacting credit risk and expected credit losses for each portfolio have been investigated by performing statistical regression analysis to understand how changes in these variables have historically impacted default rates and the components of LGD. The macro-economic variables with the most significant impact on PD and LGD, for the Group, are judged to be house price inflation; unemployment rate; household debt-to-income ratio[1]; and bank base rate.

The Group has determined an approach to the selection and application of multiple scenarios. The Group does not have an in-house economics function and has therefore sourced economic scenarios from a third party to form the basis of the economic scenarios used. The Group has considered a minimum of three scenarios on a probability-weighted approach. These scenarios include a base, an upside and a downside scenario. The combination of the three scenarios provides an unbiased but representative macro view of reasonably possible future outcomes, not biased to extreme, or stressed, scenarios. At 1 January 2018, three scenarios were used and weighted 40% to the base and 30% to each of the upside and downside scenarios. The scenarios include the key variables which ECL is sensitive to, resulting in an asymmetric and non-linear impact on ECL.

As with any economic forecasts, the projections and likelihoods of occurrence are subject to a high degree of inherent uncertainty and therefore the actual outcomes may be significantly different to those projected. The Group considers these forecasts to represent its best estimate of the possible outcomes based on reliable available information.

Where there are specific events, which due to timing or their nature, have not been incorporated into the macro-economic scenarios Management may overlay additional adjustments to ECL to take account of additional economic assumptions. This is considered when Management believe the impact of a specific event or change in market sentiment has not been appropriately captured in the ECL calculation inputs, for example events occurring very close to the reporting date.

The macro-economic assumptions adopted in the ECL calculation of the Group, and the impact of multiple economic scenarios on the ECL calculation were:

	Scenarios		
As at 30 June 2018	**Base**	**Upside**	**Downside**
House price index (5 year average)	**2.0%**	**3.9%**	**(1.1)%**
Unemployment rate (5 year average)	**4.9%**	**3.8%**	**7.1%**
Household debt service ratio (5 year average)	**11.6%**	**11.8%**	**11.2%**
Bank base rate (5 year average)	**1.2%**	**1.5%**	**0.3%**
Weighting assigned	**40%**	**30%**	**30%**

	Base case ECL	Probability weighted ECL	Difference
Impairment allowance as at 30 June 2018	**£112.4m**	**£113.3m**	**£0.9m**

	Scenarios		
As at 1 January 2018	**Base**	**Upside**	**Downside**
House price index (5 year average)	2.0%	3.5%	0.5%
Unemployment rate (5 year average)	5.2%	4.2%	6.8%
Household debt service ratio (5 year average)	11.8%	12.0%	11.4%
Bank base rate (5 year average)	1.2%	1.7%	0.2%
Weighting assigned	40%	30%	30%

	Base case ECL	Probability weighted ECL	Difference
Impairment allowance as at 1 January 2018	£103.2m	£104.4m	£1.2m

[1] Household debt service ratio is used to inform the debt-to-income ratio used in the calculation of ECL.

DIRECTORS' RESPONSIBILITY STATEMENT

The Directors confirm that these condensed consolidated half-year financial statements have been prepared in accordance with International Accounting Standard 34 '*Interim Financial Reporting'*, as adopted by the European Union and that the interim management report includes a fair review of the information required by DTR 4.2.7 and DTR 4.2.8, namely:

- an indication of important events that have occurred during the first six months and their impact on the condensed set of financial statements, and a description of the principal risks and uncertainties for the remaining six months of the financial year; and
- material related party transactions in the first six months and any material changes in the related party transactions described in the last annual report.

By order of the Board,

Jayne-Anne Gadhia CBE
Chief Executive
25 July 2018

INDEPENDENT AUDITORS' REVIEW REPORT TO VIRGIN MONEY HOLDINGS (UK) PLC

Report on the condensed consolidated half-year financial statements

Our conclusion

We have reviewed Virgin Money Holdings (UK) plc's condensed consolidated half-year financial statements (the "interim financial statements") in the 2018 half-year results of Virgin Money Holdings (UK) plc for the six month period ended 30 June 2018. Based on our review, nothing has come to our attention that causes us to believe that the interim financial statements are not prepared, in all material respects, in accordance with International Accounting Standard 34, 'Interim Financial Reporting', as adopted by the European Union and the Disclosure Guidance and Transparency Rules sourcebook of the United Kingdom's Financial Conduct Authority.

What we have reviewed

The interim financial statements comprise:

- the condensed consolidated balance sheet as at 30 June 2018;
- the condensed consolidated income statement and condensed consolidated statement of comprehensive income for the period then ended;
- the condensed consolidated cash flow statement for the period then ended;
- the condensed consolidated statement of changes in equity for the period then ended; and
- the explanatory notes to the interim financial statements.

The interim financial statements included in the 2018 half-year results have been prepared in accordance with International Accounting Standard 34, 'Interim Financial Reporting', as adopted by the European Union and the Disclosure Guidance and Transparency Rules sourcebook of the United Kingdom's Financial Conduct Authority.

As disclosed in note 1 to the interim financial statements, the financial reporting framework that has been applied in the preparation of the full annual financial statements of the Group is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

Responsibilities for the interim financial statements and the review

Our responsibilities and those of the directors

The 2018 half-year results, including the interim financial statements, is the responsibility of, and has been approved by, the Directors. The Directors are responsible for preparing the 2018 half-year results in accordance with the Disclosure Guidance and Transparency Rules sourcebook of the United Kingdom's Financial Conduct Authority.

Our responsibility is to express a conclusion on the interim financial statements in the 2018 half-year results based on our review. This report, including the conclusion, has been prepared for and only for the Company for the purpose of complying with the Disclosure Guidance and Transparency Rules sourcebook of the United Kingdom's Financial Conduct Authority and for no other purpose. We do not, in giving this conclusion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

What a review of interim financial statements involves

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410, 'Review of Interim Financial Information Performed by the Independent Auditor of the Entity' issued by the Auditing Practices Board for use in the United Kingdom. A review of interim financial information consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures.

A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK) and, consequently, does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

We have read the other information contained in the 2018 half-year results and considered whether it contains any apparent misstatements or material inconsistencies with the information in the interim financial statements.

PricewaterhouseCoopers LLP
Chartered Accountants
Edinburgh
25 July 2018

[1] The maintenance and integrity of the Virgin Money Holdings (UK) plc website is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the interim financial statements since they were initially presented on the website.

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

PART VIII
UNAUDITED PRO FORMA FINANCIAL INFORMATION

SECTION A:
ACCOUNTANT'S REPORT IN RESPECT OF THE UNAUDITED PRO FORMA INFORMATION RELATING TO THE COMBINED GROUP

The Directors
CYBG PLC
40 St Vincent Place
Glasgow
G1 2HL

31 July 2018

Dear Sirs

We report on the pro forma financial information (the "**Pro Forma Financial Information**") set out in Section B of Part VIII of the prospectus dated 31 July 2018 ("**Prospectus**"), which has been prepared on the basis described, for illustrative purposes only, to provide information about how the acquisition of Virgin Money Holdings (UK) plc by CYBG PLC (the "**Company**") might have affected the financial information presented on the basis of the accounting policies adopted by the Company in preparing the financial statements for the period ended 30 September 2017. This report is required by item 7 of Annex II of Commission Regulation (EC) No 809/2004 and is given for the purpose of complying with that item and for no other purpose.

Save for any responsibility arising under Prospectus Rule 5.5.3R (2)(f) to any person as and to the extent there provided, to the fullest extent permitted by law we do not assume any responsibility and will not accept any liability to any other person for any loss suffered by any such other person as a result of, arising out of, or in connection with this report or our statement, required by and given solely for the purposes of complying with item 23.1 of Annex I to Commission Regulation (EC) No 809/2004, consenting to its inclusion in the Prospectus.

Responsibilities

It is the responsibility of the directors of the Company to prepare the Pro Forma Financial Information in accordance with items 1 to 6 of Annex II of Commission Regulation (EC) No 809/2004.

It is our responsibility to form an opinion, as required by item 7 of Annex II of the Commission Regulation (EC) No 809/2004, as to the proper compilation of the Pro Forma Financial Information and to report that opinion to you.

In providing this opinion we are not updating or refreshing any reports or opinions previously made by us on any financial information used in the compilation of the Pro Forma Financial Information, nor do we accept responsibility for such reports or opinions beyond that owed to those to whom those reports or opinions were addressed by us at the dates of their issue.

Basis of opinion

We conducted our work in accordance with the Standards for Investment Reporting issued by the Auditing Practices Board in the United Kingdom. The work that we performed for the purpose of making this report, which involved no independent examination of any of the underlying financial information, consisted primarily of comparing the unadjusted financial information with the source documents, considering the evidence supporting the adjustments and discussing the Pro Forma Financial Information with the directors of the Company.

We planned and performed our work so as to obtain the information and explanations we considered necessary in order to provide us with reasonable assurance that the Pro Forma Financial Information has been properly compiled on the basis stated and that such basis is consistent with the accounting policies of the Company.

Our work has not been carried out in accordance with auditing or other standards and practices generally accepted in other jurisdictions and accordingly should not be relied upon as if it had been carried out in accordance with those standards and practices.

Opinion

In our opinion:

- the Pro Forma Financial Information has been properly compiled on the basis stated; and
- such basis is consistent with the accounting policies of the Company.

Declaration

For the purposes of Prospectus Rule 5.5.3R (2)(f) we are responsible for this report as part of the Prospectus and declare that we have taken all reasonable care to ensure that the information contained in this report is, to the best of our knowledge, in accordance with the facts and contains no omission likely to affect its import. This declaration is included in the Prospectus in compliance with item 1.2 of Annex I of Commission Regulation (EC) No 809/2004.

Yours faithfully

Ernst & Young LLP

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SECTION B:
UNAUDITED PRO FORMA FINANCIAL INFORMATION RELATING TO THE COMBINED GROUP

The unaudited pro forma financial information set out below has been prepared to illustrate the effect of the acquisition of Virgin Money on: (i) the net assets of the CYBG Group as at 31 March 2018 as if the acquisition had occurred on 31 March 2018; and (ii) the effect on the consolidated income statement of the CYBG Group for the financial year ended 30 September 2017 as if the acquisition had taken place on 1 October 2016. The unaudited pro forma financial information, which has been produced for illustrative purposes only, by its nature addresses a hypothetical situation and, therefore, does not represent the CYBG Group's actual financial position or results.

The unaudited pro forma financial information has been compiled on a basis consistent with the accounting policies of CYBG used to prepare its audited consolidated financial statements for the financial year ended 30 September 2017 and prepared in accordance with Annex II of the Prospectus Directive Regulation and on the basis of the notes set out below.

Shareholders should read the whole of this Prospectus and not rely solely on the unaudited financial information contained in this Section B of Part VIII. EY's report on the unaudited pro forma financial information is set out in Section A of this Part VIII (*Unaudited Pro Forma Financial Information relating to the Combined Group*).

Unaudited Pro Forma Income Statement for the financial year ended 30 September 2017

	CYBG Group for the year ended 30 September 2017	Virgin Money Group for the year ended 31 December 2017	Adjustments: Adjustments to conform to disclosures	Adjustments: Acquisition Adjustments	Unaudited Pro Forma Combined Group
			(£ million)		
	Note 1	Note 2	Note 3	Note 4	Note 5
Interest income and similar income	1,075	958	—	—	2,033
Interest expense and similar charges	(231)	(363)	—	—	(594)
Net interest income	**844**	**595**	**—**	**—**	**1,439**
Gains less losses on financial instruments at fair value	6	(3)	—	—	3
Other operating income	186	42	29	—	257
Fee and commission income	—	29	(29)	—	—
Non-interest income	**192**	**68**	**—**	**—**	**260**
Total operating income	**1,036**	**663**	**—**	**—**	**1,699**
Personnel expenses.	(166)	—	(198)	—	(364)
Restructuring expenses	(67)	—	—	—	(67)
Depreciation and amortisation expense.	(87)	—	(35)	—	(122)
Other operating and administrative expenses	(400)	—	(123)	(92)	(615)
Operating expenses	—	(356)	356	—	—
Total operating and administrative expenses before impairment losses	**(720)**	**(356)**	**—**	**(92)**	**(1,168)**
Operating profit before impairment losses	**316**	**307**	**—**	**(92)**	**531**
Impairment losses on credit exposures	(48)	(44)	—	—	(92)
Profit on ordinary activities before tax	**268**	**263**	**—**	**(92)**	**439**
Tax expense	(86)	(71)	—	—	(157)
Profit for the year	**182**	**192**	**—**	**(92)**	**282**
Profit attributable to ordinary shareholders	146	192	—	(92)	246
Profit attributable to other equity holders	36	—	—	—	36
Profit for the year attributable to equity holders	**182**	**192**	**—**	**(92)**	**282**

(1) The CYBG Group's income statement for the year ended 30 September 2017 has been extracted, without material adjustment, from the CYBG Group 2017 annual financial statements, as set out in the CYBG Annual Report 2017.

(2) The Virgin Money Group's income statement for the year ended 31 December 2017 has been extracted, without material adjustment, from the Virgin Money Group 2017 annual financial statements, as set out in the Virgin Money Annual Report 2017.

(3) The following reclassifications were made to reflect the difference in accounting presentation under the CYBG Group's presentation as opposed to that of the Virgin Money Group:

(i) The Virgin Money Group discloses "Fee and commission income" separately on its income statements whereas CYBG Group discloses this item within "Other operating income". This resulted in a £29 million reclassification between the aforementioned line items.

(ii) The CYBG Group discloses "Personnel expenses", "Depreciation and amortisation expense" and "Other operating and administrative expenses" separately on its income statement whereas the Virgin Money Group discloses these items within "Operating expenses". This resulted in a £356 million reclassification between the aforementioned line items.

(iii) The CYBG Group and the Virgin Money Group disclose equivalent income statement line items using different terms. The narrative used is summarised below:

Narrative used by the CYBG Group	Narrative used by the Virgin Money Group
"Interest income and similar income"	"Interest and similar income"
"Interest expense and similar charges"	"Interest and similar expense"
"Gains less losses on financial instruments at fair value"	"Fair value losses on financial instruments"
"Non-interest income"	"Other income"
"Total operating income"	"Total income"
"Operating profit before impairment losses"	"Profit before tax from operating activities"
"Impairment losses on credit exposures"	"Impairment"
"Tax expense"	"Taxation"

(4) Adjustments not expected to have a continuing impact:

(i) Estimated transaction costs totalling £72 million (inclusive of VAT). The adjustments relate to estimated transaction costs of £39 million (inclusive of VAT) incurred by the CYBG Group, which includes stamp duty estimated to be £9 million, and £33 million (inclusive of VAT) incurred by the Virgin Money Group, all of which are expensed; and

(ii) As a result of the Offer the Virgin Money Group will recognise an accelerated vesting charge, subsequent to 31 December 2017, in relation to its equity settled share based payment schemes of £20 million.

(5) No adjustments have been made for the following:

(i) The unaudited pro forma income statement does not reflect the effect of any fair value adjustments which may be recorded to acquired assets and liabilities. Upon completion of the purchase price allocation exercise, which will be finalised after Completion of the Combination, additional depreciation of property plant and equipment and amortisation of intangible assets, amongst other things, may be required in the Combined Group's financial statements.

(ii) No adjustment has been made to reflect any synergies that may arise after the transaction as these are dependent upon the future actions of management; and

(iii) No adjustment has been made to reflect the trading results of the CYBG Group since 30 September 2017 or the Virgin Money Group since 31 December 2017.

Unaudited Pro Forma Net Assets Statement as at 31 March 2018

	CYBG Group as at 31 March 2018	Adjustments: Virgin Money Group as at 31 December 2017	Adjustments: Adjustments to conform to disclosures	Adjustments: Acquisition Adjustments	Unaudited Pro Forma Combined Group
			(£ million)		
	Note 6	Note 7	Note 8	Note 9	Note 11
Assets					
Cash and balances with central banks	6,150	2,579	—	(72)	8,657
Due from other banks	830	—	359	—	1,189
Financial assets available for sale	1,352	1,052	—	—	2,404
Other financial assets at fair value	421	—	—	—	421
Derivative financial instruments	334	79	—	—	413
Loans and advances to customers	32,137	—	36,741	—	68,878
Loans and receivables	—	37,100	(37,100)	—	—
Due from customers on acceptances	4	—	—	—	4
Property, plant and equipment	86	74	—	—	160
Investment properties	8	—	—	—	8
Intangible assets	371	128	—	440	939
Deferred tax assets	204	12	5	—	221
Defined benefit pension assets	222	—	—	—	222
Other assets	234	84	—	—	318
Total assets	**42,353**	**41,108**	**5**	**368**	**83,834**
Liabilities					
Due to other banks	2,683	5,379	—	—	8,062
Other financial liabilities at fair value	20	—	—	—	20
Derivative financial instruments	388	94	—	—	482
Due to customers	28,463	30,808	—	—	59,271
Liabilities on acceptances	4	—	—	—	4
Provision for liabilities and charges	458	—	8	—	466
Debt securities in issue	4,447	2,737	—	—	7,184
Retirement benefit obligations	3	—	—	—	3
Deferred tax liabilities	81	—	5	—	86
Current tax liabilities	—	24	(24)	—	—
Other liabilities	2,536	241	16	—	2,793
Total liabilities	**39,083**	**39,283**	**5**	**—**	**78,371**
Net assets	**3,270**	**1,825**	**—**	**368**	**5,463**

(6) The CYBG Group's net asset information as at 31 March 2018 has been extracted, without material adjustment, from the CYBG Group 2018 unaudited interim financial statements, as set out in the CYBG Interim Report 2018.

(7) The Virgin Money Group's net asset information as at 31 December 2017 has been extracted, without material adjustment, from the Virgin Money Group 2017 annual financial statements, as set out in the Virgin Money Annual Report 2017.

(8) The following reclassifications were made to reflect the difference in accounting presentation under the CYBG Group's presentation as opposed to that of the Virgin Money Group:

(i) The Virgin Money Group discloses "Loans and receivables" separately on its balance sheet, sub categorising this balance into: "Loans and advances to banks" (£359 million), Loans and advances to customers (£36,741 million) and Debt securities (£0.3 million). The CYBG Group discloses "Due from other banks" and "Loans and advances to customers" separately on its balance sheet. £37,100 million has been reclassified from "Loans and receivables," with £359 million reclassified into "Due from other banks", £36,741 million reclassified into "Loans and advances to customers", and £0.3 million reclassified into "Other assets".

(ii) The Virgin Money Group discloses "Deferred tax assets" on a net basis whereas the CYBG Group discloses "Deferred tax assets" and "Deferred tax liabilities" on a gross basis. This resulted in £5 million reclassification between the aforementioned line items.

(iii) Within line item "Other liabilities" the Virgin Money Group has included £8 million in relation to "provisions" whereas the CYBG Group includes such items separately on its balance sheet as "Provisions for liabilities and charges". This has been reclassified between the aforementioned line items.

(iv) The Virgin Money Group discloses "Current tax liabilities" separately on its balance sheet whereas the CYBG Group discloses such items in "Other liabilities". This resulted in a £24 million reclassification between the aforementioned line items accordingly.

(v) The CYBG Group and the Virgin Money Group disclose equivalent balance sheet line items using different terms. The narrative used is summarised below:

Narrative used by the CYBG Group	Narrative used by the Virgin Money Group
"Cash and balances with central banks"	"Cash and balances at central banks"
"Financial assets available for sale"	"Available-for-sale financial assets"
"Property, plant and equipment"	"Tangible fixed assets"
"Due to other banks"	"Deposits from banks"
"Due to customers"	"Customer deposits"

(9) The adjustments arising as a result of the Offer are set out below:

(i) The equity consideration payable will be through an issuance of new ordinary shares by the CYBG Group (referred to as "consideration" in these notes). The consideration payable and the calculation of the adjustment to goodwill are set out below:

	(£ millions)
Estimated equity consideration	1,848
Net assets acquired of the Virgin Money Group (excluding intangible assets)	(1,697)
Estimated transaction costs incurred by the Virgin Money Group	33
Non-controlling interest—Additional Tier 1 securities	384
Goodwill and other intangible assets arising on acquisition	**568**
Virgin Money Group intangible assets already recognised	(128)
Pro forma goodwill and other intangible assets adjustment	**440**

The consideration of £1,848 million has been calculated as the issuance of 546,954,891 New CYBG Shares at a price of 338 pence per share being the Closing Price per CYBG Group share as at the Latest Practicable Date. The consideration is calculated on a fully diluted basis and assumes 100 per cent. vesting of awards made under Virgin Money Share Plans, including awards where settlement is deferred. The consideration payable at completion will be different from the consideration included in this pro forma financial information as the number of shares to be issued and the share price will be calculated at the Effective Date.

The net assets acquired of £1,697 million comprise the net assets of the Virgin Money Group as at 31 December 2017 of £1,825 million net of intangible assets of £128 million included in the Virgin Money Group balance sheet as at 31 December 2017.

The adjustment for the non-controlling interest relates to the Virgin Money AT1 Securities listed on the Luxembourg Stock Exchange and included at a company value of £384 million in the Virgin Money Group balance sheet as at 31 December 2017 and which have been assumed will be retained by the CYBG Group after Completion. These are classified within total equity by the Virgin Money Group and will continue to be classified within total equity by the Combined Group after completion of the acquisition. This will result in an adjustment in the calculation of goodwill attributable to the Offer.

Under IFRS acquisition accounting, it is necessary to fair value the consideration paid and all the assets and liabilities of the acquired business. In the unaudited pro forma statement of net assets, no adjustments have been made to the fair values of the individual net assets of the Virgin Money Group to reflect any re-measurement to fair value that may arise as this exercise will not be undertaken until after the effective completion date.

(ii) Estimated transaction costs of £72 million (inclusive of VAT), of which £39 million (inclusive of VAT), incurred by the CYBG Group, which includes stamp duty estimated to be £9 million, and £33 million (inclusive of VAT), incurred by the Virgin Money Group, have been shown as an adjustment to "Cash and balances with central banks".

(10) The following table illustrates the effect of the acquisition of Virgin Money on certain net asset line items of the Combined Group on a pro forma basis. This information is supplementary to the unaudited pro forma net assets statement. The details of the adjustments are described in the subsequent footnotes to the table.

	CYBG Group as at 31 March 2018	Virgin Money Group as at 31 December 2017	Unaudited Pro Forma Combined Group
		(£ million)	
	Note (a)	Note (b)	Note (c)
Assets			
Mortgages	24,139	33,685	57,824
SME lending	7,419	—	7,419
Credit cards	382	3,071	3,453
Other unsecured personal lending	809	—	809
Total gross loans and advances to customers	**32,749**	**36,756**	**69,505**
Liabilities			
Due to customers	28,463	30,808	59,271
Bank of England's Term Funding Scheme	2,252	4,236	6,488
Equity and Liabilities			
Total funding	38,863	40,749	79,612

Note (a) (i) The following financial information for the CYBG Group has been extracted, without material adjustment, from the CYBG Group's unaudited interim financial statements, as set out in the CYBG Interim Report 2018: Mortgages, Credit cards, Due to customers, Bank of England's Term Funding Scheme and Total Funding.

(ii) The following financial information for the CYBG Group has been extracted without material adjustment from the consolidation schedules that underlie the CYBG Group's unaudited interim financial statements for the period ended 31 March 2018: SME lending, and Other unsecured personal lending.

The CYBG Group 'SME lending' balance consists of: Other term lending—SME, Lease finance, Trade finance, Financial assets at fair value through profit or loss, Due from customers on acceptances and the business overdrafts and invoice finance components of the total Overdrafts balance (£1,453 million of £1,507 million total). There are no equivalent 'SME lending' balances within the Virgin Money Group.

The CYBG Group 'Other unsecured personal lending' balance consists of: Other term lending—Retail and the personal overdrafts component of the total Overdrafts balance (£54 million of £1,507 million total). There are no equivalent 'Other unsecured personal lending' balances within the Virgin Money Group.

The CYBG Group 'Total gross loans and advances to customers' balance consists of: Gross loans and advances to customers and Other financial assets at fair value (the CYBG Group's portfolio of fair valued business loans).

Included within the CYBG Group's 'Due to other banks' balance is an amount relating to the Bank of England's Term Funding Scheme.

The CYBG Group 'Total funding' balance consists of: Due to customers, Due to other banks, Debt securities in issue and Total equity.

Note (b) (i) The financial information for the Virgin Money Group has been extracted, without material adjustment, from the Virgin Money Group 2017 annual financial statements, as set out in the Virgin Money Annual Report 2017.

The Virgin Money Group 'Total gross loans and advances to customers' balance consists of: Total loans and advances to customers before allowance for impairment losses.

Included within the Virgin Money Group's 'Deposits from banks' is an amount relating to the Bank of England's Term Funding Scheme.

The Virgin Money Group 'Total funding' balance consists of: Customer deposits, Deposits from banks, Debt securities in issue and Total equity.

(ii) The CYBG Group and the Virgin Money Group disclose equivalent line items using different terms. The narrative used is summarised below:

a. The Virgin Money Group discloses "Mortgages" as ”Total loans and advances to customers secured on residential property" within the notes to the financial statements

b. The Virgin Money Group discloses "Credit cards" as ”Unsecured receivables not subject to securitisation" within the notes to the financial statements.

c. The Virgin Money Group discloses "Due to customers" as ”Customer Deposits" on its balance sheet.

Note (c) (i) Mortgages comprise 83 per cent. of Total gross loans and advances on a pro forma Combined Group basis.

(ii) Due to customers comprises 74 per cent. of Total funding on a pro forma Combined Group basis.

(11) No adjustment has been made to reflect the trading results of the CYBG Group since 31 March 2018 or the Virgin Money Group since 31 December 2017.

PART IX
SUPERVISION AND REGULATION

Banks and investment firms in the UK must be authorised and are subject to regulatory supervision. Clydesdale Bank PLC and Virgin Money Bank, as credit institutions, must comply with the relevant UK and relevant European legislation. Clydesdale Bank and Virgin Money Bank are authorised by the PRA and regulated by both the PRA and the FCA. Their activities include deposit taking as well as certain activities that amount to consumer credit business. Other entities in the CYBG Group which are regulated in the UK include Clydesdale Bank Asset Finance Limited, Yorkshire Bank Home Loans Limited, CYB Intermediaries Limited and CGF No.9 Limited, which are authorised and regulated by the FCA. Other entities in the Virgin Money Group which are regulated in the UK include Virgin Money Bank, Virgin Money Unit Trust Managers, Virgin Money Personal Financial Services Limited and Virgin Money Giving Limited.

1. UK REGULATION

Under the Financial Services Act 2012, a range of structural reforms to UK financial regulatory bodies were implemented, with the FSA being replaced from 1 April 2013 by the following bodies:

The Prudential Regulation Authority

The PRA has responsibility for the prudential regulation of deposit-takers (including banks, building societies and credit unions), insurers, and investment firms that have the potential to present significant risks to the stability of the financial system and that have been designated for supervision by the PRA.

In discharging its functions, the PRA's general objective is promoting the safety and soundness of PRA-authorised firms. The PRA is required to advance this objective primarily by seeking to: (i) ensure that the business of PRA- authorised firms is carried on in a way which avoids any adverse effect on the stability of the UK financial system; and (ii) minimise the adverse effect that the failure of a PRA-authorised firm could be expected to have on the stability of the UK financial system. Additionally, the Banking Reform Act 2013 introduces, from 1 January 2019, additional requirements on how the PRA is to advance its general objective in relation to certain matters related to ring-fenced bodies.

When discharging its general functions in a way that advances its objectives, the PRA must, so far as is reasonably possible, act in a way which, as a secondary objective, facilitates effective competition in the markets for services provided by PRA-authorised firms carrying on regulated activities.

The Financial Conduct Authority

The FCA has responsibility for conduct of business regulation in relation to all authorised firms and the prudential regulation of firms not regulated by the PRA. The FCA also continues to exercise all of the FSA's market regulatory functions, and it represents the UK's interests in markets regulation at the European Securities and Markets Authority.

When discharging its general functions, the FCA must, so far as is reasonably possible, act in a way which is compatible with its strategic objective of ensuring that relevant markets function well, and which advances one or more of its operational objectives of: (i) securing an appropriate degree of protection for consumers (the consumer protection objective); (ii) promoting effective competition in the interests of consumers in financial markets (the competition objective); and (iii) protecting and enhancing the integrity of the UK financial system (the integrity objective).

So far as is compatible with its consumer protection and integrity objectives, the FCA must discharge its general functions in a way which promotes effective competition in the interests of consumers.

The Financial Policy Committee

The FPC is a part of the Bank of England which has a primary objective of identifying, monitoring and taking action to remove or reduce systemic risks with a view to protecting and enhancing the resilience of the UK financial system. The FPC has a secondary objective to support the economic policy of the UK Government, including its objectives for growth and employment.

1.1 Financial Services and Markets Act 2000 ("FSMA")

FSMA is a critical piece of financial services legislation in the UK. Crucially, FSMA prohibits any person from carrying on a "regulated activity" by way of business in the UK unless that person is authorised or exempt under FSMA. Regulated activities include deposit-taking, effecting and carrying out contracts of insurance as well as insurance mediation, consumer credit activities and investment activities (such as dealing in investments as principal or as agent, advising on or managing investments, entering into regulated mortgage contracts or providing consumer credit). FSMA also prohibits financial promotions in the UK unless the financial promotion is issued or approved by an authorised firm or is exempt from such requirements.

The following sections set out some of the more important key elements of FSMA for a UK-authorised bank.

Threshold conditions

Authorised firms must at all times meet certain "threshold conditions" specified by FSMA. Dual-regulated firms, such as CYBG and Virgin Money, must meet both the PRA and FCA threshold conditions. The FCA threshold conditions are, in summary, that: (i) the firm is capable of being effectively supervised by the FCA; (ii) the firm maintains appropriate non-financial resources; (iii) the firm itself is a fit and proper person, having regard to the FCA's objectives; and (iv) the firm's strategy for doing business is suitable for a person carrying on regulated activities that it carries on or seeks to carry on, having regard to the FCA's operational objectives. The PRA threshold conditions require that (i) a firm is either a body corporate or partnership; (ii) if the firm is incorporated in the UK, its head office is in the UK and if it has a registered office, that office is in the UK; (iii) the business of the firm must be conducted in a prudent manner and to satisfy this it must have appropriate financial and non-financial resources; (iv) the firm itself is a fit and proper person, having regard to the PRA's objectives; and (v) the firm is capable of being effectively supervised by the PRA.

Change of control

Under FSMA, if a person intends to acquire or increase its "control" of a UK authorised person, it must first notify the appropriate regulator (in the case of CYBG as the new controller, the notification must be sent to the FCA and the PRA). The PRA must then (after consulting with the FCA) decide whether to approve the acquisition or increase of control within 60 working days after acknowledging receipt of this notice (assuming it has been provided with a complete application). The PRA will not approve any new controller or any increase of control without being satisfied that the controller is financially sound and suitable to be a controller of, or acquire increased control of, the UK authorised person. Acquiring control for the purposes of FSMA includes the acquisition of shares or voting power so that a person holds 10 per cent. or more of the total shares or voting power in an authorised person or its parent undertaking. A person will be treated as increasing his or her control over a UK authorised person, and therefore require further approval from the PRA, if the level of his or her shareholding or entitlement to voting power increases from a holding below certain thresholds to a holding above them. The thresholds are 10 per cent., 20 per cent., 30 per cent. or 50 per cent. of shares or voting power.

When determining a person's level of control, that person's holding of shares or entitlement to voting power will be aggregated with the holdings or entitlements of any person with whom he or she is "acting in concert".

Offer or increase of control without PRA approval is a criminal offence.

FCA Handbook, PRA Rulebook and other guidance

The detailed rules and guidance made by the FCA and the PRA under the powers given to them under FSMA are contained in various parts of their respective handbooks (the FCA Handbook and the PRA Rulebook).

Once authorised, and in addition to continuing to meet the threshold conditions above, firms are obliged to comply with the FCA's Principles and, if a dual-regulated firm, the PRA's Fundamental Rules, which include requirements to (i) conduct their business with due skill, care and diligence; (ii) treat customers fairly; and (iii) communicate with customers in a manner that is clear, fair and not misleading. The 11 Principles and eight Fundamental Rules are set out in the FCA Handbook and PRA Rulebook respectively.

Other modules of the FCA Handbook and PRA Rulebook which are of particular relevance to the CYBG Group and the Virgin Money Group include the Senior Management Arrangements, Systems and Controls sourcebook, the Consumer Credit sourcebook ("**CONC**"), the Banking Conduct of Business sourcebook, the Supervision sourcebook, the Dispute Resolution: Complaints sourcebook and the Mortgages and Home Finance: Conduct of Business sourcebook.

Enforcement

The FCA and the PRA have the power to take a range of enforcement actions, including the ability to sanction firms and individuals carrying out functions within them. The sanctions may include restrictions on undertaking new business, public censure, restitution, fines and, ultimately, revocation of permission to carry on regulated activities or of an individual's approval to perform particular roles within a firm. They can also vary or revoke the permissions of an authorised firm that has not engaged in regulated activities for 12 months, or that fails to meet the threshold conditions.

1.2 Consumer credit regulation

Responsibility for consumer credit transferred from the OFT to the FCA on 1 April 2014. The new framework for consumer credit regulation comprises FSMA and its secondary legislation, the CCA and rules and guidance in the FCA Handbook, in particular in the CONC (which sets out general conduct standards, rules on financial promotions, further rules on pre- and post- contractual requirements, responsible lending rules and debt advice rules).

The CCA continues to outline pre-contractual credit information requirements, the form and content of regulated credit agreements, the right to cancel and withdraw and unfair relationships, and those parts of the CCA that implement the Consumer Credit Directive 2008 have been retained.

The CCA licensing regime, exempt agreement provisions and consumer credit advertisement legislation have, however, been repealed. The FSMA financial promotions regime now applies. The FCA has also imposed new financial promotion rules for high cost short-term credit, cold calling and debt management companies.

The requirement to obtain a licence from the OFT to carry on consumer credit business has been replaced by the need for authorisation under FSMA to carry on a consumer credit regulated activity. For example, entering into a "regulated credit agreement" as lender is now a regulated activity for the purposes of FSMA. A "regulated credit agreement" is any "credit agreement" that is not an "exempt agreement". A "credit agreement" is any agreement between an individual or relevant recipient of credit ("A") and any other person ("B"), under which B provides A with "credit" of any amount. Credit is widely defined and includes cash loans and any other form of financial accommodation. Exempt agreements include those predominantly for the purposes of a business, those secured on land or otherwise by mortgage and those where a local authority or other specified type of organisation is the lender.

The FCA has greater powers of enforcement than the OFT, including the power to: bring criminal, civil and disciplinary proceedings; withdraw authorisations; suspend authorised firms for 12 months; suspend individuals from performing certain roles for two years; and the power to issue unlimited fines. It is also able to use its product intervention powers in the consumer credit market, which can include restrictions on product features and selling practices or product bans.

Regulated entities within the CYBG Group are currently authorised to carry on certain consumer credit activities: Credit Broking, Debt Adjusting, Debt Administration, Debt-Collecting, Debt-Counselling, Entering into regulated credit agreement as lender (excluding high-cost short-term credit, bill of sale agreement, and home collected credit agreement) and exercising/having right to exercise lender's rights and duties under a regulated credit agreement (excluding high-cost short-term credit, bill of sale agreement, and home collected credit agreement).

Virgin Money is currently authorised to carry out the following consumer credit activities: Credit Broking, Entering into Regulated Consumer Hire Agreements as owner, Entering into a regulated credit agreement as Lender (Excluding high-cost short-term credit, bill of sale agreement, and home collected credit agreement), Exercising or having the right to exercise the owner's rights and duties under a regulated consumer hire agreement, Exercising/having right to exercise lender's rights and duties under a regulated credit agreement (excluding high-cost, short-term credit, bill of sale agreement, and home collected credit agreement.

The FCA has recently carried out a high-cost credit review, published in Feedback Statement FS17/2 and a further update to this published in January 2018. Following on from this review, the FCA has launched two consultations based on areas of key concern from the review; CP 18/12 (*Consultation on rent-to-own, home collected credit, catalogue credit and store cards, and alternatives to high-cost credit. Discussion on rent-to own pricing*) and CP 18/13 (*High-cost Credit Review: Overdrafts*). CP 18/12 is aimed at reducing consumer harm from high-cost rent to own pricing. CP 18/13 aims to introduce reform into banks' approach to overdraft; key changes would potentially be a requirement to ban inclusion of an overdraft in a consumer's available funds, and align arranged and unarranged overdraft prices. The full impact of these consultation papers on the Combined Group (following Completion) will be unclear until the consultation period finishes and final rules on these changes are published. Final responses on both consultation papers are requested by 31 August 2018.

1.3 Regulated Mortgages

FCA Regulation of Regulated Mortgages

The FCA regulates the provision of "Regulated Mortgages", as defined under Art. 61(3)(a) of the FSMA (Regulated Activities) Order 2001. Both Clydesdale Bank PLC and Virgin Money Bank are authorised for administering regulated mortgage contracts, advising on regulated mortgage contracts, arranging (bringing about) regulated mortgage contracts and making arrangements with a view to regulated mortgage contracts, and are therefore subject to FCA regulation in relation to these activities. Yorkshire Bank Home Loans Limited is authorised for entering into a regulated mortgage contract as lender.

The FSA issued the "*Mortgages and Home Finance: Conduct of Business Sourcebook*" ("**MCoB**"), in October 2003, which sets out rules for regulated mortgage activities apply to activities in relation to regulated mortgages which are entered into on or after 31 October 2004. These rules cover, among other things, certain pre-origination matters such as financial promotion and pre-application illustrations, pre-contract and start-of-contract and post-contract disclosure, contract changes, charges and arrears and repossessions.

There are recent and proposed changes to United Kingdom mortgage regulation and, more generally, consumer credit regulation which would impact both the CYBG Group and the Virgin Money Group and, following Completion, the Combined Group.

On 10 June 2016 the FCA published their Consultation Paper, CP16/16, which considered how mortgage administration will deal with customers experiencing a payment shortfall. CP16/16 proposed changes to how payments are allocated. On 14 December 2016, the FCA published Policy Statement PS 16/25, outlining amendments to the wording of MCOB 12.4.1R on the allocation of payments received by customers with a payment shortfall; and an amendment to the definition of "payment shortfall". The new rules came into effect on 15 December 2016.

On 24 April 2017, the FCA issued its finalised guidance FG17/4 (The fair treatment of mortgage customers in payment shortfall: impact of automatic capitalisations). FG17/4 sets out a possible framework firms can use when providing customer remediation relating to correcting the effects of automatic capitalisation of payment shortfalls and, where appropriate, paying any compensation that is due to the customer. Clydesdale Bank PLC has not been affected by such remediation.

Mortgage Credit Directive

On 21 March 2016, EU Member States were required to implement a new directive on credit agreements relating to residential immovable property for consumers (the "**Mortgage Credit Directive**"). The Mortgage Credit Directive applies to: (a) credit agreements secured by a mortgage or comparable security commonly used in a member state of the European Union on residential immovable property, or secured by a right relating to residential immoveable property; (b) credit agreements the purpose of which is to purchase or retain rights in land or in an existing or proposed residential building; and (c) unsecured credit agreements the purpose of which is to renovate residential immovable property involving a maximum total amount of credit of EUR 75,000 and which are outside the Consumer Credit Directive (Directive 2008/48/EC). The Mortgage Credit Directive does not apply to certain equity release credit agreements to be repaid from the sale proceeds of an immovable property, or to certain credit granted by an employer to its employees.

On 25 March 2015 the Mortgage Credit Directive Order 2015 (the "**MCD Order**") was passed in order to make the necessary legislative changes to implement the Mortgage Credit Directive into UK law. In summary, the MCD Order: (i) puts in place a new regulatory regime for consumer buy-to-let mortgages (the "**CBTL mortgages**"): (ii) widens the definition of a regulated mortgage contract to include second mortgages; and (iii) transfers the regulation of some existing agreements (e.g. second mortgages) from the consumer credit regime to the regulated mortgage contract regime. The MCD Order took effect, for most purposes, on 21 March 2016.

On 22 July 2015, the Mortgage Credit Directive (Amendment) Order 2015 (the "**MCD (Amendment) Order**") was published. Articles 1 and 2 of the MCD Amendment Order came into force on 20 September 2015. Article 3 came into force on 21 March 2016. The MCD (Amendment) Order: (i) provides that the availability of a transitional arrangement for new loans secured by a second or subsequent mortgage is determined at the first contact with a customer, whether that contact is made by a mortgage lender or an intermediary; and (ii) clarifies the regulatory status of a small number of existing buy-to-let mortgages.

Regulations in the United Kingdom could lead to some terms of the agreements relating to mortgage loans issued by members of the CYBG Group or Virgin Money being unenforceable, which may negatively impact both CYBG and Virgin Money.

In the United Kingdom, the Unfair Terms in Consumer Contracts Regulations 1994 applied to all of mortgage loans that were entered into between 1 July 1995 and 30 September 1999. These regulations were revoked and replaced by the Unfair Terms in Consumer Contracts Regulations 1999 ("**UTCCR**") on 1 October 1999, which apply to all mortgage loans as of that date. The UTCCR generally **provided that**:

- a borrower may challenge a term in an agreement on the basis that it is an "unfair" term within the regulations and therefore not binding on the borrower (although the agreement itself continues to bind the parties if it is capable of continuing in existence without the unfair term); and
- the Competition and Markets Authority ("**CMA**") and any "qualifying body" (as defined in the regulations, such as the FCA) may seek to prevent a business from relying on unfair terms.

The Consumer Rights Bill received royal assent on 26 March 2015 and is now the Consumer Rights Act 2015 ("**CRA**"). The CRA significantly reforms and consolidates consumer law in the UK. The CRA involves the creation of a single regime out of the Unfair Contract Terms Act 1977 (which essentially deals with attempts to limit liability for breach of contract) and the UTCCR. When the unfair contract terms regime of the CRA came into force it revoked the UTCCR and introduced a new regime for dealing with unfair contractual terms as follows:

- Under Part 2 of the CRA an unfair term of a consumer contract (a contract between a trader and a consumer) is not binding on a consumer (an individual acting for purposes that are wholly or mainly outside that individual's trade, business, craft or profession). Additionally, an unfair notice is not binding on a consumer, although a consumer may rely on the term or notice if the consumer chooses to do so. A term will be unfair where, contrary to the requirement of good faith, it causes significant imbalance in the parties' rights and obligations under the contract to the detriment of the consumer. In determining whether a term is fair it is necessary to: (i) take into account the nature of the subject matter of the contract; (ii) refer to all the circumstances existing when the term was agreed; and (iii) refer to all of the other terms of the contract or any other contract on which it depends.
- Schedule 2 contains an indicative and non-exhaustive "grey list" of terms of consumer contracts that may be regarded as unfair. Notably, paragraph 11 lists "a term which has the object or effect of enabling the trader to alter the terms of the contract unilaterally without a valid reason which is specified in the contract." Although paragraph 22 provides that this does not include terms by which a supplier of financial services reserves the right to alter the rate of interest payable by or due to the consumer, or the amount of other charges for financial services without notice where there is a valid reason if the supplier is required to inform the consumer of the alteration at the earliest opportunity and the consumer is free to dissolve the contract immediately.
- A term in a consumer contract may not be assessed for fairness to the extent that (i) it specifies the main subject matter of the contract; or (ii) the assessment is of the appropriateness of the price payable under the contract by comparison with the goods, digital content or services supplied under it, to the extent that such term is transparent and prominent.
- Where a term of a consumer contract is "unfair" it will not bind the consumer. However, the remainder of the contract, will, so far as practicable, continue to have effect in every other respect. It is the duty of the court to consider the fairness of any given term. This can be done even where neither of the parties to proceedings has explicitly raised the issue of fairness.
- A trader must ensure that a written term of a consumer contract, or a consumer notice in writing, is transparent i.e. that it is expressed in plain and intelligible language and is legible. Where a term in a consumer contract is susceptible to multiple different meanings, the meaning most favourable to the consumer will prevail.
- The unfair contract terms regime in Part 2 and Schedules 2 and 3 of the CRA came into force 1 October 2015. No assurance can be given that any changes in legislation, guidance or case law on unfair terms will not have a material adverse effect on CYBG or Virgin Money. There can be no assurance that any such changes (including changes in regulators' responsibilities) will not affect the Loans.
- The extremely broad and general wording of the UTCCR makes any assessment of the fairness of terms largely subjective and makes it difficult to predict whether or not a term would be held by a court to be unfair. It is therefore possible that any loans which have been made to borrowers covered by the UTCCR may contain unfair terms which may result in the possible unenforceability of the terms of such loans.

On 11 May 2005, the European Parliament and the Council adopted a Directive (2005/29/EC) regarding unfair business-to-consumer commercial practices (the "**Unfair Practices Directive**"). Generally, this Directive applies full harmonisation, which means that member states of the European Union may not impose more stringent provisions in the fields to which full harmonisation applies. By way of exception, this Directive permits member states of the European Union to impose more stringent provisions in the fields of financial services and immovable property, such as mortgage loans.

The Unfair Practices Directive provides that enforcement bodies may take administrative action or legal proceedings against a commercial practice on the basis that it is "unfair" within this Directive. The Unfair Practices Directive is intended to protect only collective interests of consumers, and so is not intended to give any claim, defence or right to set-off to an individual consumer.

The Unfair Practices Directive has been implemented in the UK through the Consumer Protection from Unfair Trading Regulations (the "**CPUTR**"), which came into force on 26 May 2008 and affects all contracts entered into with persons who are natural persons and acting for purposes outside their respective business. Although the CPUTRs are not solely concerned with financial services, they do apply to the residential mortgage market. In addition, the FSA (and from 1 April 2013, the FCA) has taken the Unfair Practices Directive into account in reviewing its relevant rules, such as MCoB. Under the CPUTR a commercial practice is to be regarded as unfair and prohibited if it is:

(a) contrary to the standard of special skill and care which a trader may reasonably be expected to exercise towards consumers, commensurate with honest market practice and/or general principles of good faith in the trader's field of activity; and

(b) materially distorts or is likely to materially distort the economic behaviour of the average consumer (who is reasonably well-informed and reasonably observant and circumspect, and taking into account social, cultural and linguistic factors) who the practice reaches or to whom it is addressed (or where a practice is directed at or is of a type which may affect a particular group of consumers, the average consumer of that group).

In addition to the general prohibition on unfair commercial practices, the CPUTR contain provisions aimed at aggressive and misleading practices (including, but not limited to: (i) pressure selling; (ii) misleading marketing (whether by action or omission); and (iii) falsely claiming to be a signatory to a code of conduct) and a list of practices which will in all cases be considered unfair. The effect (if any) of the CPUTRs on mortgage loans issued by CYBG or Virgin Money will depend on whether those entities engage in any of the practices described in the CPUTR. Whilst engaging in an unfair commercial practice does not render a contract void or unenforceable, to do so is an offence punishable by a fine and/or imprisonment and the possible liabilities for misrepresentation or breach of contract in relation to the underlying credit agreement may result in unrecoverable losses on amounts to which such agreements apply.

From 13 June 2014, customers will also have a direct civil right of redress against business for misleading and aggressive practices, which will be introduced by the Consumer Protection from Unfair Trading Amendment Regulations 2014 (the "**CPUT Amendment Regulations**").

On 14 March 2013 the Commission published the results of its review on the application of the Unfair Practices Directive. The Commission does not propose amending the directive but has indicated that intensified national enforcement and re-enforced cooperation in cross-border enforcement are needed. Going forward the Commission will consider how it can play a more active role in enforcement and will continue to perform in-depth reviews of how the directive works in practice.

No assurance can be given that the United Kingdom's implementation of the Unfair Practices Directive, including the CPUT Amendment Regulations, will not have a material adverse effect on either CYBG or Virgin Money, as authorised providers of regulated mortgage contracts.

Home Owner and Tenant Protection

Part 1 of the Home Owner and Debtor Protection (Scotland) Act 2010 (the "**Home Owner and Debtor Protection Act**") came into force on 30 September 2010 and contains provisions imposing additional requirements on heritable creditors (the Scottish equivalent to mortgagees) in relation to the enforcement of standard securities over residential property in Scotland. The Home Owner and Debtor Protection Act amends the provisions of the Conveyancing and Feudal Reform (Scotland) Act 1970 which permitted a heritable creditor to proceed to sell the secured property where the notice period specified in a calling up notice or notice of default served in respect of the relevant standard security had expired without challenge (or where a challenge had been made but not upheld). Under the Home Owner and Debtor Protection Act, the heritable creditor is required to obtain a court order to exercise its power of sale, unless the borrower and any other occupier have surrendered the property voluntarily. In addition, the Home Owner and Debtor Protection Act requires the heritable creditor in applying for a court order to demonstrate that it has taken various preliminary steps to resolve the borrower's position, as well as imposing further procedural requirements.

Repossessions Policy

A pre-action protocol based on mortgage or home plan arrears in respect of residential property in England and Wales came into force on 19 November 2008 (the "**Pre-Action Protocol**"), setting out the steps that judges will expect any lender to take before starting a claim for possession. A number of mortgage lenders have confirmed that they will delay the initiation of repossession action for at least three months after arrears start to accrue and where the property is occupied by the borrower. The application of such a moratorium may be subject to the wishes of the relevant borrower and may not apply in cases of fraud.

The Mortgage Repossession (Protection of Tenants etc) Act 2010 came into force on 1 October 2010 and gives courts in England and Wales the same power to postpone and suspend repossession for up to two months on application by an unauthorised tenant (i.e. a tenant in possession without the lender's consent) as generally exists on application by an authorised tenant. The lender has to serve notice at the property before enforcing a possession order.

The Pre-Action Protocol and the Mortgage Repossession (Protection of Tenants etc) Act 2010 may have adverse effects in markets experiencing above average levels of possession claims for the CYBG Group or the Virgin Money Group as mortgage lenders. Delays in the initiation of responsive action in respect of mortgage loans may result in lower recoveries for the CYBG Group or the Virgin Money Group as mortgage lenders. Where the period of grace is afforded it may affect the amount recovered and may result in such recovery being less than may otherwise be the case if, for example, the property sells for less than the amount of the outstanding loan.

A further Pre-Action Protocol for Debt Claims came into force on 1 October 2017 and applies to any business when claiming payment of a debt from an individual. The Protocol encourages early and reasonable engagement between parties and aims to allow parties to resolve the matter without the need to start court proceedings. Such out of court proceedings would include discussing a reasonable payment plan or considering the use of Alternative Dispute Resolution.

The FCA published its thematic review on the fair treatment of existing interest-only mortgage customers in January 2018 (TR 18/1). The review found that progress in this area had been made by lenders, and did not propose immediate new regulation, but instead published guidance to consumers to contact their lenders as early as possible to discuss interest-only repayment options. Both the CYBG Group, the Virgin Money Group and, following Completion, the Combined Group may be impacted by any future regulation in this area.

1.4 Financial Services Compensation Scheme ("FSCS")

FSMA established the FSCS, which pays compensation to eligible customers of authorised financial services firms which are unable, or are likely to be unable, to pay claims against them. Broadly speaking, the aims of compensation payments are to provide redress for customers who are least able to sustain financial loss and therefore to assist in promoting consumer confidence in the financial system.

The actual level of compensation paid depends on the basis of claims. The FSCS only pays compensation for financial loss. Compensation limits are per person per firm, and per claim category (listed below).

Slightly different limits and rules apply if you have a claim against an insurer or a bank that was insolvent before the FSCS became operational (1 December 2001), or if your claim is against an investment firm that was declared in default before the FSCS became operational.

The maximum levels of compensation are:

- Deposits: £85,000 per person per firm (for claims against firms declared in default from 30 January 2017). From 3 July 2015, the FSCS will provide a £1 million protection limit for temporary high balances held with a bank, building society or credit union if it fails.
- Investments: £50,000 per person per firm (for claims against firms declared in default from 1 January 2010). This limit will increase to £85,000 effective 1 April 2019.
- Home Finance (e.g. mortgage advice and arranging): £50,000 per person per firm (for claims against firms declared in default from 1 January 2010). This limit will increase to £85,000 effective 1 April 2019.

- Insurance Business: Long-term insurance benefits are protected 100 per cent. Claims under compulsory insurance, professional insurance and certain claims for injury, sickness or infirmity of the policyholder are protected at 100 per cent. Protects 90 per cent. of other types of claim with no upper limit.
- General insurance advice and arranging: Protects 90 per cent. of the claim with no upper limit. Compulsory insurance is 100 per cent. (for business conducted on or after 14 January 2005).

The FSCS is funded by levies on authorised firms. However, the methodology for determining levies per institution going forward will be governed by the new Deposit Guarantee Schemes Directive (see below).

1.5 Financial Ombudsman Service ("FOS")

FSMA established the FOS, which provides customers with a free and independent service designed to resolve disputes where the customer is not satisfied with the response received from the regulated firm. The FOS resolves disputes for eligible persons that cover most financial products and services provided in (or from) the UK. The jurisdiction of the FOS extends to include firms conducting activities under the CCA. The maximum monetary award by the FOS is £150,000 (excluding any interest and costs) for complaints received by the FOS on or after 1 January 2012. The FOS may also make directions awards, which direct the business to take such steps as the FOS considers just and appropriate.

Although the FOS takes account of relevant regulation and legislation, its guiding principle is to resolve cases on the basis of what is fair and reasonable; in this regard, the FOS is not bound by law or even its own precedent. The decisions made by the FOS are binding on regulated firms.

1.6 Senior managers regime, certification regime and conduct rules

The Senior Managers Regime and Certification Regime, which came into force on 7 March 2016 has three elements, as set out below. The new framework encourages individuals to take greater responsibilities for their actions, which in turn should make it easier for both firms, and regulators, to hold individuals to account:

- ***The Senior Managers Regime (SMR)***: This regime is intended: (i) to ensure that the key responsibilities within banks are assigned to specific individuals, who carry out a senior management function, and (ii) that such senior managers are made fully aware of those responsibilities and made to understand that they will be held to account for how they carry them out. Senior managers are pre-approved by the regulators. The regime replaces the concept of significant influence function under the Approved Persons Regime.
- ***The Certification Regime***: This regime, which sits alongside the Senior Managers Regime, applies to other bank staff whose actions or behaviour could significantly harm CYBG, Virgin Money or any of their customers. Such staff are not pre-approved by the regulators. Instead, banks must certify that these individuals are fit and proper for their roles on an on-going basis.
- ***Conduct Rules***: The conduct rules are high-level requirements that apply to persons within scope of the SMR and the certification regime. They will also apply to most employees of banks based in the UK or those who deal with customers in the UK. These rules replace the Statement of Principle and Code of Practice for Approved Persons.

1.7 Approved persons regime

Under the approved persons regime, individuals performing certain roles at certain regulated firms must be approved by the relevant firm and regulators as fit and proper to perform such roles. These individuals must also comply with a behavioural code known as the Statements of Principle and Code of Practice for Approved Persons.

The Senior Managers and Certification Regime has replaced the approved persons regime at certain FCA- and PRA-regulated firms, such as UK credit institutions. The Senior Managers and Certification Regime will be extended in December 2019 to replace the approved persons regime where the latter regime currently remains.

1.8 Other relevant legislation and regulation

Payment Services Regulations 2017 ("PSR")

Under the PSR, the FCA is responsible for regulating payment services in the UK. The PSR establish an authorisation regime, requiring payment service providers to either be authorised or registered with the FCA. The PSR also contain certain rules about providing payment services that payment service providers must comply with, including in relation to consent for payment transactions, unauthorised or incorrectly executed transactions, liability for unauthorised payment transactions, refunds, execution of payment transactions, execution time, information to be provided to payment service users and liability of payment services providers if things go wrong.

UK Money Laundering Regulations

The UK Money Laundering Regulations 2007 were repealed by the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 ("**Money Laundering Regulations 2017**") which came into force on 26 June 2017. Like the Money Laundering Regulations 2007, the UK Money Laundering Regulations 2017 place a requirement on the CYBG Group and the Virgin Money Group to verify the identity and address of customers opening accounts with it, and to keep records to help prevent money laundering and fraud. However, changes introduced by the Money Laundering Regulations 2017 include changes to anti-money laundering procedures at law firms, changes to customer due diligence, the introduction of a central register for beneficial owners and provides for greater focus on risk assessment. Guidance in respect of firms' anti-money laundering and counter-terrorist financing obligations is produced by the Joint Money Laundering Steering Group.

Data Protection Act 2018

The Data Protection Act 2018 (the "**DPA**") supplements the General Data Protection Regulation (EU 2016/679), and came into force on 25 May 2018 (superseding the Data Protection Act 1998). It also implements the EU Data Protection Directive (EU 2016/680) into UK law. Those responsible for processing and controlling personal data must ensure that their data policies and processes reflect these requirements. The DPA appoints the Information Commissioner as the independent data protection regulator and contains requirements for data controllers to notify the Information Commissioner of breaches of the DPA.

Consumer Rights Act 2015

The Consumer Rights Act 2015 came into force on 1 October 2015. It gives effect in the UK to the Unfair Contract Terms Directive and revokes the Unfair Terms in Consumer Contracts Regulations 1999. It deals with unfair contract terms and consumer notices. The main effect of this legislation is to consolidate the rules dealing with the fairness of contractual terms when dealing with a consumer as well as clarifying the remedies that consumers have.

Foreign Account Tax Compliance Act ("FATCA")

The United States has enacted rules that generally impose a reporting and withholding regime with respect to certain U.S. source payments made by, and financial accounts held with, entities that are classified as financial institutions under FATCA. The United States has entered into an intergovernmental agreement regarding the implementation of FATCA with the United Kingdom.

The FATCA provisions impose substantial burdens on UK businesses in identifying U.S. taxpayers, and registering and reporting information. Further, significant aspects of how FATCA will apply in the future remain unclear and, as a result, the scope of compliance may change.

Financial Reporting Council ("FRC")

The FRC is an independent UK regulatory body responsible for promoting high quality corporate governance and reporting to foster investment. Among other things, the FRC sets UK codes and standards for governance, accounting, auditing and actuarial work. It also monitors disclosure compliance by public companies with the applicable financial reporting framework and investigates misconduct by professional accountants and actuaries.

International Financial Reporting Standards ("IFRS"), previously known as International Accounting Standards ("IAS")

The IAS Regulation is Regulation (EC) No. 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of International Accounting Standards. It is one of the steps taken by the EU to assist the overall convergence of accounting standards on an international scale.

The main aim of the IAS Regulation is to ensure that publicly traded companies in the EU apply a single set of high quality international accounting standards for the preparation of their consolidated financial statements (known as group accounts under the 2006 Act). Under the 2006 Act, "international accounting standards" is used to refer to the international accounting standards within the meaning of the IAS Regulation.

International Financial Reporting Standard 9: ('Financial Instruments' ("IFRS 9")

The new accounting standard governing the accounting for financial instruments became effective for annual reporting periods beginning on or after 1 January 2018. The standard introduced revised financial asset classifications and fundamentally changed the calculation and recognition of credit losses by introducing the requirement to base impairment provisions on expected credit losses over the life of the financial asset. It requires either a 12 month or lifetime credit loss to be recognised for all loans, in contrast with the current standard (IAS 39) which required recognition of losses only when there is evidence of impairment. The calculation of expected credit losses needs to include forward looking macro-economic variables and incorporate a probability weighted multiple scenario approach.

The CYBG Group has initiated a project to develop and implement the modelling, data, processes, systems and disclosures required to comply with IFRS 9. The CYBG Group has entered a parallel run period to assess the impact of the standard and will implement IFRS 9 with effect from 1 October 2018.

Competition regulation

In November 2014, the CMA launched an in-depth market investigation into the personal current account and SME retail banking sectors after identifying concerns about the effectiveness of competition in these sectors. The CMA identified features of the personal and business current account and SME lending markets that were not working well and having an adverse effect on competition. On 2 February 2017, the CMA published the Retail Banking Market Investigation Order 2017 which implements the remedies identified in the CMA Retail Banking Market Investigation final report. These include overdraft alerting, prompts to switch accounts, enhanced service quality and account comparison information. The CYBG Group has implemented all the mandatory parts of the Order although. challenges were experienced in delivering one part of the Order within mandated timelines and the regulators are being kept informed. Additional requirements such as open banking remedies were imposed upon larger firms and are optional for other firms.

1.9 Regulatory and other changes resulting from the UK exit from the European Union

As a significant proportion of the current and anticipated regulatory regime applicable to the CYBG Group in the UK is derived from EU directives and regulations, the UK exiting the EU could materially change the legal and regulatory framework applicable to the CYBG Group's, the Virgin Money Group's and, following Completion, the Combined Group's operations, including in relation to its regulatory capital requirements. For more information see "*Risk Factors—Risks in relation to the UK's vote to leave the EU*".

1.10 Other

In addition to those laws and regulations described above, the CYBG Group and the Virgin Money Group are also subject to, and complies with, a number of legal and regulatory requirements that relate to, amongst others, employment, health and safety and data protection laws and regulations.

The FCA is conducting an ongoing review into the business models used in the retail banking sector. Launched in May 2017, the FCA published a progress report on this review on 27 June 2018. This progress report outlines the current progress on the review, which is particularly focussed on assessing the impact of technological change and new regulatory initiatives. In the next stage of the Review the FCA will look at a number of scenarios—including changing customer behaviour, the impact of regulatory and technological developments and changes to banks' business models.

2. EUROPEAN UNION LEGISLATION

The regulatory framework for banking and financial services within the UK is currently shaped to a large degree by legislation emanating from the EU. Regulations of the EU apply directly in EU Member States while directives are required to be implemented into national law by Member States.

The following principal items of current and proposed EU legislation have particular relevance for the CYBG Group, the Virgin Money Group and, following Completion, the Combined Group.

2.1 Capital Requirement Regulation and Directive

The Basel Committee on Banking Supervision introduced significant changes to the existing capital requirements framework for banks in 2011 to 2013 with the final reform package being issued in December 2017. The intention of these new capital and liquidity requirements was to reinforce capital standards, with heightened requirements for global systemically important banks, and to establish minimum liquidity standards for credit institutions. The changes (referred to as the "**Basel III reforms**") include new requirements for a bank's capital base, measures to strengthen the capital requirements for counterparty credit exposures arising from certain transactions and the introduction of a leverage ratio as well as short-term and longer- term standards for liquidity and funding (the "**Liquidity Coverage Ratio**" and the "**Net Stable Funding Ratio**" respectively).

The Basel III reforms have been implemented in the EU by the Capital Requirements Regulation (the "**Capital Requirements Regulation**") and the associated Capital Requirements Directive (the "**CRD IV Directive**", known together with the Capital Requirements Regulation as "**CRD IV**") which were adopted by the European Parliament and European Council on 26 June 2013. It is intended that EU Member States will implement the new capital standards and the new Liquidity Coverage Ratio as soon as possible (with provisions for phased implementation, meaning that some of the measures will not apply in full until January 2019). A binding Net Stable Funding Ratio was proposed as part of amendments to CRD IV, published in November 2016.

In December 2017, the Basel Committee agreed to further Basel III reforms, including reforms relating to the standardised and internal ratings-based approaches for credit risk, and a revised output floor. The Basel Committee expects member countries to implement these 2017 reforms, sometimes referred to as Basel IV, by 1 January 2022 (with the exception of those relating to the output floor, which will be phased in from 1 January 2022).

Capital

A bank's ability to absorb losses is determined by the amount of capital it holds. Consequently, a bank's total assets and RWAs determine the minimum capital that a bank is required to hold. Three types of capital defined by the Capital Requirements Regulation include:

- CET1 Capital: comprising common equity and retained earnings;
- Additional Tier 1 Capital: comprising deeply subordinated perpetual instruments issued in accordance with the requirements of the Capital Requirements Regulation; and
- Tier 2 Capital: comprising dated or perpetual subordinated instruments issued in accordance with the requirements of the Capital Requirements Regulation as well as: (i) any share premium account generated by the issuance of such instruments; and (ii) certain other risk-weighted exposure amounts.

The principal metrics used to assess capital strength are the CET1 ratio, Total Capital Ratio and the Leverage Ratio.

Liquidity

A bank's ability to manage shocks to the financial system is assessed by the extent to which its assets are covered by funding with equal or longer maturity. The principal metrics to assess bank funding and liquidity are the NSFR and LCR.

- The NSFR is a key component of the Basel III reforms (discussed above) which is due to come into force in 2018. The ratio seeks to calculate the proportion of long-term assets which are funded by long term, stable funding. The Basel III regulations state that a bank's NSFR must be at least 100 per cent.
- The LCR is designed to ensure that financial institutions have the necessary assets available to withstand short-term liquidity disruptions. Banks are required to hold an amount of highly liquid assets equal to or greater than their net cash outflow over a 30-day period. The LCR was introduced in October 2015, but is subject to a phased implementation such that the full 100 per cent. minimum will not be enforced until 1 January 2018.
- Firms may also use a series of non-regulatory measures. For example, the LDR is defined as the ratio of total customer loans to deposits.

2.2 Consumer Credit Directive

In April 2008, the European Parliament and the Council of the European Union adopted a second directive on consumer credit (Directive 2008/48/EC) which provides that, subject to exemptions, loans not exceeding €75,000 will be regulated. This directive repealed and replaced the first Consumer Credit Directive and required Member States to implement the directive by 11 June 2010. The Consumer Credit Directive was implemented in the UK through a series of implementing regulations.

In essence, the Consumer Credit Directive requires member states to ensure that suppliers of consumer credit provide a comprehensible set of information to consumers in good time before a consumer credit agreement is entered into, the aim being to permit consumers to more easily compare consumer credit agreements and to better understand the features and obligations of such agreements. The pre-contractual information required to be provided by creditors must follow the Standard European Consumer Credit Information standardised form. In addition, member states must implement two essential rights for consumers: the right to withdraw from the credit agreement without giving any reason within a period of 14 days after the conclusion of the contract and the right to repay their credit early at any time. In respect of the latter, the creditor can ask for a fair and objectively justified compensation.

2.3 European Market Infrastructure Regulation ("EMIR")

EMIR was adopted by the European Parliament and European Council on 4 July 2012. EMIR provides for certain over-the-counter derivative contracts to be submitted to central clearing and imposes, among other things, margin posting and other risk mitigation techniques, reporting and record keeping requirements. The clearing and margin requirements are being phased in and certain reporting obligations are already in force. The CYBG Group and the Virgin Money Group are "Category 2" financial institutions for the purposes of EMIR and have been required to adhere to EMIR requirements on a phased basis, including centrally clearing any derivatives from 21 December 2016.

2.4 Bank Recovery and Resolution Directive ("BRRD")

The BRRD was published in the Official Journal of the EU on 12 June 2014 and EU Member States were required to have put in place national legislation implementing the provisions of the BRRD by 1 January 2015. The provisions of the BRRD (including those relating to bail-in) have been implemented in the UK by means of a mixture of legislative provisions, new rules in the FCA Handbook and the PRA Rulebook and amendments to HM Treasury's SRR Code of Practice.

2.5 Deposit Guarantee Schemes Directive

The Deposit Guarantee Schemes Directive required each EU Member State to introduce at least one deposit guarantee scheme, with implementation by 1 July 1995. The Deposit Guarantee Schemes Directive has been reviewed and a new directive to recast and replace the existing rules was adopted by the European Parliament and European Council on 16 April 2014 and published in the Official Journal on 12 June 2014. The UK deposit guarantee scheme is the FSCS. The main changes include a tighter definition of deposits, mandatory part pre-funding of deposit guarantee schemes, a requirement that deposit guarantee schemes repay customers within a week and that banks must be able to provide information at any time.

2.6 Payment Services Directive

Directive 2007/64/EC on payment services in the internal market harmonises the regulatory regime across the EU for payment services (the "**PSD**"). The PSD was implemented in the UK through the Payment Services Regulation 2009 and related amending legislation. The regulations create a separate authorisation and registration regime which differs from the authorisation requirements under FSMA, for businesses which provide payment services (including credit card services) in the UK. Credit institutions are only subject to the conduct of business requirements in the regulations to the extent that they provide payment services.

In July 2013 the European Commission proposed a revised payment services directive ("**PSD2**") to take account of new types of payment services due to technological development and to harmonise the transposition of certain rules set out in the Payment Services Directive that had been transposed or applied by Member States in different ways, leading to regulatory arbitrage and legal uncertainty. It also published a proposal for a regulation on multilateral interchange fees. Taken together, the proposals are designed to (i) extend the scope of the Payment Services Directive as regards geographical scope, currencies covered and payment services regulated, (ii) limit the scope of available exemptions under the Payment Services Directive, (iii) increase consumer rights and payment security and (iv) reduce interchange fees for card payments and prohibit surcharging. The new PSD2 regime came into force in the UK from 13 January 2018, and was implemented through the Payment Services Regulations 2017, which came into force on 18 July 2017.

2.7 General Data Protection Regulation ("GDPR")

In 2012 the European Commission published a proposal for the GDPR, which would replace the Data Protection Act 1998 (and the equivalent laws in other EU and EEA Member States) with an EU regulation having direct effect in the UK. A political agreement was reached on 15 December 2015 and the GDPR (Regulation (EU) 2016/679) was published on the Official Journal on 4 May 2016. The GDPR came into force on 25 May 2018. In essence, the GDPR increases compliance requirements and includes significant financial penalties of up to four per cent. of the annual worldwide turnover of company groups.

2.8 Fourth EU Anti Money Laundering Directive

The Fourth EU Anti Money Laundering Directive (Directive 2015/849) amends Regulation No 648/2012 and repeals Directive 2005/60/EC. EU Member States were required to have incorporated it into national law by 26 June 2017. From 26 June 2017, financial institutions, accountants, tax advisers, lawyers, trust providers and estate and letting agents with whom trustees form a business relationship must have complied. The updated Directive has made changes to customer due diligence and the central register of beneficial ownership, introduced enhanced measures for local politically-exposed persons, removed the automatic exemption from enhanced customer due diligence and expanded the scope of the Directive to companies with majority-owned subsidiaries located in countries outside of the EU, while emphasising a risk-based approach.

2.9 FCA Asset Management Market Study

The FCA launched a market study into the asset management sector in November 2015, publishing its interim findings in November 2016 and a final report in June 2017. The final report identified a number of concerns in relation to the UK asset management industry, including a concern that there is weak competition in a number of areas in the market. The FCA also expressed concerns as to how asset managers communicate their objectives to customers. The final report also concluded that investors' awareness of charges is often poor and that sustained, high profits have been generated by firms from such charges in this market over a number of years. The FCA has proposed remedies to address some of these concerns and on 5 April 2018 published a policy statement regarding the implementation of final rules and guidance. The remedies included measures to strengthen the rules on authorised fund managers to act in their investors' best interests, governance reforms to hold asset managers to greater account, a requirement for more independent directors on fund management boards, and more express regulatory requirements on fund managers to consider value for money.

PART X
TAXATION

The following statements summarise certain UK tax aspects of the New CYBG Shares. They are based on current UK legislation and an understanding of current published practice of HMRC as at the date of this Prospectus, both of which may change, possibly with retrospective effect. This Part is intended as a general guide and, except where express reference is made to the position of non-UK residents, applies only to Shareholders who are resident in, and if individuals, domiciled in, the UK for tax purposes. They relate only to Shareholders who hold their New CYBG Shares directly as an investment (other than in an individual savings account or within a pension scheme) and who are the absolute beneficial owners of those New CYBG Shares. This Part does not deal with certain types of Shareholder, such as persons who hold or acquire New CYBG Shares in the course of a trade or by reason of their (or another person's) employment, collective investment schemes and insurance companies.

If you are in any doubt as to your tax position or if you are resident or otherwise subject to tax in any jurisdiction other than the UK, you should consult an appropriate professional adviser.

1. DIVIDENDS FROM NEW CYBG SHARES

1.1 Withholding taxes

CYBG will not be required to withhold UK tax when paying a dividend.

The amount of any liability to UK tax on dividends paid by CYBG will depend upon the individual circumstances of the CYBG Shareholder.

1.2 UK resident individual shareholders

All dividends received by a UK resident individual CYBG Shareholder from CYBG or from other sources will form part of the CYBG Shareholder's total income for income tax purposes and will constitute the top slice of that income. A nil rate of income tax will apply to the first £2,000 of taxable dividend income received by the CYBG Shareholder in a tax year. Where the dividend income is above the £2,000 dividend allowance, the first £2,000 of the dividend income will be charged at the nil rate and any excess amount will be taxed at the rate that would apply to that amount if the nil rate did not exist. The rates are 7.5 per cent. to the extent that the excess amount falls within the basic rate tax band, 32.5 per cent. to the extent that the excess amount falls within the higher rate tax band and 38.1 per cent. to the extent that the excess amount falls within the additional rate tax band. Please note that Scottish income tax rates do not apply to this "savings income", and accordingly a shareholder who is tax resident in Scotland will continue to be subject to the UK rates noted above.

1.3 Other shareholders

Dividends paid by CYBG to CYBG Shareholders who are subject to UK corporation tax should generally fall within one or more of the classes of dividend qualifying for exemption from corporation tax, although the exemptions are not comprehensive and are also subject to anti-avoidance rules. CYBG Shareholders within the charge to corporation tax should consult their own professional advisers.

CYBG Shareholders who are not resident in the UK for UK tax purposes will not be liable to UK income or corporation tax on dividends paid on the CYBG Shares unless they are carrying on a trade, profession or vocation in the UK and the dividends are either a receipt of that trade or, in the case of corporation tax, the CYBG Shares are held by or for a UK permanent establishment through which the trade is carried on.

A CYBG Shareholder resident outside the UK may be subject to taxation on dividend income under local law. A CYBG Shareholder who is resident outside the UK for tax purposes should consult his own tax adviser concerning his tax position on dividends received from CYBG.

2. CHARGEABLE GAINS

2.4 Disposal of New CYBG Shares

A disposal or deemed disposal of CYBG Shares by a CYBG Shareholder who is (at any time in the relevant UK tax year) resident in the UK for tax purposes may, depending upon the CYBG Shareholder's circumstances and subject to any available exemption or relief give rise to a chargeable gain or an allowable loss for the purposes of UK taxation of capital gains.

CYBG Shareholders who are not resident in the UK for UK tax purposes will not generally be subject to UK taxation of capital gains on the disposal or deemed disposal of CYBG Shares unless they are carrying on a trade, profession or vocation in the UK through a branch or agency (or, in the case of a corporate CYBG Shareholder, a permanent establishment) in connection with which the CYBG Shares are used, held or acquired.

An individual CYBG Shareholder who has ceased to be resident for tax purposes in the UK (or has become treated as resident outside the UK for the purposes of a double tax treaty ("**Treaty non-resident**")) for a period of five years or fewer and who disposes of all or part of his CYBG Shares during that period may be liable to UK capital gains tax on any gain on his return to the UK, subject to any available exemptions or reliefs.

Shareholders should note that capital gains tax rules are particularly complex and are advised to consult a professional adviser to determine their particular position.

3. STAMP DUTY AND STAMP DUTY RESERVE TAX ("SDRT") ON TRANSFERS OF NEW CYBG SHARES

3.1 General

Stamp duty at the rate of 0.5 per cent. (rounded up to the next multiple of £5) of the amount or value of the consideration given is generally payable on an instrument transferring New CYBG Shares. An exemption from stamp duty is available on an instrument transferring New CYBG Shares where the amount or value of the consideration is £1,000 or less, and it is certificated on the instrument that the transaction effected by the instrument does not form part of a larger transaction or series of transactions in respect of which the aggregate amount or value of the consideration exceeds £1,000. Alternatively, a charge to SDRT will arise on an unconditional agreement to transfer New CYBG Shares (at the rate of 0.5 per cent. of the amount or value of the consideration payable). However, if within six years of the date of the agreement becoming unconditional an instrument of transfer is executed pursuant to the agreement, and stamp duty is paid on that instrument, any SDRT already paid will be refunded (generally, but not necessarily, with interest) **provided that** a claim for repayment is made, and any outstanding liability to SDRT will be cancelled. The liability to pay stamp duty is generally satisfied by the purchaser or transferee. Liability for SDRT lies with the purchaser or transferee.

3.2 New CYBG Shares held through CREST

Paperless transfers of New CYBG Shares within CREST are generally liable to SDRT, rather than stamp duty, at the rate of 0.5 per cent. of the amount or value of the consideration. In the absence of an applicable exemption or relief, CREST is obliged to collect SDRT on relevant transactions settled within the system. There is a statutory obligation for the charge to be borne by the purchaser or transferee though accountability for payment may vest with another party. Under the CREST system, no stamp duty or SDRT will arise on a transfer of New CYBG Shares into the system unless such a transfer is made for a consideration in money or money's worth, in which case a liability to SDRT (usually at a rate of 0.5 per cent.) will arise.

3.3 New CYBG Shares held through Clearance Systems or Depositary Receipt Arrangements

Under current UK law, where New CYBG Shares are issued or transferred (a) to, or to a nominee for, a person whose business is or includes the provision of clearance services or (b) to, or to a nominee or agent for, a person whose business is or includes issuing depositary receipts, stamp duty (in the case or a transfer) or SDRT (in the case of an issue or a transfer) will be payable at the higher rate of 1.5 per cent. of the amount or value of the consideration payable or, in certain circumstances, the value of the New CYBG Shares (rounded up to the next multiple of £5 in the case of stamp duty). This stamp duty or SDRT will strictly be accountable by the depositary or clearance service operator or their nominee, as the case may be, but will, in practice, generally be reimbursed by participants in the clearance service or depositary receipt system. Once the shares are in a clearance service transfers are generally not subject to stamp duty or SDRT, unless the clearance service has opted for the alternative charge. Clearance services may opt, provided certain conditions are satisfied, for the normal rate of stamp duty or SDRT (0.5 per cent. of the amount or value of consideration given) to apply to issues or transfers of New CYBG Shares into, and to transactions within, such clearance services instead of the higher rate of 1.5 per cent. generally applying to an issue or transfer of New CYBG Shares into the clearance service and instead of the exemption from SDRT on transfers of New CYBG Shares while in the service.

However, following litigation HMRC has confirmed that they will no longer seek to apply the 1.5 per cent. SDRT charge on an issue of shares or securities to a clearance service or depositary receipt system anywhere in the world (or on a transfer of shares or securities to such entities where the transfer is an integral part of an issue of share capital) on the basis that the charge is not compatible with EU law. It is noted that on 23 June 2016 the UK voted in a referendum to leave the European Union. However, in the Autumn Budget 2017 the government confirmed that this treatment will continue to be applied following the UK's exit from the European Union.

HMRC's view is that the 1.5 per cent. SDRT or UK stamp duty charge will continue to apply to an issue of shares or securities to a clearance service or depositary receipt system where the issue is not an integral part of the raising of capital. Accordingly, specific professional advice should be sought before paying the 1.5 per cent. charge.

PART XI
CYBG DIRECTORS, PROPOSED DIRECTORS, CYBG SENIOR MANAGERS AND CORPORATE GOVERNANCE

1. DIRECTORS

The CYBG Directors as at the date of this Prospectus are:

Name	Age	Position	Date appointed
James Pettigrew	60	Chairman and Non-Executive Director	27 August 2015
David Bennett	56	Deputy Chairman and Senior Independent Non-Executive Director	22 October 2015
David Duffy	56	Executive Director and Chief Executive Officer	29 September 2015
Ian Smith	52	Executive Director and Group Chief Financial Officer	27 August 2015
Debbie Crosbie	48	Executive Director and Group Chief Operating Officer	27 August 2015
Clive Adamson	62	Independent Non-Executive Director	1 July 2016
Paul Coby	62	Independent Non-Executive Director	1 June 2016
Adrian Grace	55	Independent Non-Executive Director	29 September 2015
Fiona MacLeod	51	Independent Non-Executive Director	12 September 2016
Dr Teresa Robson-Capps	63	Independent Non-Executive Director	29 September 2015
Tim Wade	58	Independent Non-Executive Director	12 September 2016

The business address of each of the CYBG Directors is, and following their appointment at Admission, the registered office of Clydesdale Bank PLC at 30 St Vincent Place, Glasgow G1 2HL.

The management expertise and experience of each of the executive CYBG Directors ("**Executive Directors**") and the non-executive CYBG Directors ("**Non-Executive Directors**") is set out below:

1.1 James Pettigrew, Chairman and Non-Executive Director

James Pettigrew joined CYBG Group in September 2012 and became Chairman in 2014. He chairs the Governance and Nomination Committee and is a member of the Remuneration Committee.

James has over 30 years' experience in business and finance gained from executive and senior positions principally within financial services. James was formerly Chief Executive Officer at CMC Markets PLC, Chief Operating Officer at Ashmore Group PLC, Group Finance Director at ICAP PLC and Deputy Group Finance Director and Group Treasurer at Sedgwick Group PLC. He is a chartered accountant and has extensive Non-Executive Director experience in a listed environment. He was previously Chairman of The Edinburgh Investment Trust PLC, Senior Independent Non-Executive Director of Crest Nicholson PLC, Non-Executive Director at Aberdeen Asset Management PLC, Non-Executive Director at AON UK Limited and Non-Executive Director at Hermes Fund Managers Limited. He is a past President of the Institute of Chartered Accountants of Scotland. His breadth of experience, credibility with key stakeholders and strong leadership qualities make him an effective Chairman.

James is Chairman of Miton Group PLC; Chairman of RBC Europe Limited, BlueBay Asset Management (Services) Ltd and BlueBay Asset Management LLP (members of the RBC group); Senior Independent Non-Executive Director of Rathbone Brothers Plc and Rathbone Investment Management Limited (part of the Rathbone Brothers Plc group); Chairman of Scottish Financial Enterprise; and Co-Chair of the Financial Services Advisory Board.

1.2 David Bennett, Deputy Chairman and Senior Independent Non-Executive Director

David Bennett joined CYBG Group in October 2015 and is the Deputy Chairman and Senior Independent Non-Executive Director of the Company. He is a member of the Audit Committee, the Risk Committee, the Remuneration Committee and the Governance and Nomination Committee.

David has significant experience in retail banking gained from a career spanning more than 30 years and including executive and senior roles in both the UK and internationally. David was Group Finance Director of Alliance & Leicester plc for six years before becoming its Group Chief Executive. Following the acquisition of Alliance & Leicester plc by Banco Santander he was appointed Executive Director on the Board of Abbey

National plc. His in-depth experience of retail banking and involvement in organisational, operational and structural change is invaluable as the CYBG Group executes its strategy. He was formerly Chairman of Homeserve Membership Limited and has significant Non-Executive Director experience in a listed environment which has included being a Non-Executive Director of Bank of Ireland (UK) PLC, easyJet plc, and CMC Markets PLC.

David is Senior Independent Non-Executive Director of Ashmore Group plc, Non-Executive Director of PayPal (Europe) S.a.r.l et Cie, S.C.A and Chairman of various companies within the Together Financial Services Limited group.

1.3 David Duffy, Executive Director and Chief Executive Officer

David Duffy joined CYBG Group in June 2015 as CEO.

David has significant international finance and banking experience gained from a career spanning almost three decades. David's proven ability to build and transform businesses and lead strong management teams brings significant value to all of the CYBG Group's stakeholders. Prior to joining the CYBG Group, David was Chief Executive Officer at Allied Irish Banks plc, one of the largest retail and commercial banks in Ireland. He is a former Chief Executive Officer of Standard Bank International where he had responsibility for operations in the UK, Europe, Latin America and Asia. He was also previously Head of Global Wholesale Banking Network with ING Group and President and Chief Executive Officer of the ING wholesale franchises in the United States and Latin America. David is a past President of the Banking and Payments Federation of Ireland and a past Director of the European Banking Federation. David's broad-based skills, leadership, energy and strategic vision are invaluable to the CYBG Group as it continues its strategic journey and cultural transformation.

David is Senior Independent Director of NewTA Limited (trading as UK Finance), the industry body representing leading firms providing finance, banking, markets and payments-related services in or from the UK; HM Treasury Fintech Envoy for England and a Board member of The Northern Powerhouse Partnership.

1.4 Ian Smith, Executive Director and Group Chief Financial Officer

Ian Smith joined CYBG Group in November 2014 from Deloitte LLP where he was a partner specialising in financial services.

Ian has considerable experience in finance, audit and advising on bank strategy and corporate transactions gained from a career spanning more than 25 years. He has held senior finance roles in HBOS plc and Lloyds Banking Group plc.

1.5 Debbie Crosbie, Executive Director and Group Chief Operating Officer

Debbie Crosbie joined the CYBG Group in 1997.

Debbie has broad experience and knowledge gained over 20 years in the banking sector, particularly around information technology, complex project delivery, material outsourcing and strategy and planning. She has significant experience at a senior management level and is a strong advocate for customers and improving the customer experience by driving a change and transformation journey which has the customer as its core focus. Since joining the CYBG Group in 1997 Debbie has held a variety of positions including Head of Technology Governance, Head of Strategic Projects and Head of the Group's Development Centre. She was Chief Information Officer from 2008 to 2011, became Operations & IT Director in 2011, was appointed Executive Director in 2014 and became Chief Operating Officer in 2015. Debbie was Acting Chief Executive Officer from February 2015 to June 2015 and during this period led the preparation for the CYBG Group's demerger and IPO and was part of the management team which completed the transaction. She was previously a Non-Executive Director of the Scottish Court Service. She holds an Honours degree in Industrial Relations from the University of Strathclyde and is a Fellow of the Chartered Institute of Bankers.

Debbie is Vice-Chair of the Board of CBI Scotland, member of the Board of Glasgow Economic Leadership and member of the Strathclyde Business School Advisory Board.

1.6 Clive Adamson, Independent Non-Executive Director

Clive Adamson joined CYBG Group in July 2016. He chairs the Risk Committee and is a member of the Audit Committee.

Clive has considerable experience of UK and global economic, banking and regulatory matters gained from an extensive career in banking and financial services regulation. He held senior executive and advisory positions with the Financial Conduct Authority (FCA), the former Financial Services Authority and the Bank of England. He was previously Head of Supervision and an Executive Director of the Board of the FCA until May 2015. His strong understanding of the UK and global banking industry and related risks is invaluable to the Board.

Clive is Chairman at JP Morgan International Bank Limited; Non-Executive Director of The Prudential Assurance Company Limited; Non-Executive Director at Ashmore Group plc; and senior adviser at McKinsey & Company.

1.7 Paul Coby, Independent Non-Executive Director

Paul Coby joined CYBG Group in June 2016 and is a member of the Risk Committee.

Paul is an accomplished IT professional with significant e-commerce, international and technology experience. In particular, his understanding of how technology has changed consumer behaviour, how advances in digital technology can impact customer outcomes and his appreciation of the end-to-end customer journey in a strategic omni-channel context is invaluable to the CYBG Group as the CYBG Group develop new products and digital capability. In April 2018, Paul was appointed Chief Information Officer (CIO) of Johnson Matthey PLC. Prior to this, Paul was the John Lewis Partnership's CIO, responsible for leading and coordinating IT across the John Lewis, Waitrose and JLP Group. Previously, Paul was IT Director at John Lewis and CIO at British Airways for 10 years. Paul's other previous roles include Chairman of the Societe Internationale de Telecommunications Aeronautiques (SITA), the global provider of systems, solutions and telecommunications to the air transport industry, Non-Executive Director at Pets at Home Group PLC and at P&O Ferries Limited, Chairman of the eSkills UK CIO Board and Chairman of the oneworld CIO Group which coordinated IT links across the 10 airline oneworld Alliance partners.

1.8 Adrian Grace, Independent Non-Executive Director

Adrian Grace joined CYBG Group in December 2014 and is Chairman of the Remuneration Committee.

Adrian has extensive financial, business leadership and general management experience gained from a career which has spanned a range of consumer and commercial financial services sectors and involved a variety of senior roles. Adrian's experience of designing and implementing substantial change programmes and delivering transformational growth through simple customer focused visions and plans is aligned to the CYBG Group's strategy. Having started his career with the Leeds Permanent Building Society and then Mercantile Credit, Adrian joined GE Capital where he spent time in the UK, Asia, and the Americas. He became Managing Director of the Small Business Division at Sage Group plc. He was Chief Executive at Barclays Insurance and Managing Director of Commercial Banking within the Corporate Division of HBOS. Since 2011 Adrian has been Chief Executive Officer at Aegon UK having joined Aegon in 2009 as Group Business Development Director. He was previously on the boards of the Association of British Insurers and Scottish Financial Enterprise.

Adrian is a Director of various companies within the Aegon Group and a member of the FCA Practitioner Panel representing the life and pensions sector.

1.9 Fiona MacLeod, Independent Non-Executive Director

Fiona MacLeod joined CYBG Group in September 2016 and is a member of the Risk Committee and of the Governance and Nomination Committee.

Fiona has 30 years' international business experience in leading complex, large scale business transformation and in managing the commercial, human resources and cultural aspects of change programmes. She has demonstrated this both as an executive and as an advisory consultant to both listed and governmental organisations. A substantial part of her career was at BP Group plc where she held various executive positions encompassing Mergers and Acquisitions, Branding and Marketing and latterly the role of President Retail, USA & Latin America. Fiona was formerly Senior Independent Non-Executive Director of SThree plc.

Fiona is a Non-Executive Director of Denholm Oilfield Services Limited.

1.10 Dr Teresa Robson-Capps, Independent Non-Executive Director

Dr Teresa Robson-Capps joined CYBG Group in October 2014 and is a member of the Audit Committee.

Teresa has extensive financial, customer service and general management experience from across a range of industries including telecommunications, financial services and retail. She is a chartered management accountant and has a Doctorate in Accounting and Management Control. Teresa has a breadth of experience gained from executive leadership roles with BT Mobile, Sears plc, Eagle Star/Zurich Financial Services, Cable & Wireless, Reality and Accenture. She joined HSBC Group in 2006 and from 2010 was Deputy Head, Direct Bank & First Direct. Teresa also has strong board experience gained from her previous roles as Chairman of ACS Clothing Group Limited and Non-Executive Director of Broker Network Holdings Limited, Paymentshield Group Holdings Limited, PowerPlace Insurance Services Limited and Towergate Insurance Limited.

Teresa is a Non-Executive Director of Hastings Group Holdings PLC, FIL Holdings (UK) Limited and Yorkshire Water Services Limited.

1.11 Tim Wade, Independent Non-Executive Director

Tim Wade joined CYBG Group in September 2016. He chairs the Audit Committee and is a member of the Risk Committee.

Tim has over 20 years' senior experience in retail financial services, including retail banking in both the UK and internationally. An Australian national, he is an experienced Chief Financial Officer, a chartered accountant and a Fellow of the Institute of Chartered Accountants of Australia. Tim was Managing Director at AMP International, responsible for AMP Bank and the Virgin Direct (now Virgin Money) joint venture. He began his career at Arthur Andersen working in Melbourne and Singapore, and in 1994 he joined Colonial Limited, the mutual financial services group, as Chief Taxation Counsel. He became Group Chief Financial Officer in 1997 and Executive Director of State Bank of New South Wales. Tim subsequently oversaw the IPO of Colonial and was involved in Colonial's subsequent acquisition by Commonwealth Bank – at the time the largest acquisition in Australian corporate history. His previous Non-Executive Director board experience includes Friends Life Group Limited and Monitise plc.

Tim is Chairman at Macquarie Bank International Limited; Non-Executive Director of companies within the Chubb European Group Limited and The Access Bank UK Limited groups; and Non-Executive Director of The Coeliac UK Trading Company Limited.

2. PROPOSED DIRECTORS

The Proposed Directors, who will become directors of the Company following Completion (subject to regulatory approval), are:

Name	Age	Position
Geeta Gopalan [(1)]	54	Independent Non-Executive Director
Darren Pope[(1)]	52	Independent Non-Executive Director
Amy Stirling[(1)]	48	Non-Executive Director

Note

(1) Subject to PRA approval.

2.1 Geeta Gopalan, Independent Non-Executive Director

Geeta Gopalan has over 25 years of experience of financial services and retail banking, particularly payments and digital innovation. Geeta was Director of Payment Services with HBOS plc and previously Managing Director, UK Retail Bank and Business Development Head EME at Citigroup. Geeta was formerly the Chair of Monitise Europe. She is a chartered accountant. Geeta is also a Non-Executive Director of Ultra Electronic Holdings plc and Wizink Bank SA, of which she is Chair of the Audit and Risk Committee and a Non-Executive Member and Vice Chair of the England Committee of the Big Lottery Fund. Geeta was appointed to the board of Virgin Money in July 2015.

2.2 Darren Pope, Independent Non-Executive Director

Darren Pope has over 30 years of experience in retail banking and financial services. Darren held the post of Chief Financial Officer of TSB Bank plc, having taken a lead role in the design and divestment of the TSB business from Lloyds Bank plc and its subsequent IPO and takeover. He previously held a number of executive and senior roles at Lloyds Banking Group plc including Retail Bank Commercial Director. He is a fellow of the Chartered Institute of Certified Accountants. Darren is also Independent Non-Executive Director and Chair of Audit Committee of Equiniti Group plc. Darren was appointed to the board of Virgin Money in March 2017.

2.3 Amy Stirling, Non-Executive Director

Amy Stirling has extensive board, financial and management experience from senior and board roles in a range of sectors including telecommunications, financial services and commerce. She was previously Non-Executive Director at Pets at Home Group plc and the UK Cabinet Office. Amy is a Fellow of the Institute of Chartered Accountants of England and Wales. Amy is also Chief Financial Officer of the Virgin Group and Non-Executive Director and Chair of the Audit and Risk Committee and the Valuation Committee at RIT Capital Partners plc. Amy was appointed to the board of Virgin Money in December 2017.

3. CYBG SENIOR MANAGERS

The CYBG Senior Managers are:

Name	Age	Position
Kate Guthrie	54	Group Human Resources Director
Enda Johnson	38	Group Corporate Development Director
Fergus Murphy	54	Group Customer Value Director
Gavin Opperman	53	Group Customer Banking Director
Helen Page	48	Group Innovation & Marketing Director
James Peirson	40	Group General Counsel
Mark Thundercliffe	53	Group Chief Risk Officer

3.4 Kate Guthrie, Group Human Resources Director

Kate Guthrie joined CYBG Group in January 2016. Kate has over 30 years of domestic and international HR experience, having worked in six different blue chip organisations in four industrial sectors. Kate joined from Lloyds Banking Group after 11 years of service in a number of senior HR director positions, most recently HR Director, Culture, Capability and Engagement.

3.5 Enda Johnson, Group Corporate Development Director

Enda Johnson joined CYBG Group in September 2015. He is responsible for leading the strategic planning process across CYBG, and CYBG's strategic stakeholder engagement plan - fully aligning this to CYBG's cultural transformation and customer / commercial strategies. Before joining CYBG Group, Enda worked at Allied Irish Banks in Dublin, where he joined as Head of Strategy and was appointed to Head of Corporate Affairs / Strategy and the Executive Leadership Team in July 2012. Prior to this, Enda was as a member of the Banking Unit at the Irish National Treasury Management Agency (NTMA), where he worked on the recapitalisation and restructure of Irish banks following the global financial crisis and subsequent programme of financial support for Ireland provided by the IMF, ECB and EU in 2010. Before joining the NTMA, he worked with Merrill Lynch in New York, London and California, in their investment banking and capital markets divisions focusing on client advisory and equity transactions for global clients on a cross industry basis.

3.6 Fergus Murphy, Group Customer Value Director

Fergus Murphy joined CYBG Group in January 2016. He has over 20 years' experience in financial services. Prior to joining CYBG Group, Fergus held a number of key roles at Allied Irish Banks from 2011 until 2015 including Director of Products & Capital Markets and, most recently, Director of Corporate and Institutional Banking. From 2008 until 2011 he served as CEO and managing director of EBS Building Society and EBS Limited. Fergus also held a number of senior positions at Rabobank International between 1994 and 2007. He served as CEO of Asia Region from 2003 and was previously a member of their Global Financial Markets (GFM) Management Team, holding roles as Head of Global Treasury and Head of Global Investment Books. Fergus spent his earlier career in the BNP Group working as a derivatives and corporate trader, in the Markets Division.

3.7 Gavin Opperman, Group Customer Banking Director

Gavin Opperman joined the CYBG Group in November 2015. Gavin has over 30 years of leadership experience in risk, operations and across front line digital, retail, commercial, corporate and investment banking services. Gavin was previously Regional Head of Consumer Banking, Standard Chartered based in China, and prior to that held a number of senior positions across Asia in a career spanning 20 years with Barclays Group

3.8 Helen Page, Group Innovation & Marketing Director

Helen Page joined CYBG Group in December 2012 and has over 25 years' experience in marketing, consultancy and product development. Almost 15 years of those have been spent in financial services. Prior to joining CYBG Group, Helen spent eight years at RBS in a number of roles. She became Managing Director for Marketing and Innovation and held responsibility for all UK brands across the Retail, Commercial and Corporate divisions. During this time, Helen was responsible for developing and delivering "Helpful Banking" for NatWest. Helen was also Head of Brand Marketing at Argos, where she re-launched the catalogue company as a retailer and played a key role when the business became "Retailer of the Year" and "Advertiser of the Year" in 2003. Prior to Argos, Helen held a number of product and marketing roles at Abbey National (now Santander), where she became Head of Marketing. She also has experience in research, consultancy and central government roles. Helen has a degree in economics, development and planning and holds a diploma in Marketing from the Chartered Institute of Marketing.

3.9 James Peirson, Group General Counsel

James Peirson joined NAB in May 2005 and was appointed General Counsel for CYBG Group in November 2014. His previous roles at NAB include leading NAB's London Branch legal team and roles supporting NAB and Clydesdale Bank Treasury activities as part of NAB Group's Capital & Funding legal team in Melbourne and London. Prior to joining NAB, James worked in private legal practice at Hogan Lovells in London.

3.10 Mark Thundercliffe, Group Chief Risk Officer

Mark Thundercliffe was appointed in September 2016 and has 30 years of Financial Services experience. He joined the CYBG Group from HSBC where he was Chief Risk Officer responsible for management and oversight of risk for HSBC's Retail Banking and Wealth Management business in 18 countries across the UK, Europe, the Middle East and Africa. Mark has also held a number of senior international positions including President and CEO (Asia) with Home Credit in Hong Kong and he was also an Executive Director and Business Head (Russia) with Renaissance Capital in Moscow. With Citigroup he progressed from Chief Risk Officer (UK & Ireland) to become CEO of CitiFinancial (Russia). Prior to Citi, he worked with Associates Capital Corporation, latterly as Executive and Business Head, based in India.

4. CYBG DIRECTORS', PROPOSED DIRECTORS' AND CYBG SENIOR MANAGERS' CONFIRMATIONS

Save as disclosed below, during the period of five years preceding the date of this Prospectus none of the CYBG Directors, Proposed Directors or CYBG Senior Managers:

(a) has any convictions in relation to fraudulent offences;

(b) has been associated with any bankruptcy, receivership or liquidation when acting in his or her capacity as a member of the administrative, management or supervisory body or senior manager of another company, save for Teresa Robson-Capps, who was a director at Towergate Partnershipco Limited which was placed into members' voluntary liquidation on 24 August 2015 and Adrian Grace who was a director at Aegon Platform Services Limited which was placed into members' voluntary liquidation on 21 September 2015; or

(c) has received any official public incrimination and/or sanction by any statutory or regulatory authorities (including designated professional bodies) or has been disqualified by a court from acting as a director of a company or from acting in the management or conduct of the affairs of a company.

Save as disclosed in this paragraph, none of the CYBG Directors, Proposed Directors or CYBG Senior Managers has any potential conflicts of interests between their duties to the Company and their private interests or other duties.

5. CORPORATE GOVERNANCE

The CYBG Group is committed to ensuring high standards of corporate governance. Throughout the year ended 30 September 2017 and as at the Latest Practicable Date, CYBG fully complied with all relevant provisions of the April 2016 edition of the UK Corporate Governance Code, except with regard to membership of the Remuneration Committee which from 1 July 2018, following the retirement of David Browne, a former non-executive director and a former member of the Remuneration Committee, comprised two independent non-executive directors in addition to the Chairman. The Governance and Nomination Committee, in consultation with the Chairman of the Remuneration Committee, is reviewing the composition of the

Remuneration Committee and the intention is to appoint a new member to reinstate compliance with the UK Corporate Governance Code.

5.1 **Board composition**

The UK Corporate Governance Code recommends that at least half the members of the board of directors (excluding the chairman) of a company with a premium listing of equity shares in the UK should be independent in character and judgement and free from relationships or circumstances which are likely to affect, or could appear to affect, their judgement.

The UK Corporate Governance Code also recommends that the board should appoint one of the independent non-executive directors as senior independent director to provide a sounding board for the chairman and to serve as an intermediary for the other directors when necessary and David Bennett has been appointed to fill this role. The senior independent director should be available to shareholders if they have concerns with contact through the normal channels of chairman, chief executive or other executive directors has failed to resolve or for which contact is inappropriate.

Currently, the Board comprises 11 members, consisting of the Chairman, three Executive Directors and seven Independent Non-Executive Directors and following Completion and subject to receipt of the relevant regulatory approvals will comprise 14 members, consisting of the Chairman, three Executive Directors, nine Independent Non-Executive Directors and one Non-Executive Director appointed by Virgin Enterprises pursuant to its right under the Brand Licence Agreement. Accordingly, no individual or small group of individuals dominate the Board's decision-making.

5.2 **Board committees**

In accordance with the recommendations of the UK Corporate Governance Code, the Board has established four principal Board committees, namely: the Governance and Nomination Committee; the Remuneration Committee; the Audit Committee; and the Risk Committee, each with formally delegated duties and responsibilities with charters available on CYBG's website. From time to time, separate committees may be set up by the Board to consider specific issues when the need arises. The Board established a special purpose IRB and Credit IFRS 9 Committee to oversee the transition from a standardised approach to calculating capital requirements for credit risk to an IRB approach, and the implementation of the credit element of the IFRS 9 accounting standard which will be effective for the CYBG Group in the reporting period beginning 1 October 2018.

(a) ***Governance and Nomination Committee***

The Governance and Nomination Committee assists the Board in discharging its responsibilities relating to governance and the composition and make-up of the Board. The Governance and Nomination Committee is responsible for evaluating the balance of skills, experience, independence, knowledge and diversity on the Board, the size, structure and composition of the Board, retirements and appointments of additional and replacement directors and will make appropriate recommendations to the Board on such matters. The Governance and Nomination Committee also leads the process for the periodic evaluation of the performance and effectiveness of the Board, Board committees and individual Directors, considers succession planning, taking into account the skills and expertise that will be needed on the Board in the future and makes recommendations to the Board on the CYBG Group's corporate governance arrangements to be consistent with best practice and good corporate governance standards.

The UK Corporate Governance Code provides that a majority of the members of a company's nomination committee should be independent non-executive directors and the chairman or an independent non-executive director should chair the committee.

The Company's Governance and Nomination Committee is composed of three members, namely the Board's Chairman, James Pettigrew, and two Independent Non-Executive Directors, David Bennett and Fiona MacLeod. The Chairman of the Governance and Nomination Committee is James Pettigrew. The Company therefore considers that it complies with the UK Corporate Governance Code recommendations regarding the composition of a company's nomination committee.

(b) ***Remuneration Committee***

The Remuneration Committee assists the Board in determining its responsibilities in relation to remuneration, including making recommendations to the Board on the CYBG Group's policy on executive remuneration, determining the individual remuneration and benefits package of each of the Executive Directors within the CYBG Group, including pension rights and any compensation payments and determining the remuneration arrangements of the CYBG Group senior management and other categories of employees who have a material impact on the CYBG Group's risk profile who sit below Board level.

The UK Corporate Governance Code provides that the remuneration committee should consist of at least three independent non-executive directors. In addition, the chairman of a company may be a member of, but not chair, the remuneration committee if he/she was considered independent on appointment as chairman.

The membership of the Company's Remuneration Committee comprises two Independent Non-Executive Directors namely Adrian Grace, David Bennett, and the Board's Chairman, James Pettigrew, who was considered independent on appointment as Board Chairman. The Chairman of the Remuneration Committee is Adrian Grace.

(c) ***Audit Committee***

The Audit Committee assists the Board in discharging its responsibilities with regard to financial reporting, external and internal audits and controls, including reviewing the Company's annual financial statements, reviewing and monitoring the extent of the non-audit work undertaken by external auditors, advising on the appointment of external auditors, reviewing the effectiveness of the Company's internal audit activities, internal controls and risk management systems, and the application of the CYBG Group whistleblowing procedures. It focuses in particular on compliance with accounting policies and ensuring that an effective system of internal financial control is maintained. The ultimate responsibility for reviewing and approving the annual report and accounts and the half-yearly reports remains with the Board.

The UK Corporate Governance Code recommends that the Audit Committee should consist of at least three independent non-executive directors, that at least one member should have recent and relevant financial experience and that the audit committee as a whole shall have competence relevant to the sector in which the company operates.

The membership of the Company's Audit Committee comprises four Independent Non-Executive Directors (namely, Tim Wade, Clive Adamson, David Bennett and Dr Teresa Robson-Capps). The Chairman of the Audit Committee is Tim Wade. The Board considers that Tim Wade has recent and relevant financial experience, having held a number of senior finance roles. The other Audit Committee members have significant or recent experience in the financial services and banking industries. The Company therefore considers that it complies with the UK Corporate Governance Code recommendations regarding the composition of a company's audit committee.

(d) ***Risk Committee***

The Risk Committee is responsible for providing oversight and advice to the Board in relation to current and potential future risk exposures of CYBG Group and future risk strategy, reviewing and approving various formal reporting requirements, promoting a risk awareness culture within CYBG Group and ensuring that CYBG Group's strategy, principles, policies and resources are aligned to its risk appetite, as well as to regulatory and industry best practices.

The membership of the Company's Risk Committee comprises five Independent Non-Executive Directors namely, Clive Adamson, David Bennett, Paul Coby, Fiona MacLeod and Tim Wade. The Chairman of the Risk Committee is Clive Adamson.

PART XII
QUANTIFIED FINANCIAL BENEFITS STATEMENT

Paragraph 4 of the Announcement contained statements of estimated cost savings and synergies expected to arise from the Offer (together, the "**Quantified Financial Benefits Statement**").

A copy of the Quantified Financial Benefits Statement is set out below:

The CYBG Directors, having reviewed and analysed the potential synergies of the Combined Group, as well as taking into account the factors they can influence, believe that the Combined Group can deliver shareholder value through expected realisation of approximately £120 million of annual pre-tax cost synergies. Incremental to these quantified cost synergies, the Combined Group will benefit from avoiding planned future Virgin Money digital bank running costs, given the existing CYBG capabilities.

It is currently envisaged that the approximately £120 million of annual pre-tax cost synergies will be realised principally from:

i) ***Organisational design:*** *Reduction of FTEs across the Combined Group, removing duplication of senior management roles, delivering approximately £35 million of run rate cost savings.*

ii) ***Central cost management:*** *Approximately £35 million of run rate cost savings generated by rationalisation of the Combined Group's central functions locations; with scale efficiencies in IT, central procurement costs, third party outsourcing and other operating expenses. Central cost management savings are net of incremental trademark licence fees related to the use of the Virgin Money brand.*

iii) ***Operational efficiency:*** *Reduction of FTEs across the Combined Group through removing duplication of central functions roles, integrating customer service operating models and driving efficiencies through increased digitisation and automation, delivering approximately £35 million of run rate cost savings.*

iv) ***Network efficiencies:*** *Optimisation of the Combined Group's branch network, delivering approximately £15 million of run rate cost savings.*

The run rate of these annual pre-tax cost synergies will be fully achieved by the end of the financial year ending 30 September 2021, with approximately 28 per cent. achieved as at 30 September 2019 and approximately 67 per cent. as at 30 September 2020. It is therefore expected that the first year of full run rate cost synergies will be the financial year ending 30 September 2022. The cost synergies recognised during the financial year ending 30 September 2019 are expected to be approximately £20 million and approximately £50 million recognised during the financial year ending 30 September 2020.

The identified recurring cost synergies will accrue as a direct result of the Combination and would not be achieved on a standalone basis.

It is expected that the realisation of these cost synergies would result in one-off pre-tax costs to achieve of approximately £240 million. These are expected to be phased broadly evenly across a three year period: employee restructuring costs and IT migration strategy phased over all three years following completion of the Offer, contract break fees to be recognised in the third year following completion of the Offer, and the optimisation of branches and office locations to be achieved in years two and three following completion of the Offer. Aside from these one-off exceptional costs and the incremental trademark licence fees incorporated into the assessed cost synergies, no material dis-synergies are expected in connection with the Combination.

These statements relating to identified synergies and estimated savings relate to future actions or circumstances which by their nature involve risks, uncertainties and contingencies. As a consequence, the identified synergies and estimated savings referred to may not be achieved, may be achieved later or sooner than estimated, or those achieved could be materially different from those estimated.

Further information on the bases of belief supporting the Quantified Financial Benefits Statement, including the principal assumptions and sources of information, is set out below.

Bases of Belief and Principal Assumptions

Following initial discussions regarding the Combination, a CYBG synergy development team was established to assess the potential synergies arising from the Combination.

The team, which comprises senior CYBG strategy and financial personnel has worked to identify, challenge and quantify potential synergies as well as the potential costs to achieve such synergies. The team has worked with the relevant functional heads and other personnel at both CYBG and Virgin Money to test synergies assumptions and identify synergy initiatives.

In preparing the Quantified Financial Benefits Statement, both CYBG and Virgin Money have shared certain operating and financial information to facilitate the analysis in support of evaluating the potential synergies available from the creation of the Combined Group. However, as is typical of these exercises, confidentiality and regulatory considerations have limited the extent of the sharing of data and information. Where the sharing of data has been limited, the synergy development team has made estimates and assumptions to aid its development of individual synergy initiatives. The assessment and quantification of the potential synergies have, in turn, been informed by the CYBG management's industry experience and knowledge of the existing businesses.

The cost base used for the quantified financial benefits exercise is the combination of the CYBG cost base contained in its 30 September 2017 full year results and the Virgin Money cost base contained in its 31 December 2017 full year results.

In addition to these potential quantified synergies, the CYBG Directors believe that further value can be created through realisation of revenue and funding synergies, as well as the avoided planned future digital bank running costs. These incremental potential synergies have not been quantified for the purposes of reporting under the Takeover Code.

The integration of the businesses will require combining the Virgin Money businesses and group functions with CYBG's business and group functions. It is anticipated that the customer facing brand for the Combined Group will transition to Virgin Money over time.

The CYBG Directors have, in addition, made the following assumptions, all of which are outside their influence:

(A) There will be no material impact on the underlying operations of either CYBG or Virgin Money or their ability to continue to conduct their businesses.

(B) There will be no material change to macroeconomic, political, regulatory or legal conditions in the markets or regions in which CYBG and Virgin Money operate that will materially impact on the implementation or costs to achieve the proposed cost savings.

(C) There will be no change in tax legislation or tax rates or other legislation in the UK that could materially impact the ability to achieve any benefits.

In addition, the CYBG Directors have assumed that the cost synergies are substantively within their control, albeit that certain elements are dependent in part on negotiations with third parties.

Notes

These statements are not intended as a profit forecast and should not be interpreted as such. These statements of estimated synergies relate to future actions and circumstances which, by their nature, involve risks, uncertainties and contingencies. As a result, the estimated synergies referred to may not be achieved, or may be achieved later or sooner than estimated, or those achieved could be materially different from those estimated. Neither the Quantified Financial Benefits Statement nor any other statement in this Prospectus should be construed as a profit forecast or interpreted to mean that CYBG's earnings in the first full year following the Effective Date, or in any subsequent period, will necessarily match or be greater than or be less than those of CYBG or Virgin Money for the relevant preceding financial period or any other period.

Due to the scale of the Combined Group, there may be additional changes to the Combined Group's operations. As a result, and given the fact that the changes relate to the future, the resulting synergies may be materially greater or less than those estimated.

Reports and confirmations

As required by Rule 28.1(a) of the Takeover Code, Deloitte, as reporting accountants to CYBG, and Morgan Stanley and Deutsche Bank, as financial advisers to CYBG, provided the opinions required under that Rule. Copies of these reports were included at Parts B and C of Appendix 4 of the Announcement.

PART XIII
ADDITIONAL INFORMATION

1. RESPONSIBILITY STATEMENT

CYBG, the CYBG Directors and the Proposed Directors, whose names appear in the section entitled "Directors, Proposed Directors, Company Secretary, Registered Office and Advisers", accept responsibility for the information contained in this Prospectus. To the best of the knowledge of CYBG, the CYBG Directors and the Proposed Directors (each of whom have taken all reasonable care to ensure that such is the case) the information contained in this Prospectus is in accordance with the facts and does not omit anything likely to affect the import of such information.

2. COMPANY DETAILS

The Company was incorporated in England and Wales on 18 May 2015 with registered number 9595911 as a public company limited by shares under the 2006 Act with the name Pianodove PLC. Pianodove PLC changed its name to CYBG PLC on 1 October 2015. The principal legislation under which the Company operates is the 2006 Act and the regulations made thereunder. The registered office of the Company is at 20 Merrion Way, Leeds, LS2 8NZ (telephone number: 0113 807 2000). The head office and principal place of business in the UK of the Company is at 30 St Vincent Place, Glasgow, G1 2HL (telephone number: 0141 242 4533).

3. INFORMATION ON THE SHARE CAPITAL

3.1 Issued share capital

The issued and fully paid share capital of CYBG as at the close of business on the Latest Practicable Date consists of:

	Issued and fully paid	Aggregate nominal value
Ordinary shares of £0.10	886,010,853	£88,601,085.30

Save as described in paragraph 3.2 below, none of the capital of the Company has been paid for with assets other than cash within the period from incorporation to the Latest Practicable Date.

3.2 History of share capital

On 18 May 2015, the Company was incorporated as a public limited company with one ordinary £1 share.

Since incorporation, the issued share capital of the Company has been changed as follows:

(a) on 11 September 2015, the Company issued 49,999 ordinary shares of £1.00 each, resulting in an issued share capital of 50,000 ordinary shares;

(b) on 20 November 2015, the 50,000 ordinary shares were consolidated into one ordinary share of £50,000 and then immediately divided into ordinary shares with a nominal value of £1.25 each in the capital of the Company on the basis of 40,000 divided ordinary shares for every one consolidated ordinary share;

(c) on 8 February 2016, CYBG became the new holding company for CYB Investments Limited Group ("**CYBI**") and its subsidiaries by way of a share for share exchange with its then sole shareholder, NAB, and became unconditionally listed on the London Stock Exchange;

(d) on 8 February 2016, the Company issued 879,275,256 £1.25 ordinary shares in exchange for the acquisition of the entire share capital of CYBI which comprised 2,232,012,512 ordinary shares of £0.10 each. The consideration for the issuance of CYBG shares was determined by applying the 5-day volume weighted average price (VWAP) of CYBG shares and CYBG Chess Depositary Instruments ("**CDIs**") over the first 5 trading days from 3 February 2016, giving a value of £1,732 million. The nominal value of the shares issued was £1,099 million and the balance of £633 million was transferred to a merger reserve in accordance with Section 612 of the 2006 Act;

(e) following court approval, on 10 February 2016, the nominal share capital of the Company was reduced to £0.10 per share by the cancellation of £1.15 from the nominal value of each ordinary share; as a result, £1,011 million was transferred to retained earnings;

(f) during the year ended 30 September 2016, 2,216,596 ordinary shares were issued under employee share schemes with an aggregate nominal value of £0.22 million;

(g) during the year ended 30 September 2017, 2,074,214 ordinary shares were issued under employee share schemes with an aggregate nominal value of £0.21 million;

(h) during the six months ended 31 March 2018, 1,545,527 ordinary shares were issued under employee share schemes with an aggregate nominal value of £0.15 million; and

(i) between 1 April 2018 and the Latest Practicable Date, 859,260 ordinary shares were issued under employee share schemes with an aggregate nominal value of £0.09 million.

There have been no other changes in the share capital of CYBG during the period covered by the historical financial information incorporated into this Prospectus.

3.3 **Authorities in relation to share capital**

On 31 January 2018, at the Annual General Meeting of CYBG, CYBG Shareholders resolved that:

(a) the CYBG Directors be generally and unconditionally authorised in accordance with section 551 of the 2006 Act to exercise all the power of the Company to allot shares in the Company and/or to grant rights to subscribe for or to convert any security into shares in the Company:

(A) up to an aggregate nominal amount of £29,498,292 (such amount to be reduced by the aggregate nominal amount allotted or made under paragraph (B) below in excess of such sum); and

(B) comprising equity securities (as defined in section 560(1) of the 2006 Act) up to an aggregate nominal amount of £58,996,584 (such amount to be reduced by the aggregate nominal amount of any allotments or grants made under paragraph (A) above) in connection with an offer by way of a rights issue:

(1) to ordinary shareholders in proportion (as nearly as may be practicable) to their existing holdings; and

(2) to holders of other equity securities as required by the rights of those securities or, subject to such rights, as the CYBG Directors otherwise consider necessary,

and so that the CYBG Directors may impose any limits or restrictions and make any arrangements which they consider necessary or appropriate to deal with treasury shares, fractional entitlements, record dates, legal, regulatory or practical problems in, or under the laws of, any territory or any other matter,

such authorities to apply until the end of the next Annual General Meeting of the Company (or, if earlier, until the close of business on 31 March 2019) (unless previously revoked or varied by the Company in general meeting) but, in each case, so that the Company may make offers and enter into agreements before the authority expires which would, or might, require shares to be allotted or rights to subscribe for or convert securities into shares to be granted after the authority expires and the CYBG Directors may allot shares or grant rights to subscribe for or convert securities into shares under any such offer or agreement as if the authority had not expired.

(b) the CYBG Directors be generally empowered pursuant to section 570 of the 2006 Act to allot equity securities (as defined in section 560(1) of the 2006 Act) for cash pursuant to the authority granted by resolution (a) above and/or pursuant to section 573 of the 2006 Act to sell ordinary shares held by the Company as treasury shares for cash, in each case, as if section 561 of the 2006 Act did not apply to any such allotment or sale, such power to be limited:

(A) to the allotment of equity securities and/or sale of treasury shares for cash in connection with an offer of, or invitation to apply for, equity securities (but in the case of an allotment pursuant to the authority granted under paragraph (B) of resolution (a), such power shall be limited to the allotment of equity securities in connection with an offer by way of a rights issue only):

(1) to ordinary shareholders in proportion (as nearly as may be practicable) to their existing holdings; and

(2) to holders of other equity securities, as required by the rights of those securities or, subject to such rights as the CYBG Directors otherwise consider necessary,

and so that the CYBG Directors may impose any limits or restrictions and make any arrangements which they consider necessary or appropriate to deal with treasury shares, fractional entitlements, record dates, legal, regulatory or practical problems in, or under the laws of, any territory or any other matter; and

(B) in the case of the authority granted under paragraph (A) of resolution (a) and/or in the case of any sale of treasury shares for cash, (in each case, otherwise than under paragraph (A) above), to the allotment of equity securities or sale of treasury shares up to a nominal amount of £4,424,743 calculated, in the case of equity securities which are rights to subscribe for, or to convert securities into, ordinary shares by reference to the aggregate nominal amount of relevant shares which may be allotted pursuant to such rights,

such power to apply until the end of the next Annual General Meeting of the Company (or, if earlier, until the close of business on 31 March 2019) (unless previously revoked or varied by the Company in general meeting) but, in each case, so that the Company may make offers, and enter into agreements before the authority expires, which would, or might, require equity securities to be allotted (and treasury shares to be sold) after the power expires and the CYBG Directors may allot (or sell) equity securities under any such offer or agreement as if the power had not expired.

(c) in addition to any power granted under resolution (b) above, the CYBG Directors be generally empowered pursuant to section 570 of the 2006 Act to allot equity securities (as defined in section 560(1) of the 2006 Act) for cash pursuant to the authority granted by resolution (a) above and/or pursuant to section 573 of the 2006 Act to sell ordinary shares held by the Company as treasury shares for cash, in each case free of the restriction in section 561 of the 2006 Act, such power to be:

(A) limited to the allotment of equity securities and/or sale of treasury shares for cash up to an aggregate nominal amount of £4,424,743 calculated, in the case of equity securities which are rights to subscribe for, or to convert securities into, ordinary shares by reference to the aggregate nominal number of relevant shares which may be allotted pursuant to such rights; and

(B) used only for the purposes of financing (or refinancing, if the authority is to be used within six months after the original transaction) a transaction which the CYBG Directors determine to be an acquisition or other capital investment of a kind contemplated by the Statement of Principles on Disapplying Pre-emption Rights most recently published by the Pre-emption Group prior to the date of the Notice of the 2018 Annual General Meeting of the Company being 7 December 2017,

such power to apply until the end of the next Annual General Meeting of the Company (or, if earlier, until the close of business on 31 March 2019) (unless previously revoked or varied by the Company in general meeting) but, in each case, so that the Company may make offers and enter into agreements before the power expires which would, or might, require equity securities to be allotted or rights to subscribe for or to convert any security into shares to be granted (or treasury shares to be sold) after the power ends and the CYBG Directors may allot equity securities or grant such rights (or sell treasury shares) under any such offer or agreement as if the power conferred hereby had not ended.

Pursuant to the Offer, up to 548,000,000 New CYBG Shares will be issued. Details of the resolutions, authorisations and approvals by virtue of which the New CYBG Shares will be issued, together with details of the AT1 Resolutions, pursuant to which the CYBG Directors will be granted certain authorities to allot CYBG Shares if required in respect of the Virgin Money AT1 Securities and any additional AT1 Securities, are set out in the Notice of General Meeting which is set out at the end of the Circular, and which is incorporated by reference into this Prospectus.

3.4 Issued ordinary share capital immediately following the issue and allotment of the New CYBG Shares

Immediately following the issue and allotment of the New CYBG Shares, CYBG will have in issue up to 1,434,010,853 fully paid ordinary shares of £0.10 each.

3.5 Dilution on issue and allotment of the New CYBG Shares

If Completion occurs, it will result in the issue of 546,954,891 New CYBG Shares to the Virgin Money Shareholders, which would result in the Virgin Money Shareholders holding approximately 38 per cent. of the Combined Group. If Completion occurs, existing CYBG Shareholders will suffer an immediate dilution as a result of the Offer, following which they will hold approximately 62 per cent. of the enlarged issued ordinary share capital of CYBG.

4. INFORMATION ON THE NEW CYBG SHARES

4.1 Description of the type and class of securities admitted

The New CYBG Shares will be ordinary shares with a nominal value of £0.10 each. The ISIN of the New CYBG Shares will be GB00BD6GN030. The New CYBG Shares will be created under the 2006 Act and the CYBG Articles. Following Completion, CYBG will have one class of ordinary shares, the rights of which are set out in the CYBG Articles.

The New CYBG Shares will be credited as fully paid and free from all liens, equities, charges, encumbrances and other interests, and will rank in full for all dividends and distributions on the ordinary share capital of CYBG declared, made or paid with reference to a record date falling on or after the Effective Date.

4.2 Listing

Application will be made to the FCA for the New CYBG Shares to be admitted to the premium segment of the Official List. Application will also be made to the London Stock Exchange for the New CYBG Shares to be admitted to trading on its Main Market. It is expected that Admission will become effective, and that dealings in the New CYBG Shares will commence on the London Stock Exchange, by no later than 8.00 a.m. on the Effective Date, which subject to the satisfaction (or, where permitted, waiver) of certain conditions, is expected to occur in the fourth quarter of calendar year 2018. Listing of the New CYBG Shares is not being sought on any stock exchange other than the London Stock Exchange. Steps will also be taken to allow for the quotation of CDIs representing the New CYBG Shares on the ASX following Completion.

4.3 Form and currency of the New CYBG Shares

The New CYBG Shares will be issued in registered form and will be capable of being held in certificated and uncertificated form.

Title to the certificated New CYBG Shares will be evidenced by entry in the register of members of CYBG and title to uncertificated New CYBG Shares will be evidenced by entry in the operator register maintained by Euroclear (which forms part of the register of members of CYBG). The registrar of CYBG is Computershare.

No share certificates will be issued in respect of the New CYBG Shares in uncertificated form. If any such shares are converted to be held in certificated form, share certificates will be issued in respect of those shares in accordance with the CYBG Articles and applicable legislation.

If passed, the authority to allot New CYBG Shares pursuant to the CYBG Offer Resolution will exist in addition to the allotment authorities currently in existence relating to: (i) the issue of shares up to an aggregate nominal amount of £29,498,292 pursuant to the resolution passed at CYBG's annual general meeting held on 31 January 2018; (ii) the issue of shares up to an aggregate nominal amount of £200,000,000 pursuant to the terms of the Capped Indemnity Deed; and (iii) the issue of shares up to an aggregate nominal amount of £450,000,000 in connection with the issue by the CYBG of £450,000,000 fixed rate reset perpetual subordinated contingent convertible notes.

The New CYBG Shares will be denominated in pounds sterling.

4.4 Rights attached to the New CYBG Shares

Each New CYBG Share will be issued credited as fully paid and will rank *pari passu* in all respects with the Existing CYBG Shares and will have the same rights (including voting and dividend rights and rights on a return of capital) and restrictions as each CYBG Share, as set out in the CYBG Articles. This includes the right to receive and retain in full all dividends and other distributions (if any) made paid or declared with reference to a record date falling on or after the Effective Date.

Please refer to paragraph 12 in this Part XIII (*Additional Information*) for further information about the rights attaching to CYBG Shares, as set out in the CYBG Articles.

4.5 Dates of issue and settlement

The New CYBG Shares are expected to be issued and allotted on the date of Completion, which is expected to be in the fourth quarter of calendar year 2018 and those entitled to the New CYBG Shares are expected to be entered on CYBG's register of members on that day.

4.6 **Description of restrictions on free transferability**

Save as set out in this Prospectus, the New CYBG Shares will be freely transferable.

CYBG may, under the CYBG Articles and the 2006 Act, send out statutory notices to those it knows or has reasonable cause to believe have an interest in its shares, asking for details of those who have an interest and the extent of their interest in a particular holding of shares. When a person receives a statutory notice and fails to provide any information required by the notice within the time specified in it, CYBG can apply to the Court for an order directing, amongst other things, that any transfer of the shares which are the subject of the statutory notice is void.

The CYBG Directors may also, without giving any reason, refuse to register the transfer of any CYBG Shares which are not fully paid.

5. **CDIs**

CDIs are able to be traded on the ASX using CHESS. If Admission occurs, New CYBG Shares will be able to be traded on the London Stock Exchange, but will not be able to be traded on the ASX. This is because ASX rules require all trading to take place on CHESS (the ASX's electronic transfer and settlement system), and the New CYBG Shares cannot be held directly under the CHESS system or traded on the ASX through CHESS directly as UK law and regulation does not permit CHESS to be used for electronic transferring and holding legal title to securities in companies incorporated under the 2006 Act. CDIs have been created to facilitate electronic settlement and transfer of title in Australia for companies in this situation. It will be possible to convert New CYBG Shares into CDIs so that they can be traded on the ASX using CHESS.

The CDIs are a type of depositary interest which provide the holder with beneficial ownership of the underlying CYBG Shares. The legal title to these CYBG Shares is held by CHESS Depositary Nominees Pty Ltd (the "**Authorised Nominee**"), an Australian depositary entity, being an approved general participant of ASX Settlement and a wholly owned subsidiary of the ASX (I 071 346 506/AFSL 254 514). The Authorised Nominee does not receive any fees for acting as the Authorised Nominee in respect of CDIs.

Each CDI represents a beneficial interest in one CYBG Share and, unlike CYBG Shares, each CDI is able to be transferred and settled electronically on the ASX with settlement occurring in CHESS.

There are a number of differences between holding the CDIs and the CYBG Shares. The major differences are that:

- holders of CDIs from time to time ("**CDI Holders**") do not have legal title in the underlying CYBG Shares to which the CDIs relate. Legal title to the CYBG Shares is held by the Authorised Nominee. CDI Holders have beneficial ownership of the underlying CYBG Shares and legal and beneficial ownership of the CDIs; and
- CDI Holders are not be able to vote personally as Shareholders at a meeting of the Company. Instead, CDI Holders are provided with a voting instruction form which enables them to instruct the Authorised Nominee (as legal owner of the CYBG Shares) in relation to the exercise of voting rights. In addition, CDI Holders are able to request the Authorised Nominee to appoint the CDI Holder or a third-party nominated by the CDI Holder as its proxy so that the proxy so appointed may attend meetings and vote personally as the Authorised Nominee's proxy.

5.1 **Summary of rights and entitlements**

If a CDI Holder is sponsored by a participant in CHESS, the holder can hold their CDIs on the CHESS CDI sub-register. Otherwise, the CDIs will be held on the issuer-sponsored CDI sub-register. Each CDI Holder will receive a holding statement which sets out the number of CDIs held by it and the reference number of the holding. These holding statements will be provided to holders when a holding is first established and if there is a change in their holding of CDIs.

CDIs are issued, held and traded subject to the relevant provisions of the CYBG Articles.

A summary of the rights and entitlements of CDI Holders is set out below. Further information about CDIs is available from the Australian Registrar, CHESS or any stockbroker in Australia.

5.2 **Ratio of CDIs to CYBG Shares**

Each CDI represents one underlying CYBG Share.

5.3 Meetings

Where CDI Holders instruct the Authorised Nominee to appoint the CDI Holder or another person nominated for that purpose as its proxy in accordance with the procedures summarised below, the proxy so appointed will be able to attend and vote at meetings as the Authorised Nominee's proxy.

5.4 Voting

In order to vote at a meeting of the Company, a CDI Holder may:

- instruct the Authorised Nominee, as legal owner of the CYBG Shares, to vote the CYBG Shares represented by their CDIs in a particular manner—the instruction form must be completed and returned to the Australian Registrar prior to a record date fixed for the relevant meeting and notified to CDI Holders in the voting instructions included in a notice of meeting; or
- instruct the Authorised Nominee, as legal owner of the CYBG Shares, to appoint the CDI Holder or a third-party nominated for that purpose by the CDI Holder as its proxy so that the proxy so appointed may attend meetings and exercise the votes attached to the CYBG Shares represented by their CDIs as the Authorised Nominee's proxy. The instruction form must be completed and returned to the Australian Registrar prior to a record date fixed for the relevant meeting and notified to CDI Holders; or
- convert their CDIs into a holding of CYBG Shares and vote these at the meeting (this must be undertaken prior to a record date fixed by the Board for determining the entitlement of members to attend and vote at the meeting and, if the holder later wishes to sell their investment on the ASX, it would first be necessary to convert those CYBG Shares back to CDIs).

As CDI Holders will not appear on the Company's share register as the legal holders of CYBG Shares, they will not be entitled to vote at the Company meetings unless one of the above steps is taken.

Further details on the conversion process are set out below. Instruction forms and details of these alternatives will be included in each notice of meeting sent to CDI Holders by the Company.

5.5 Converting CDIs to CYBG Shares

CDI Holders may at any time convert their CDIs to a holding of underlying CYBG Shares by:

- in the case of issuer-sponsored CDIs, notifying the Australian Registrar; or
- in the case of CDIs sponsored on the CHESS sub-register, notifying their CHESS participant.

In both cases, once the Australian Registrar has been notified, it will cancel the CDIs and procure the transfer on the Australian branch register of the relevant number of CYBG Shares from the Authorised Nominee into the name of the former CDI Holder that has requested the conversion (or their CREST participant). The CYBG Shares will then be removed to the Company's UK principal share register and a certificate will be issued in the name of the relevant former CDI Holder or the CYBG Shares deposited into their account with their CREST participant.

Holding CYBG Shares will, however, prevent a person from selling their CYBG Shares on ASX, as only CDIs will be traded on the ASX.

A broker or the Australian Registrar can assist CDI Holders to convert CDIs to CYBG Shares that can be traded on London Stock Exchange. There may be a fee for this service—the Australian Registrar or a broker can advise of this when conversion is arranged by the CDI Holder.

5.6 Resolution Powers

The entitlement of any CDI Holder to CDIs, or any rights attaching to CDIs, are subject to the exercise by a relevant authority of any power existing from time to time under relevant legislation, among others, pursuant to which the shares or other securities of or relating to (or rights attaching to such shares or other securities) a bank, banking group company or investment firm can be compulsorily transferred, cancelled, reduced, suspended or converted into other securities, in each case, in whole or in part and/or any other law, regulation, rule or requirement relating to, or in connection with, the resolution of banks, banking group companies and/or investment in effect and applicable in the UK to the Company or any of its subsidiary undertakings.

5.7 **Converting CYBG Shares to CDIs**

CYBG Shares (including New CYBG Shares) may be converted into CDIs. Holders of CYBG Shares may at any time convert those CYBG Shares to become:

- certificated CDI Holders—by completing and lodging a UK Register Removal and CDI Issuance Form to the Australian Registrar (see details below on where to return the form); and
- CREST holders CDI Holders—by having their CREST participant submit an electronic CREST withdrawal/CDI issuance request.

UK register removal and CDI issuance forms should be returned to Computershare's Global Transaction team.

The Australian Registrar will then move the CYBG Shares to the Australian branch register and procure the transfer of the securities from the holder's name into the name of the Authorised Nominee and establish a CDI holding in the name of the relevant holder in the Company's CDI register. Holding statements will then be issued to the CDI Holder.

A broker or the Australian Registrar can assist a Shareholder to convert CYBG Shares to CDIs. There may be a fee for this service—the Australian Registrar or a broker can advise of this when conversion is arranged by the Shareholder.

5.8 **Communication with CDI Holders**

CDI Holders will receive all notices and company announcements (such as annual reports) that Shareholders are entitled to receive.

5.9 **Dividends and other Shareholder distributions**

The Company is required to treat CDI Holders, in respect of the distribution of dividends and other entitlements, as if they were the holders of the underlying CYBG Shares.

CDIs have all the direct economic benefits of legal ownership to which direct holders of CYBG Shares are entitled.

If a cash dividend or any other cash distribution is declared in a currency other than Australian or New Zealand dollars, the Company will convert that dividend or other cash distribution to which CDI Holders are entitled into:

- Australian dollars for CDI Holders resident in Australia; or
- New Zealand dollars for CDI Holders resident in New Zealand;

and distribute it to the relevant CDI Holders in accordance with the CDI Holder's entitlement. All other holders will receive any cash dividends or cash distributions in pounds sterling.

Due to the need to convert dividends from pounds sterling to Australian or New Zealand dollars in the above mentioned circumstances, CDI Holders may potentially be advantaged or disadvantaged by exchange rate fluctuations, depending on whether the Australian dollar weakens or strengthens against the pound sterling during the period between the declaration of the dividend and conversion into Australian dollars.

5.10 **Corporate Action**

The Company is required to treat CDI Holders, in respect of corporate action, as if they were the holders of the underlying CYBG Shares, to the extent possible.

In addition to the distribution of dividends and other entitlements, corporate action includes, but is not limited to, bonus issues, rights issues, mergers and reconstructions (including any action taken by the Company to reduce, or that will have the effect of reducing, the number of CDIs held by the Authorised Nominee).

5.11 **Takeovers**

If a takeover bid is made in respect of any of the CYBG Shares of which the Authorised Nominee is the registered holder, the Authorised Nominee is prohibited from accepting the offer made under the takeover bid except to the extent that acceptance is authorised by the relevant CDI Holders in respect of the CYBG Shares represented by such holding of CDIs in accordance with the ASX Settlement Operating Rules. The Authorised Nominee must accept a takeover offer in respect of the CYBG Shares represented by such holding of CDIs if a CDI Holder instructs it to do so and must notify the entity making the takeover bid of the acceptance.

5.12 **Rights on liquidation or winding up**

In the event of the Company's liquidation, dissolution or winding up, a CDI Holder will be entitled to the same economic benefit on their CDIs as Shareholders.

5.13 **Other rights**

As CDI Holders will not appear on the Australian branch register as legal holders of CYBG Shares, any other right conferred on CDI Holders may be exercised by means of them instructing the Authorised Nominee.

5.14 **Fees**

It is not expected that a CDI Holder will incur any additional fees or charges as a result of holding CDIs instead of CYBG Shares.

5.15 **Trading in CDIs**

CDI Holders who wish to trade in CDIs will be transferring beneficial title to the CYBG Shares rather than legal title. The transfer will be settled electronically by delivery of the relevant CDIs holding through CHESS, thereby avoiding the need to effect settlement by the physical delivery of certificates. Trading in CDIs is no different to trading in other CHESS-approved securities.

5.16 **Further information**

For further information in relation to CDIs and the matters referred to above, please refer to the ASX website www.asx.com.au (see ASX Guidance Note 5 *CHESS Depositary Interests (CDIs)* and the Authorised Nominee's *Understanding CHESS Depositary Interests*), the ASIC MoneySmart website www.moneysmart.gov.au or contact your broker or the Australian Registrar at the details provided below:

Computershare Investor Services Pty Limited
Yarra Falls
452 Johnston Street
Abbotsford
Victoria 3067
Australia

6. OTHER DIRECTORSHIPS

In addition to their directorships of CYBG and its subsidiaries, the CYBG Directors, the Proposed Directors and the CYBG Senior Managers hold, or have held, the following directorships and are or were members of the following partnerships, within the past five years:

Name	Current directorships / partnerships	Past directorships / partnerships
CYBG Directors		
James Pettigrew	BlueBay Asset Management (Services) Ltd	Hermes Fund Managers Limited
	BlueBay Asset Management LLP	CCAB Limited
	RBC Europe Limited	AON UK Limited
	Rathbone Brothers PLC	Aberdeen Asset Management PLC
	Rathbone Investment Management Limited	Rivercrest Capital LLP
	Lydekker Mews Residents Association Limited	The Edinburgh Investment Trust PLC
	Miton Group PLC	Crest Nicholson Holdings PLC
David Bennett	Blemain Finance Limited	Bank of Ireland (UK) PLC
	Spot Finance Limited	Jerrold Holdings Limited
	Ashmore Group PLC	David Bennett Advisory Ltd
	Paypal (Europe) S.à.r.l et Cie S.C.A.	easyJet PLC
	Together Personal Finance Limited	Homeserve Membership Ltd
David Duffy	NewTA Limited	Allied Irish Banks plc

Name	Current directorships / partnerships	Past directorships / partnerships
Ian Smith	67 Pall Mall Limited	Deloitte LLP
Debbie Crosbie		
Clive Adamson	The Prudential Assurance Company Limited	Financial Conduct Authority
	J.P. Morgan International Bank Limited	
	Ashmore Group PLC	
Paul Coby		Pets at Home Group plc
		Randalls Cottages Ltd
		P&O Ferries Holdings Limited
		The Digital Apprenticeship Company
		The Tech Partnership Limited
		Société Internationale de Télécommunications Aéronautiques
Adrian Grace	Aegon UK Corporate Services Limited	Intrinsic Financial Services Limited
	Aegon UK Services Limited	Aegon UK Distribution Holdings Limited
	Scottish Equitable plc	Scottish Equitable International Holdings PLC
	Aegon UK IT Services Limited	Scottish Equitable Finance Limited
	Scottish Equitable Holdings Limited	Noah Financial Services Limited
	Aegon Investment Solutions Ltd.	Aegon Platform Services Limited
	Aegon Investment Solutions Nominee 1 (Gross) Ltd	Aegon Benefits Solutions Limited
	Aegon Investment Solutions—Nominee 2 (Net) Ltd	Aegon Ireland PLC
	Aegon Investment Solutions—Nominee 3 (ISA) Ltd.	Scottish Financial Enterprise
	Aegon UK Plc	
	Aegon Holdings (UK) Limited	
	Aegon Pensions Trustee Limited	
	Aegon UK Property Fund Limited	
	Scottish Equitable (Managed Funds) Limited	
	Scottish Equitable Life Assurance Society	
	Aegon SIPP Nominee Ltd	
	Aegon SIPP Guarantee Nominee Limited	
	Newcast Property Developments (One) Limited	
	Newcast Property Developments (Two) Limited	
	Momentum Group Limited	
	Cofunds Limited	
	Cofunds Nominees Limited	
	Cofunds Leasing Limited	
	Minster Nominees Limted	
	Dorset Nominees Limited	
	Aegon Investments Limited	

Name	Current directorships / partnerships	Past directorships / partnerships
	Andrew Nominees Limited	
	Victoria Nominees Limited	
	Lochside Nominees Limited	
	Witham Institutional Nominee Limited	
	Aegon SIPP Nominee 2 Limited	
	Origen Trustee Services Limited	
Fiona MacLeod	Denholm Oilfield Services Limited	SThree Plc
		Glendevon Leadership Limited
Dr Teresa Robson-Capps .	Hastings Group Holdings PLC	Towergate Insurance Limited
	Yorkshire Water Services Limited	TIG Finco PLC
	FIL Holdings (UK) Limited	TIG Midco Ltd
		TIG Topco Ltd
		ACS Clothing Group Limited
		Broker Network Holdings Limited
		Paymentshield Group Holdings Limited
		Towergate PartnershipCo Limited
Tim Wade	Macquarie Bank International Limited	Monitise Limited
	The Access Bank UK Limited	Friends Life Group Limited
	The Coeliac Trading Company Limited	Friends Life Holdings PLC
	The AB EBT Limited	Coeliac UK
	ACE Europe Life Limited	RSL Servco Limited
	Chubb Underwriting Agencies Limited	Finance Pronto Limited
	Chubb European Group Limited	
	The Access Group Hong Kong Limited	
Proposed Directors		
Geeta Gopalan	Wizink Bank S.A.	VocaLink Holdings Limited
	Ultra Electronics Holdings Plc	Pilotlight
	Virgin Money Holdings (UK) plc	Advanced Payment Technology Limited
	Virgin Money plc	
	Marlborough College	
	Big Lottery Fund England	
Darren Pope	Virgin Money plc	World Remit Limited
	Virgin Money Holdings (UK) plc	TSB Bank plc
	Equiniti Group plc	TSB Banking Group plc
		TSB Scotland (Investment) Nominees Limited
Amy Stirling	Barfair Limited	Fairbridge Garden Centre Limited
	Classboss Limited	Mviva Limited
	RIT Capital Partners PLC	Old Opal Telecom Limited
	VEL Holdings Limited	Opal Telecommunications PLC
	Virgin Holdings Limited	Pets at Home Group PLC
	Virgin Management Limited	Prince's Trust International
	Virgin Money Holdings (UK) plc	Switch2 Telecoms Limited
	Virgin UK Holdings Limited	
	Virgin.com Limited	
	VM Advisory Limited	

Name	Current directorships / partnerships	Past directorships / partnerships
CYBG Senior Managers		
Kate Guthrie	Action for Children Action for Children Services Ltd Action for Children (Scotland) Ltd	Scottish Widows Pension Trustees Limited Scottish Widows Services Limited Bank of Scotland Foundation
Enda Johnson		
Fergus Murphy		IBEC Limited EBS Designated Activity Company Haven Mortgages Limited AIB Capital Markets PLC AIB Corporate Finance Financial Services Ireland
Gavin Opperman		Standard Chartered Bank (Hong Kong) Ltd Standard Chartered Bank Korea Limited Standard Chartered Korea Limited Standard Chartered Bank (China) Limited
Helen Page		
James Peirson		
Mark Thundercliffe		Marks & Spencer Financial Services PLC HFC Bank Metropolitan Collection Services Limited HSBC Bank A.S Turkey

7. INTERESTS OF THE CYBG DIRECTORS, PROPOSED DIRECTORS AND CYBG SENIOR MANAGERS

7.1 *CYBG Shares*

As at the Latest Practicable Date, the interests (all of which are beneficial) of the CYBG Directors, the Proposed Directors and the Senior Managers, their immediate families and (so far as is known to them or could with reasonable diligence be ascertained by them) persons connected (within the meaning of section 252 of the 2006 Act) with the CYBG Directors and Proposed Directors in the issued share capital of CYBG, including: (i) those arising pursuant to transactions notified to CYBG pursuant to the Market Abuse Regulation; or (ii) those of connected persons of the CYBG Directors and the Proposed Directors, which would, if such connected person were a CYBG Director or Proposed Director, be required to be disclosed under (i) above, together with such interests as are expected to subsist immediately following Admission are set out in the following table.

	As at the Latest Practicable Date		Interests Immediately following Admission[(1)]	
	Number of CYBG Shares	Percentage of issued share capital of CYBG	Number of CYBG Shares	Percentage of issued share capital of Combined Group
CYBG Directors*				
James Pettigrew	50,000	0.006%	50,000	0.003%
David Bennett	16,386	0.002%	16,386	0.001%
David Duffy	213,438**	0.024%	213,438**	0.015%
Ian Smith	138,070***	0.016%	138,070***	0.010%
Debbie Crosbie	140,771****	0.016%	140,771****	0.010%
Clive Adamson	0	0%	0	0%
Paul Coby	0	0%	0	0%
Adrian Grace	16,220	0.002%	16,220	0.001%
Fiona MacLeod	7,000	0.001%	7,000	0.001%
Dr Teresa Robson-Capps	0	0%	0	0%
Tim Wade	20,000	0.002%	20,000	0.001%
Proposed Directors				
Geeta Gopalan	0	0	0	0
Darren Pope	0	0	0	0
Amy Stirling	0	0	0	0
CYBG Senior Managers				
Kate Guthrie	29,342****	0.003%	29,342****	0.002%
Enda Johnson	37,768****	0.004%	37,768****	0.003%
Fergus Murphy	362,890****	0.041%	362,890****	0.025%
Gavin Opperman	47,084****	0.005%	47,084****	0.003%
Helen Page	58,151****	0.007%	58,151****	0.004%
James Peirson	51,936*****	0.006%	51,936*****	0.004%
Mark Thundercliffe	23,532******	0.003%	23,532******	0.002%

* David Browne, a CYBG Director at the date of the Announcement, holds 5,000 CYBG Shares. David Browne is no longer a director of CYBG having stepped down following his resignation on 30 June 2018, as announced on 28 March 2018.

** this includes 415 shares held via the CYBG SIP, and CDIs which represent interests in 4,080 CYBG shares beneficially owned

*** this includes 1,218 shares held via the CYBG SIP and CDIs which represent interests in 4,502 CYBG shares beneficially owned

**** this includes 415 shares held via the CYBG SIP

***** this includes 415 shares held via the CYBG SIP and CDIs which represent interests in 266 ordinary shares beneficially owned

****** this includes 159 shares held via the CYBG SIP

(1) Figures are calculated assuming that the interests in CYBG of the CYBG Directors, the Proposed Directors and the CYBG Senior Managers as at close of business on the Latest Practicable Date do not change other than pursuant to the issue of the New CYBG Shares, that 546,954,891 New CYBG Shares are issued in connection with the Offer and that no further issues of CYBG Shares occur between the Latest Practicable Date and Admission.

7.2 *Share Plans*

In addition to their interests disclosed above, as the Latest Practicable Date, the following CYBG Directors and CYBG Senior Managers had the following outstanding awards over CYBG Shares:

Name	Award date	Plan	CYBG Shares under award at Latest Practicable Date	Vesting date
David Duffy	09/03/2017	Long Term Incentive Plan	375,897	09/03/2020
	24/11/2017	Long Term Incentive Plan	319,284	01/12/2020
	11/02/2016	Deferred Equity Plan	768,560	11/02/2019
	24/11/2017	Deferred Equity Plan	80,459	20/06/2018
Ian Smith	09/03/2017	Long Term Incentive Plan	172,912	09/03/2020
	24/11/2017	Long Term Incentive Plan	146,871	01/12/2020
	11/02/2016	Deferred Equity Plan	230,568	11/02/2019
	24/11/2017	Deferred Equity Plan	36,973	20/06/2018
Debbie Crosbie	09/03/2017	Long Term Incentive Plan	169,153	09/03/2020
	24/11/2017	Long Term Incentive Plan	143,678	01/12/2020
	11/02/2016	Deferred Equity Plan	230,568	11/02/2019
	24/11/2017	Deferred Equity Plan	36,206	20/06/2018
CYBG Senior Managers				
Kate Guthrie	09/03/2017	Long Term Incentive Plan	114,648	09/03/2020
	24/11/2017	Long Term Incentive Plan	97,381	01/12/2020
	11/02/2016	Deferred Equity Plan	39,068	11/02/2019
	24/11/2017	Deferred Equity Plan	22,222	20/06/2018
Enda Johnson	09/03/2017	Long Term Incentive Plan	101,492	09/03/2020
	24/11/2017	Long Term Incentive Plan	89,399	01/12/2020
	11/02/2016	Deferred Equity Plan	71,732	11/02/2019
Fergus Murphy	09/03/2017	Long Term Incentive Plan	131,564	09/03/2020
	24/11/2017	Long Term Incentive Plan	111,749	01/12/2020
	11/02/2016	Deferred Equity Plan	44,832	11/02/2019
	24/11/2017	Deferred Equity Plan	17,432	20/06/2018
Gavin Opperman	09/03/2017	Long Term Incentive Plan	142,841	09/03/2020
	24/11/2017	Long Term Incentive Plan	143,678	01/12/2020
	11/02/2016	Deferred Equity Plan	44,832	11/02/2019
	31/05/2016	Deferred Equity Plan	56,448	31/05/2019
	24/11/2017	Deferred Equity Plan	32,758	20/06/2018
Helen Page	09/03/2017	Long Term Incentive Plan	105,251	09/03/2020
	24/11/2017	Long Term Incentive Plan	89,399	01/12/2020
	11/02/2016	Deferred Equity Plan	122,969	11/02/2019
James Peirson	09/03/2017	Long Term Incentive Plan	77,058	09/03/2020
	24/11/2017	Long Term Incentive Plan	76,628	01/12/2020
	11/02/2016	Deferred Equity Plan	102,474	11/02/2019
Mark Thundercliffe	09/03/2017	Long Term Incentive Plan	140,961	09/03/2020
	24/11/2017	Long Term Incentive Plan	119,731	01/12/2020
	11/02/2016	Deferred Equity Plan	12,254	20/09/2018
	24/11/2017	Deferred Equity Plan	22,988	20/06/2018

8. COMPENSATION

The remuneration policy of CYBG is set out on pages 99 to 107 of the CYBG Annual Report 2017, which is incorporated by reference into this Prospectus. The CYBG Directors are compensated in accordance with this remuneration policy.

8.1 Total remuneration

In the financial year ended 30 September 2017, the aggregate total remuneration paid (including contingent or deferred compensation) and benefits in kind granted (under any description whatsoever) to the CYBG Directors and CYBG Senior Managers by members of CYBG Group was £13.5 million.

Details of the Executive Directors' total remuneration for the year ended 30 September 2017 are incorporated by reference from the CYBG Annual Report 2017, under the "*Executive Directors - single total figure of remuneration (audited)*" heading in the Directors' Remuneration Report on page 109.

Details of the Non-Executive Directors' total remuneration for the year ended 30 September 2017 are incorporated by reference from the CYBG Annual Report 2017, under the "*Non-Executive Directors (Audited)*" heading in the Directors' Remuneration Report on page 114.

8.2 Pension entitlements

The aggregate amounts set aside or accrued by the CYBG Group to provide pension, retirement or similar benefits for the CYBG Directors and CYBG Senior Managers for the year ended 30 September 2017 was £40,311.

9. DETAILS OF THE CYBG DIRECTORS' SERVICE CONTRACTS

Details of the terms of the Directors' service contracts are incorporated by reference from the CYBG Annual Report 2017, under the "*Service contracts and policy on payments for loss of office*" heading in the Directors' Remuneration Report on pages 105 and 106.

Each Proposed Director has entered into a letter of appointment with the Company which takes effect from Completion, subject to the usual regulatory approvals, as follows:

(a) Geeta Gopalan will be engaged as an independent non-executive director under an appointment letter dated 24 July 2018 and approved by the CYBG Board on 30 July 2018. She will also serve as a member of the CYBG Risk Committee and will be entitled to a fee of £70,000 per annum and an additional fee of £10,000 per annum for her role as a member of the CYBG Risk Committee;

(b) Darren Pope will be engaged as an independent non-executive director under an appointment letter dated 26 July 2018. He will also serve as a member of the CYBG Audit Committee and will be entitled to a fee of £70,000 per annum and an additional fee of £10,000 per annum for his role as a member of the CYBG Audit Committee; and

(c) Amy Stirling will be engaged as a non-executive director under an appointment letter dated, and approved by the CYBG Board on, 30 July 2018 pursuant to her nomination by VEL under the terms of the Brand Licence Agreement.

Where relevant, the fees set out above are inclusive of any further amounts due for holding additional offices, directorships or committee appointments within CYBG Group.

Each of the Proposed Directors will also be appointed as a non-executive director of Clydesdale Bank PLC under separate appointment letters which also take effect from Completion, subject to the usual regulatory approvals.

Each of the Proposed Directors will be engaged for an initial term of three years, but terminable by either party on not less than three months' written notice. Upon termination, the Proposed Directors are not entitled to receive any payments or benefits other than, to the extent applicable, accrued fees for past services, payment of fees in lieu of notice and reimbursement for any outstanding reasonably incurred expenses.

Each Proposed Director is eligible for directors' and officers' liability insurance cover and reimbursement of reasonable business expenses. The Proposed Directors are not entitled to participate in CYBG Group's bonus, share or other incentive arrangements.

Each Proposed Director is subject to a confidentiality undertaking without limitation in time. They are not subject to post-termination restrictive covenants.

The current intention is that on Completion, each of the CYBG Directors at that time (including the Proposed Directors) will become directors of Virgin Money alongside the Proposed Directors, subject to any necessary regulatory approvals.

10. MAJOR CYBG SHAREHOLDERS

As at the Latest Practicable Date, CYBG had been notified in accordance with Rule 5 of the Disclosure Guidance and Transparency Rules of the following interests in its ordinary shares:

Name of CYBG Shareholder	Number of issued shares held	Percentage of issued share capital	Percentage of issued share capital of the Combined Group
Coopers Investors Pty Ltd	52,888,470	5.97%	3.69%
Investors Mutual Limited	45,016,877	5.08%	3.14%
Schroders PLC	44,572,459	5.03%	3.11%
Perpetual Limited and subsidiaries	44,463,361	5.02%	3.10%
Pendal Group Limited	36,399,949	4.11%	2.54%
JCP Investments Partners Ltd	35,251,058	3.98%	2.46%
BT Investment Management Limited	27,036,329	3.05%	1.89%
AMP Life Limited, AMP Capital Investors Limited, Ipac Asset Management Limited, AMP Capital Investors (NZ) Limited	26,608,485	3.00%	1.86%

This table details interests in CYBG's voting rights which have been notified to CYBG under Rule 5 of the Disclosure Guidance and Transparency Rules as at the Latest Practicable Date. It assumes that 546,954,891 ordinary shares are issued to the Virgin Money Shareholders in connection with the Offer and that no further issue of CYBG Shares occur between the Latest Practicable Date and the date of Completion.

Save as disclosed above, CYBG is not aware of any person who, as at the Latest Practicable Date, directly or indirectly, has a holding of CYBG Shares which is notifiable under English law.

Following Completion and Admission, the Virgin Money Shareholders will in aggregate hold approximately 38 per cent. of the Combined Group and Virgin Holdings will hold approximately 13 per cent. of the Combined Group.

Save as set out above, CYBG, the CYBG Directors and the Proposed Directors are not aware of any persons who, as at the Latest Practicable Date, directly or indirectly, jointly or severally, exercise or could exercise control over CYBG nor is it aware of any arrangements the operation of which may at a subsequent date result in a change of control of CYBG.

None of the Shareholders referred to in this paragraph 10 has different voting rights from any other CYBG Shareholder in respect of any CYBG Shares held by them.

11. RELATED PARTY TRANSACTIONS

Details of related party transactions (which for these purposes are those set out in the standards adopted according to Regulation (EC) No 1606/2002) that CYBG has entered into are set out below:

(a) during the financial year ended 30 September 2017, such transactions are disclosed in accordance with the respective standard adopted according to Regulation (EC) No 1606/2002 in notes 5.3 and 6.6 on pages 240 and 248, respectively, of the CYBG Annual Report 2017 which is hereby incorporated by reference into this Prospectus; and

(b) during the financial years ended 30 September 2016 and ended 30 September 2015, such transactions are disclosed in accordance with the respective standard adopted according to Regulation (EC) No 1606/2002 in note 12 on pages 237-240 of the CYBG Annual Report 2016 which is hereby incorporated by reference into this Prospectus.

During the period from 30 September 2017 up to the Latest Practicable Date, CYBG entered into the following related party transactions:

Transactions with pension schemes

CYBG Group incurred costs in relation to pension scheme administration. These costs, which amounted to £0.3 million as at 30 June 2018, were charged to the CYBG Group sponsored scheme. CYBG Group has deposits of £27 million at 30 June 2018 placed by the Scheme at market rates.

Pension contributions of £14 million were made during the period to 30 June 2018 to the Yorkshire and Clydesdale Bank Pension Scheme sponsored by CYBG Group.

Save as disclosed above CYBG Group has not entered into any material related party transactions between 1 October 2017 and the Latest Practicable Date.

12. ARTICLES OF ASSOCIATION OF CYBG

The CYBG Articles are available for inspection at the address specified in paragraph 27 below. CYBG's objects are unrestricted save to the extent otherwise provided in the CYBG Articles.

A summary of the CYBG Articles can be found under the heading "*Articles of Association*" on pages 422 to 434 of the CYBG IPO Prospectus (which is incorporated by reference into this Prospectus).

13. CYBG GROUP MATERIAL CONTRACTS

The following contracts (not being contracts entered into in the ordinary course of business) have been entered into by CYBG or another member of the CYBG Group either: (i) within the period of two years immediately preceding the date of this Prospectus which are or may be material to the CYBG Group; or (ii) which contain any provisions under which any member of the CYBG Group has any obligation or entitlement which is, or may be, material to the CYBG Group as at the date of this Prospectus.

13.1 Sponsor's Agreement

On 31 July 2018, the Company and Morgan Stanley (the "**Sponsor**") entered into a sponsor's agreement, pursuant to which the Company appointed Morgan Stanley as sponsor in connection with the applications for Admission and the publication of this Prospectus and the Circular (the "**Sponsor's Agreement**"). Under the terms of the Sponsor's Agreement, the Company has agreed to provide the Sponsor with certain customary indemnities, undertakings, representations and warranties. The indemnities provided by the Company indemnify the Sponsor and its associates against, inter alia, claims made against them or losses incurred by them in connection with the Offer, Admission or the arrangements contemplated by this Prospectus, the Circular and other relevant documents, subject to certain exceptions. In addition, the Sponsor's Agreement provides that the Sponsor may, in its absolute discretion terminate the Sponsor's Agreement before Admission in certain specified circumstances which are customary for an agreement of this nature.

13.2 Co-operation Agreement

For a description of the principal terms of the Co-operation Agreement, please refer to paragraph 9 of Part I (*Information About the Offer*) of this Prospectus.

13.3 Brand Licence Agreement

CYBG will be licensed to use the "Virgin Money" and "Virgin" trade marks under the Brand Licence Agreement. The Brand Licence Agreement amends and restates, from Completion, the Existing Brand Licence Agreement in place between Virgin Enterprises Limited ("**VEL**") and Virgin Money and which was entered into on 1 October 2014.

The definitive terms of the Brand Licence Agreement were agreed between CYBG and VEL on 18 June 2018. On Completion, the amendments agreed to the Existing Brand Licence Agreement will be made and at the same time that agreement will be novated from Virgin Money to CYBG ("**Novation Effective Date**").

Grant

The Brand Licence Agreement grants, subject to certain exclusions and reservations of rights, CYBG exclusive rights to use the "Virgin Money" names and logos (and several "Virgin Money" sub-brands including the "Virgin Money Giving" trade mark (together, the "**Virgin Money Trade Marks**")) for financial services and products as defined below, and certain related non-exclusive licences in respect of the "Virgin" trade marks (together with the Virgin Money Trade Marks, the "**Licensed Trade Marks**"). The licences are granted on a perpetual basis, subject to the parties' rights to terminate the Brand Licence Agreement described below. The territorial scope of the licences granted by VEL is limited to the United Kingdom (the "**Territory**").

CYBG is granted, subject to certain exclusions and reservations of rights, the exclusive right to use the Virgin Money Trade Marks in respect of all banking and financial services and products which are offered in the ordinary course of business by UK clearing banks or challenger banks, all investment or savings products and services, and all insurance products and services ("**Financial Services**").

VEL also grants certain non-exclusive licences which include the right for CYBG to use the Licensed Trade Marks in relation to:

(a) subject to certain restrictions, activities which are ancillary to or incidental to Financial Services;

(b) products or services which consist of or relate to both Financial Services provided by or on behalf of CYBG under the Licensed Trade Marks and own-branded services and products provided by a third party partner including through or as part of CYBG's branches or online portals;

(c) sponsorship activities in relation to the promotion of the CYBG Group's business;

(d) any activity carried out for the purpose of raising capital or finance to be deployed in carrying on its business (excluding for the benefit of any person outside the Combined Group), and the holding of shares or other investments in any corporate or other entity or organisation carrying out the activities licensed in respect of Financial Services or under (a) and (b) above;

(e) signage, advertisements, promotional brochures, CYBG's permitted e-presence and other materials in connection with and in the ordinary course of the activities described at (a) and (b) above;

(f) promotional products and activities whose purpose is to promote Financial Services, but which are not charged for/are for charitable purposes; and

(g) part of its business, trading or registered company name, or lender of record name and to use the same on its corporate materials and communications which bear the company name.

VEL also grants the Company: (i) an exclusive licence to use certain 'legacy' brands in relation to Financial Services in respect of credit cards until 1 October 2019; and (ii) a licence to use various domain names (including those containing the Licensed Trade Marks).

The licences granted by VEL are sub-licensable by CYBG to a member of its group, or to a third party, without the consent of VEL subject to certain conditions. Rights of first refusal also apply in certain circumstances, as described below. Sub-licences are not permitted in respect of an activity that would reasonably be considered to be immoral, unlawful or exploitative of the weak but excluding in the ordinary course the enforcement of legal rights (including repossessions and enforcement of debts).

Must-Use

CYBG will be required to operate at least 80 per cent. of its activities which fall within the scope of the Brand Licence Agreement, calculated quarterly by reference to the Combined Group's relevant turnover, under the "Virgin Money" brand, following the rebranding period (which is expected to be no later than 3 years from the Novation Effective Date).

The remaining 20 per cent. of the Combined Group's relevant turnover may be generated under non-Licensed Trade Marks through a defined set of circumstances, including:

(a) under CYBG's brands existing at the time the definitive terms of the Brand Licence Agreement were agreed as: (i) part of corporate names as at the Novation Effective Date, including in order to issue commercial bank notes in Scotland; (ii) for the purposes of maintaining CYBG's trade mark registrations; and (iii) for developing and testing new products and services, provided that an alternate brand is not promoted by CYBG as its "innovation brand";

(b) the Yorkshire and Clydesdale brands for CYBG's SME and corporate business, unless the Board decides to rebrand the SME and corporate business under the Licensed Trade Marks;

(c) in respect of acquisitions which do not result in CYBG failing to comply with the 80 per cent. must-use requirements (otherwise such acquisitions must be rebranded); and

(d) pursuant to a marketing arrangement, third party partnership or other joint venture, except for such arrangements entered into following the rebranding period.

Breaches of the must-use requirement are capable of remedy.

Rights of First Refusal and duties to mitigate the risk of confusion

The Brand Licence Agreement contains rights of first refusal in respect of VEL granting the right to a third party to offer Financial Services in any other part of the EEA as described below:

(a) if VEL: (i) has a bona fide intention to offer Financial Services in Ireland under any of the Licensed Trade Marks, or is approached by a third party that demonstrates to VEL a bona fide and credible proposal to provide Financial Services in Ireland under any of the Licensed Trade Marks; or (ii) receives an unsolicited and credible offer from a third party which operates an Irish clearing bank offering Financial Services in Ireland to rebrand its business under the Licensed Trade Marks, VEL is required to notify CYBG. CYBG shall within 30 days notify VEL whether it wishes to explore the opportunity further. If it does, the parties shall discuss the opportunity in good faith on an exclusive basis, or in the case of (ii) a non-exclusive basis, until the earlier of (a) 60 days following CYBG notifying VEL, and (b) CYBG confirming it does not wish to proceed. In the case of (ii), the periods of time can be reduced by agreement; and

(b) if VEL: (i) has a bona fide intention to offer Financial Services in the EEA other than in the United Kingdom or Ireland under any of the Licensed Trade Marks, or is approached by a third party that demonstrates to VEL a bona fide and credible proposal to provide Financial Services in the EEA under any of the Licensed Trade Marks; or (ii) receives an unsolicited and credible offer from a third party which operates a clearing bank offering Financial Services in the EEA to rebrand its business under the Licensed Trade Marks (subject to the below), VEL is required to notify CYBG. CYBG shall notify VEL within 15 days whether it wishes to explore the opportunity further, following which the parties shall discuss on a non-exclusive basis, until the earlier of (a) 30 days following CYBG notifying VEL, and (b) CYBG confirming it does not wish to proceed. In the case of (ii), VEL is not required to notify CYBG if the third party is, in VEL's reasonable opinion, a bank which is significantly larger than CYBG.

If, following the processes described above, VEL grants a new licence to a third party to use the Licensed Trade Marks in relation to any Financial Services in the EEA, VEL is required to discuss in good faith any reasonable suggestions or concerns CYBG has to mitigate the risk of confusion with or damage to CYBG's business, and shall procure that its licensee takes all reasonable steps to mitigate any confusion.

The Brand Licence Agreement contains further rights of first refusal in respect of CYBG offering services (including under third party brands) through its branches or online portals which are licensed to another VEL licensee, or a VEL licensee offering a service ancillary to its business which constitutes a Financial Service. In each case, if a VEL licensee or CYBG (as applicable) is willing and able to offer the relevant product or service, then an offer must be obtained and the offeree must not enter into an agreement with a third party for the provision of the product or service on terms which are on aggregate less favourable than those offered by the offeror. VEL is obliged to include this right of first refusal in favour of CYBG in its future licences, and to use all reasonable endeavours to ensure its licensees comply with the right.

Governance

VEL shall at all times during the term of the Brand Licence Agreement be entitled to nominate, remove, or reappoint one person as a director of CYBG (the "**Representative Director**"). CYBG may only object to a proposed appointee by VEL if CYBG (in its reasonable opinion) determines that such appointment or continuation in office would have a material adverse effect on the reputation or good standing of CYBG.

CYBG agrees that it shall not propose any resolution to its shareholders which would, if passed, remove, reduce, restrict, impair or otherwise prejudice the rights and powers of VEL and the Representative Director set out in the governance-related provisions of the Brand Licence Agreement, the articles of association of CYBG, or any letter of appointment.

The Representative Director must resign (without the right to seek compensation) upon termination of the Brand Licence Agreement, and CYBG can terminate the appointment of the Representative Director if he or she materially breaches his or her obligations under the terms of his or her letter of appointment, is removed from office by the shareholders, or is disqualified from his or her position by operation of law.

Royalties

CYBG shall pay to VEL under the Brand Licence Agreement:

(a) a pro-rated royalty payment of up to £3,000,000 for the period from the Novation Effective Date to the First Quarter Date following the Novation Effective Date;

(b) £12,000,000 for the 12 months following the First Quarter Date (Year 1);

(c) £13,000,000 for the 12 months following the end of Year 1 (Year 2);

(d) £14,000,000 for the 12 months following the end of Year 2 (Year 3); and

(e) £15,000,000 for the 12 months following the end of Year 3 (Year 4).

Thereafter, for each 12-month period (the relevant royalty period), the royalty shall be, (A) a minimum royalty of £15,000,000 (the "**Minimum Royalty**"), plus, unless the Combined Group generates relevant turnover greater than £2.1 billion in Year 3 (the "**Threshold Amount**"), (B) a one per cent royalty on any incremental relevant turnover against Year 3 relevant turnover.

If the Combined Group relevant turnover exceeds the Threshold Amount in Year 3, then thereafter (including in Year 4), for each relevant royalty period, the royalty shall be: (A) the Minimum Royalty; plus (B) a 1 per cent. royalty on incremental Combined Group relevant turnover above £2.1 billion.

In respect of certain material acquisitions, the Brand Licence Agreement provides for a reduced royalty on the turnover of the acquired business for a limited period following its acquisition. For the reduced royalty to apply, the turnover of the acquired business (calculated by reference to the turnover of that business in the 12-month period prior to notice of the proposed acquisition being given) must be equivalent to more than 20 per cent. of the sum of: (i) Combined Group relevant turnover; and (ii) the turnover of the acquired business. If CYBG completes such an acquisition, the royalty payable on incremental Combined Group relevant turnover which is attributable to the acquired business is reduced by 50 per cent. for the shorter of: (i) the completion of the rebrand of that business to operate under the Licensed Trade Marks; and (ii) 18 months from the completion of the acquisition.

The Minimum Royalty is subject to indexation (calculated by reference to the percentage change in the UK Consumer Price Index during the relevant period) from the fifth year following Completion, with any change in the amount of the Minimum Royalty payable as a result of indexation being set-off (to the extent possible) against the amount of the royalty payable on applicable incremental Combined Group relevant turnover. All amounts payable under the Brand Licence Agreement are exclusive of applicable VAT.

Termination

VEL has the right to terminate the Brand Licence Agreement by written notice if CYBG:

(a) challenges VEL's ownership of, entitlement to license and/or the validity of the Licensed Trade Marks;

(b) is insolvent;

(c) is in continuing material breach which is not remedied;

(d) is in material breach through any act or omission which: (i) results in the "Virgin Money" name being brought into serious disrepute; and (ii) has a material adverse impact on the "Virgin" trade marks and VEL's group;

(e) undergoes a change of control unless the change of control is a permitted change of control, which includes any change of control arising from any sale of the shares of CYBG which has been consented to by VEL and VEL shall only be entitled to withhold consent if the purchaser is: (i) a direct competitor of VEL or any of its licensees in the Territory; or (ii) involved in any business, or activity, or possesses a reputation of financial standing, which would be reasonably likely to materially damage the value or reputation of the Licensed Trade Marks;

(f) fails to procure, where so required that a guarantee of CYBG's payment obligations under the Brand Licence Agreement is entered into by a member of the acquirer's group within 20 business days of a permitted change of control;

(g) acquires a company or business which engages in any Prohibited Activity; or

(h) deliberately and intentionally is in a continuing material breach of the must-use requirement, or transfers a material proportion of the Combined Group's assets out of the Combined Group deliberately and intentionally to circumvent and deprive VEL of substantially all of the intended economic benefit of the Brand Licence Agreement. On termination in these circumstances becoming effective, CYBG is required to pay to VEL in lieu of damages the Exit Fee as described below.

CYBG has the right to terminate the Brand Licence Agreement if: (i) VEL, or a VEL licensee, or any of their respective employees, directors, agents or representatives, commits any act or omission which brings the

"Virgin" trade marks into serious disrepute or has a material adverse impact on CYBG's business; (ii) VEL is insolvent; or (iii) CYBG undergoes a change of control provided that notice of termination is given within 60 days of the change of control and the Exit Fee as described below is paid.

On termination of the Brand Licence Agreement, CYBG is afforded a two year debranding period.

Acquisitions of CYBG

On an acquisition of CYBG, CYBG can elect to terminate the Brand Licence Agreement within 60 days of completion of the acquisition, with the termination becoming effective subject to the payment of the exit fee to VEL as described below (the "**Exit Fee**").

If the Exit Fee is payable prior to the end of Year 3, it shall be £250,000,000. From Year 4 onwards, the Exit Fee shall be an amount equal to the net present value of royalties for a 40-year period from the date of termination, calculated using the following formula:

$$TP = \sum_{t=1}^{40} \frac{RP\ * (1+g)^t}{(1+(g+5\%))^t}$$

where:

TP is the termination payment;

t is the number of years over which the calculation applies, ranging from t=1, 2, 3, … up to a maximum of 40 (where 1 denotes the first anniversary of the date of termination);

RP is an amount equivalent to the royalty payments payable to VEL in the 12 month period prior to the date of termination; and

g is the long-term growth rate for royalty payments and shall be equal to the simple average of the annual nominal growth rates for UK gross domestic product for the maximum forecast period as set by the Office for Budget Responsibility in its latest Economic and Fiscal Outlook, Table Long-term economic determinants.

If CYBG does not wish to terminate the Brand Licence Agreement then it continues in full force and effect save that a suitably creditworthy member of the acquirer group can be required by VEL to provide a guarantee in respect of CYBG's payment obligations under the Brand Licence Agreement. A failure to do so constitutes a termination right for VEL (as set out above).

VEL's Reserved Rights

The Brand Licence Agreement includes a reservation of rights by VEL which covers certain services in relation to investment banking. VEL may further to use, or license any VEL licensee to use, any Virgin trade mark (but not the Virgin Money Trade Marks) or any translation thereof in relation to:

(a) raising equity or debt or other finance for itself or any other VEL licensee or making its own investments;

(b) the provision of services and products other than the Financial Services to any person;

(c) the establishment and operation of any collective investment scheme either by way of any single offer or series of related offers, to be no more than 250 private customers or private investors in circumstances where such persons might reasonably be regarded as high net worth individuals, or in the case of an offer of securities for subscription or sale, such offer is deemed not to be an offer to the public in the United Kingdom; and/or

(d) the provision of banking, insurance and investment services and advice to its own employees in the form of benefits provided in the normal course of business.

Subject to the right of first refusal described above, nothing shall prevent VEL from licensing the use of any Virgin trade mark (but not the Virgin Money Trade Marks) in relation to, without limitation:

(a) the provision of payment processing, store cards and loyalty schemes;

(b) the provision of any finance, hire purchase, credit and/or insurance in relation to (but not in isolation from) the products and/or services (not being Financial Services) which that VEL licensee offers and/or sells in the ordinary course of business;

(c) the provision of vouchers and stored value cards redeemable as payment for the products and/or services which that VEL licensee offers and/or sells;

(d) access in any medium to third party branded products or services which may fall within Financial Services, provided that: (i) such use does not endorse or encourage customers to cease to use or purchase the products and services provided by CYBG and start to use or purchase similar products and services provided by VEL licensee or third party; and (ii) it is clear that such products or services are not the products or services of the relevant VEL licensee;

(e) the personal use in the Territory by a person ordinarily resident outside the Territory of Virgin branded financial products or services provided to that person pursuant to an agreement relating to a territory outside the Territory;

(f) in the case of Virgin Atlantic, Virgin Galactic, Virgin Hyperloop, and Virgin Holidays a credit card or pre-paid card made available to their customers as an ancillary part of their main business;

(g) in the case of any VEL licensee which operates an airline, aerospace or travel or holiday business, foreign exchange services and/or travel insurance services made available to their customers as an ancillary part of their main business; and/or

(h) in the case of Virgin Active, Virgin Pulse and Virgin Care, access to life and health insurance products made available to their customers as an ancillary part of their main business.

Indemnity/Liability

CYBG has agreed to indemnify VEL for all third party claims brought against VEL by reason of CYBG's carrying out of the activities licensed under the Brand Licence Agreement and/or the use of the Licensed Trade Marks by CYBG in breach of the Brand Licence Agreement (except where such claim arises due to VEL's breach of the Brand Licence Agreement).

VEL has agreed to indemnify CYBG for all third party claims brought against CYBG that the use of the Licensed Trade Marks pursuant to the Brand Licence Agreement infringes the third party's intellectual property rights.

Each party's total liability under the Brand Licence Agreement (including in respect to the indemnities) is capped at £200,000,000 (save for royalties and any Exit Fee payable by CYBG).

Governing Law

The Brand Licence Agreement is governed by English law and is subject to the jurisdiction of the Courts of England and Wales.

14. VIRGIN MONEY GROUP MATERIAL CONTRACTS

The following contracts (not being contracts entered into in the ordinary course of business) have or are proposed to be entered into by Virgin Money or another member of the Virgin Money Group either: (i) within the period of two years immediately preceding the date of this Prospectus which are or may be material to the Virgin Money Group; or (ii) which contain any provisions under which any member of the Virgin Money Group has any obligation or entitlement which is, or may be, material to the Virgin Money Group as at the date of this Prospectus.

14.1 Aberdeen Standard Investments JV

As announced by Virgin Money on 20 March 2018, Virgin Money and ASI are proposing to form a new strategic joint venture for the provision of asset management services to Virgin Money customers.

As part of the joint venture transaction, Virgin Money is proposing to enter into a share sale and purchase agreement pursuant to which Virgin Money will sell 50 per cent. less one share of its shareholding in its wholly owned subsidiary, Virgin Money Unit Trust Managers Limited ("**VMUTM**") to Aberdeen Asset Management PLC ("**AAM**") (the draft agreement being the "**AAM SPA**"). The consideration payable by AAM to Virgin Money under the AAM SPA comprises £40,000,000 plus an amount equivalent to 50 per cent. of the amount of required regulatory capital of VMUTM (plus an agreed margin).

Completion of the share sale and purchase is expected to be conditional, amongst other things, on approval by the FCA of the change of control of VMUTM and certain other customary closing conditions. Subject to FCA and other relevant approvals, completion of the AAM SPA is currently expected to occur by the end of 2018.

The AAM SPA contains customary warranties provided by both Virgin Money and AAM. Virgin Money intends to grant AAM a customary indemnity in respect of certain specified potential VMUTM liabilities. The warranties and indemnity arrangements under the AAM SPA are expected to be subject to standard limitations including, amongst other things, aggregate caps on Virgin Money's liabilities and time limits for bringing claims.

The AAM SPA is also expected to provide that, on completion of the share sale and purchase, the parties and VMUTM will enter into a joint venture agreement ("**AAM JVA**") which will govern the relationship between the parties. It is proposed that the AAM JVA will include customary provisions for a 50:50 deadlocked joint venture including, amongst other things, provisions relating to the governance and funding of VMUTM, the termination of the joint venture and exit arrangements. The AAM SPA also contemplates that certain related commercial arrangements will be agreed and entered into by Virgin Money and/or AAM (or other entities within the ASI group) with VMUTM, subject to certain terms and conditions being satisfied.

14.2 Co-operation Agreement

Virgin Money is also party to the Co-operation Agreement described in paragraph 9 of Part I (*Information about the Offer*) of this Prospectus.

15. WORKING CAPITAL

CYBG is of the opinion that the CYBG Group has sufficient working capital for its present requirements, that is for the next 12 months from the date of this Prospectus.

16. SIGNIFICANT CHANGE

16.1 There has been no significant change in the financial or trading position of the CYBG Group since 31 March 2018, being the date to which the unaudited interim financial statements set out in the CYBG Interim Report 2018 and incorporated by reference into this Prospectus was prepared.

16.2 There has been no significant change in the financial or trading position of the Virgin Money Group since 30 June 2018, being the date to which the unaudited interim financial information set out in Part VII (*Historical Financial Information relating to the Virgin Money Group*) of this Prospectus was prepared.

17. LEGAL AND ARBITRATION PROCEEDINGS

17.1 CYBG Group

There are no, nor have there been any, governmental, legal or arbitration proceedings (including such proceedings which are pending or threatened of which CYBG is aware) during the last 12 months prior to the date of this Prospectus which may have, or have had, a significant effect on CYBG's and/or the CYBG Group's financial position or profitability.

17.2 Virgin Money Group

There are no, nor have there been any, governmental, legal or arbitration proceedings (including such proceedings which are pending or threatened of which CYBG is aware) during the last 12 months prior to the date of this Prospectus which may have, or have had, a significant effect on Virgin Money's and/or the Virgin Money Group's financial position or profitability.

18. MANDATORY TAKEOVER BIDS, SQUEEZE-OUT RULES, SELL-OUT RULES AND TAKEOVER BIDS

18.1 Mandatory takeover bids

The Takeover Code applies to CYBG. Under the Takeover Code, if an acquisition of interests in shares were to increase the aggregate holding of an acquirer and persons acting in concert with it to an interest in shares carrying 30 per cent. or more of the voting rights in CYBG, the acquirer and, depending upon the circumstances, persons acting in concert with it, would be required (except with the consent of the Takeover Panel) to make a cash offer for the outstanding shares at a price not less than the highest price paid for any interest in shares by the acquirer or his concert parties during the previous 12 months. A similar obligation to make such a mandatory offer would also arise on the acquisition of an interest in shares by a person holding (together with any persons acting in concert) an interest in shares carrying between 30 per cent. and 50 per cent. of the voting rights in CYBG if the effect of such acquisition were to increase that person's percentage of the voting rights.

18.2 Squeeze-out rules

Under the 2006 Act, if a "takeover offer" (as defined in section 974 of the 2006 Act) is made for the CYBG Shares and the offeror were to acquire, or unconditionally contract to acquire, not less than 90 per cent. in value of the shares to which the offer relates (the "**Offer Shares**") and not less than 90 per cent. of the voting rights attached to the Offer Shares, within three months of the last day on which its offer can be accepted, it could acquire compulsorily the outstanding shares not assented to the offer. It would do so by sending a notice to outstanding shareholders telling them that it will acquire compulsorily their shares and then, six weeks later, it would execute a transfer of the outstanding shares in its favour and pay the consideration to CYBG, which would hold the consideration on trust for outstanding shareholders. The consideration offered to the shareholders whose shares are acquired compulsorily under the 2006 Act must, in general, be the same as the consideration that was available under the takeover offer.

18.3 Sell-out rules

The 2006 Act also gives minority shareholders a right to be bought out in certain circumstances by an offeror who has made a takeover offer. If a takeover offer related to all the CYBG Shares and at any time before the end of the period within which the offer could be accepted the offeror held or had agreed to acquire not less than 90 per cent. of the CYBG Shares to which the offer relates, any holder of CYBG Shares to which the offer related who had not accepted the offer could by a written communication to the offeror require it to acquire those CYBG Shares. The offeror would be required to give any shareholder notice of his right to be bought out within one month of that right arising. The offeror may impose a time limit on the rights of the minority shareholders to be bought out, but that period cannot end less than three months after the end of the acceptance period. If a shareholder exercises his or her rights, the offeror is bound to acquire those CYBG Shares on the terms of the offer or on such other terms as may be agreed.

18.4 Takeover bids

No public takeover bid has been made in relation to CYBG during the last financial year or the current financial year.

19. SUBSIDIARIES

19.1 CYBG Group's organisation structure

The Company is the holding company of the CYBG Group. The Company has the following significant subsidiary undertakings (each of which is considered by the Company to be likely to have a significant effect on the assessment of its assets and liabilities, financial position or the profits and losses):

Name	Percentage Ownership	Country of incorporation/residence	Principal activity
Clydesdale Bank PLC	100	Scotland	Banking
Yorkshire Bank Home Loans Limited	100	England & Wales	Mortgage Finance
CYB Intermediaries Limited	100	England & Wales	Intermediation
Clydesdale Bank Asset Finance Limited	100	Scotland	Asset Finance
CGF No.9 Limited	100	Scotland	Asset Finance

18.2 Virgin Money Group's organisation structure

Subsidiaries of the Virgin Money Group

Virgin Money is the holding company of the Virgin Money Group. Virgin Money has the following significant subsidiary undertakings (each of which is considered by the Company to be likely to have a significant effect on the assessment of its assets and liabilities, financial position or the profits and losses):

Name	Percentage Ownership	Country of incorporation/ residence	Principal activity
Virgin Money plc	100	England & Wales	Banking
Virgin Money Unit Trust Managers Limited	100	England & Wales	Investments
Virgin Money Personal Financial Services Limited	100	England & Wales	Investments

20. PROPERTY, PLANT AND EQUIPMENT

As at 31 May 2018, CYBG Group occupied 191 properties throughout the UK. Of these, 9 were held as freeholds, 32 as long-term leaseholds (leases of greater than 30 years at term commencement) and 150 as short-term leaseholds (leases of less than 30 years at commencement). The majority of these properties are retail branches along with some Business & Private Banking locations. The properties are primarily located in Scotland, the Midlands and the North of England. Other buildings include CYBG Group's Head Office at 40 St Vincent Place/51 West George St, Glasgow, the Investor Suite on 15th Floor Leadenhall, London and other customer support centres located to suit business needs, predominantly in and around Glasgow.

In addition, as at 31 May 2018 there were 68 properties which were vacant and 30 properties which were sub-let.

CYBG Group has plans to move to a new single head office location in Glasgow in the future. It currently leases buildings on St Vincent Place, Queen Street and Stockwell Street, but plans to move all CYBG employees based within those buildings into a new leased office space to be built on Bothwell Street. The new office will be fitted to a bespoke layout and employees will be involved in the design and specification to ensure it meets the needs of the business.

CYBG Group does not own any material properties. The material properties leased by CYBG Group are as follows:

Location	Desc & Tenure	Use	Area (Sq. M)
30–40 St Vincent Pl., Glasgow	Leasehold to 2024	Head Office	3760
51 West George St., Glasgow	Leasehold to 2027	Head Office	4664
5 Fl Granite House, Stockwell St., Glasgow	Leasehold to 2024	Customer Support Centre	2902
1 Fl Guildhall, Queen St., Glasgow	Leasehold to 2024	Customer Support Centre	1719
2 Fl Guildhall, Queen St., Glasgow	Leasehold to 2019	Customer Support Centre	1719
3–5 Fl Guildhall, Queen St., Glasgow	Leasehold to 2024	Customer Support Centre	4857
7 Fl Guildhall, Queen St., Glasgow	Leasehold to 2024	Treasury and Dealing Room	1390
Bering House, Clydebank	Leasehold to 2024	Customer Support Centre	1440
Tasman House, Clydebank	Leasehold to 2024	Customer Support Centre	402
7 North Ave., Clydebank	Leasehold to 2024	Customer Support Centre	3066
Timor House, Clydebank	Leasehold to 2024	Customer Support Centre	1186
Production Block, 8 North Ave., Clydebank	Leasehold to 2024	Customer Support Centre	3094
The Bunker Data Centre, Sylvania Way, Clydebank	Leasehold to 2032	Data Centre	2393
Data Centre, Gordon Ave., Hillington	Leasehold to 2042	Data Centre	4605
20 Merrion Way, Leeds	Leasehold to 2024	Customer Support Centre	7,181
15th Floor Leadenhall Building, London	Leasehold to 2030	Head Office & Investor Suite	1,610

21. EMPLOYEES

In the six months ended 31 March 2018, CYBG Group had an average of 6,614 on and off payroll full time equivalent employees, including an average of 694 contractors and casual contracts primarily to supplement the permanent employee base within the Customer Operations function.

22. EMPLOYEE SHARE PLANS

22.1 Overview

The Board has adopted the following plans:

- the CYBG Deferred Equity Plan ("**DEP**");
- the CYBG Long Term Incentive Plan ("**LTIP**");
- the CYBG Share Incentive Plan (the "**SIP**"); and
- the CYBG Save As You Earn Plan ("**SAYE Plan**" and together with the DEP, the LTIP and the SIP, the "**Share Plans**")).

22.2 **DEP**

The DEP is a discretionary plan under which a proportion of any bonus awarded under the Short Term Incentive Plan to material risk takers and any other employees selected by the Remuneration Committee will be deferred into an award over CYBG Shares which will, as a minimum, vest in accordance with the requirements of the PRA Remuneration Code.

The DEP may also be used to award other types of award for recognition, commencement or retention purposes.

22.3 **LTIP**

The Executive Directors and certain other employees are eligible to participate in the LTIP which provides a direct link to the achievement of sustainable performance over the longer term. Awards granted under the LTIP will vest after a performance period (intended to be three years initially), subject to the achievement of satisfactory levels of performance up until the point of vesting.

All awards will be in line with the requirements of the PRA Remuneration Code.

22.4 **SIP**

The SIP, which is registered with HMRC, is an all-employee share plan which offers three ways to provide CYBG Shares to employees based in the UK on a tax-favoured basis: free, partnership and matching CYBG Shares. The SIP contains all three elements and the Board has the power to decide which, if any, of them should be implemented. The Board may also allow a participant to reinvest any dividends paid in buying additional dividend shares. The SIP operates in conjunction with a trust, which will hold CYBG Shares on behalf of employees.

22.5 **SAYE Plan**

The SAYE Plan, which is registered with HMRC, is an all-employee savings-related share option plan under which participants save a monthly amount to buy CYBG Shares. The Board may decide to operate the SAYE Plan in the future.

22.6 **Terms common to the Share Plans**

Overall plan limits

In any 10-year period, not more than 10 per cent. of the issued share capital may be issued under the Share Plans and all other employees' share plans adopted by the Company. This limit does not include awards which have lapsed but will include awards satisfied with treasury CYBG Shares as if they were newly issued CYBG Shares for so long as required by UK institutional investor guidelines.

22.7 **Source of shares**

Awards under the Share Plans may be granted over newly issued CYBG Shares, CYBG Shares held in treasury or CYBG Shares purchased in the market.

22.8 **Timing of awards**

With the exception of the SIP, awards may normally only be granted within the six week period beginning with the Company's announcement of its results for any period. Awards may be granted outside these periods in exceptional circumstances, as determined by the Board (or the Remuneration Committee). No awards may be granted for more than 10 years after 8 February 2016.

22.9 **Amendments**

The Board (or the Remuneration Committee) can amend the Share Plans in any way. However, shareholder approval will be required to amend certain provisions to the advantage of participants. These provisions relate to eligibility, individual and plan limits, the basis for determining a participant's entitlement to, and the terms of, the CYBG Shares or cash comprised in awards, the adjustment of awards on any variation in the Company's share capital and the amendment powers.

Minor amendments can however be made without shareholder approval to benefit the administration of the Share Plans, to take account of a change in legislation or to obtain or maintain favourable tax, exchange control or regulatory treatment.

22.10 General

Any CYBG Shares issued under the Share Plans will rank equally with CYBG Shares of the same class in issue on the date of allotment except in respect of rights arising by reference to a prior record date.

Options and awards granted under the Share Plans are personal to participants and, except on death, may not be transferred.

Awards will not form part of pensionable earnings.

22.11 SIP

Eligibility

All UK tax-resident employees of the Company and any participating subsidiaries must be offered the opportunity to join the SIP. The Board can set a minimum qualifying period of employment which may not exceed 18 months or, in certain circumstances, six months.

22.12 Free Shares

Free Shares ("**Free Shares**") up to a maximum of £3,600 can be awarded to each participant in any tax year. Free Shares must be awarded on similar terms, although the number of Free Shares awarded to each participant may be varied by reference to remuneration, length of service and hours worked. An award of Free Shares can be subject to performance targets.

Free Shares must be held in the SIP for a period of between three and five years at the discretion of the Board and will be free of income tax if held in the SIP for five years. During this period the participant cannot withdraw the Free Shares from the trust unless he leaves employment or a change of control event occurs.

The Board can provide that the Free Shares will be forfeited if the employee leaves employment, other than where he leaves due to injury, disability, redundancy, transfer of the employing business or company out of CYBG Group, retirement or on death (as a "**Good Leaver**").

22.13 Partnership Shares

The Board may invite participants to buy CYBG Shares using contributions from pre-tax salary ("**Partnership Shares**") up to a maximum limit set by the Board which cannot exceed the lower of £1,800 or 10 per cent. of pre-tax salary in any tax year. A participant may stop and start deductions at any time.

Participants' contributions can be used to buy CYBG Shares immediately or can be accumulated for up to 12 months before being used to buy CYBG Shares.

Partnership Shares may be withdrawn from the SIP by the participant at any time and are not forfeitable in any circumstances but the participant will have to pay income tax if the CYBG Shares are taken out of the SIP within five years of being bought (unless the participant is a Good Leaver).

22.14 Dividends

The Board may allow a participant to reinvest any dividends paid on Free, Partnership or Matching Shares in buying additional Shares ("**Dividend Shares**") which must be held in the SIP for three years, unless the participant leaves employment or a change of control event occurs. Dividend Shares are not forfeitable in any circumstances.

22.15 Voting rights

Participants may direct the trustees of the SIP how to exercise the voting rights attributable to the CYBG Shares held on their behalf. The trustees of the SIP will not exercise the voting rights unless they receive the participants' instructions.

22.16 **SAYE Plan**

Invitations and Eligibility

The CYBG Group does not currently operate a SAYE Plan. The Board may at any time (but subject to any relevant regulatory restrictions) invite all eligible employees to apply for options. An eligible employee is any employee or any director who is obliged to devote not less than 25 hours a week to his duties with that company who:

- is employed by the Company or a participating subsidiary and is tax resident in the UK on the date that options are granted; and
- has been continuously employed by the Company or a participating subsidiary for a qualifying service period (not exceeding five years) set by the Board.

The Board can nominate employees who do not satisfy these conditions to participate and can decide which subsidiaries participate.

22.17 **Savings contracts**

An eligible employee who applies for an option under the SAYE Plan must also enter into a savings contract for a period of three or five years. The Board has discretion to determine which savings contract will be made available under any invitation to apply for options. Under the savings contract, the employee will agree to make monthly savings contributions of at least £5 but not more than £500 per month. CYBG Shares can only be bought using the amount saved plus any bonus paid under the savings contract.

22.18 **Option Price**

The option price must not be less than 80 per cent. of the market value of the CYBG Shares on the date specified in the invitation.

22.19 **Scaling down**

Applications to participate in the SAYE Plan may be scaled down by the Board if they exceed the number of CYBG Shares available for the grant of options. The ways in which scaling down may be carried out are set out in the rules of the SAYE Plan.

22.20 **Exercise of options**

Options are normally exercisable for a period of six months after the third or fifth anniversary of the start of the savings contract. Special provisions allow early exercise in the case of a Good Leaver. If a participant ceases employment for any other reason within three years of the grant date, his option will lapse.

22.21 **Change of control, merger or other reorganisation**

Options may generally be exercised early in the event of a change of control, scheme of arrangement, other reorganisation or on the winding up of the Company. Internal reorganisations do not automatically trigger the early exercise of options.

22.22 **Variation of capital**

Options may be adjusted in the event of any variation in the share capital of the Company.

22.23 **Terms common to the LTIP and DEP ("Executive Plans")**

Overall limits of the Executive Plans

In any 10-year period, not more than five per cent. of the issued share capital may be issued under awards granted under the Executive Plans and any other discretionary employees' share plans adopted by the Company. This limit does not include awards which have lapsed but will include awards satisfied with CYBG Shares transferred out of treasury for so long as required by UK institutional investor guidelines.

22.24 **Forms of awards**

Awards may be granted in different forms as (a) a conditional right to acquire CYBG Shares in the future at no cost, (b) an option with a nil exercise price or (c) an acquisition of CYBG Shares that are forfeitable in the event that specified vesting conditions are not met.

22.25 **Malus and clawback**

Certain participants in the Executive Plans will be material risk takers for the purposes of the PRA Remuneration Code and malus and clawback provisions will apply to them. For these participants, the Remuneration Committee may, within seven years of the grant of an award, decide to reduce the number of CYBG Shares or, where relevant, the cash amount to which an award relates (malus) or require the participant to make a repayment in respect of an award (clawback) where there is a material misstatement of financial results or in other circumstances prescribed by the PRA Remuneration Code.

22.26 **Dividend equivalents**

For awards made prior to 1 January 2018, the Remuneration Committee may decide at any time before vesting that participants should receive an additional benefit equal in value to any dividends that they would have received during the vesting period, if they had been the holders of the vested CYBG Shares. The benefit can be provided as a cash sum or in the form of CYBG Shares. Alternatively, the Remuneration Committee may grant an award on terms that the number of CYBG Shares subject to the award shall increase by assuming that dividends that would have been paid on those CYBG Shares during the vesting period would have been used to buy further CYBG Shares. Following regulatory changes, no dividends are payable on deferred remuneration on awards made after 1 January 2018.

22.27 **Cash alternative and cash awards**

Where an award has vested (or, in the case of an option, has been exercised) the Remuneration Committee may elect, instead of delivering CYBG Shares, to pay cash to the participant. The amount to be paid (subject to deduction of tax or similar liabilities) shall be equal to the market value of the CYBG Shares subject to the award. The Executive Plans also have flexibility to allow cash-settled awards to be granted from the outset if considered appropriate.

22.28 **Holding period**

Awards will be subject to a holding period of at least six months following vesting to the extent required by the PRA Remuneration Code. During the holding period, the award will be subject to the malus and clawback provisions but not to the leaver provisions. Instead, a participant will only lose the award where employment is terminated due to gross misconduct. The Remuneration Committee may set a different holding period for subsequent awards, depending on regulatory requirements which apply to CYBG Group in the future.

22.29 **Leaving CYBG Group**

If a participant ceases to be employed as a Good Leaver, or for any other reason at the discretion of the Remuneration Committee, the award will vest on the normal vesting date to the extent that any performance condition has been met over the performance period and pro-rated for time, unless the Remuneration Committee decides otherwise. Alternatively, the Remuneration Committee may allow an award to vest early, subject to satisfaction of the performance condition up to the date that the participant leaves.

22.30 **Takeovers and reorganisation**

Awards will vest in the event of a change of control of the Company to the extent the performance condition has been met up to the event in question and, unless the Remuneration Committee decides otherwise, will be pro-rated for time. Internal reorganisations do not automatically trigger the early vesting of awards.

If any other corporate events occur such as a demerger, delisting or special dividend which, in the opinion of the Remuneration Committee, may affect the current or future value of CYBG Shares, the Remuneration Committee may determine that awards will vest. In this case awards will vest to the extent the performance condition has been met up to the event in question and, unless the Remuneration Committee decides otherwise, will be pro-rated for time.

22.31 **Variation of capital**

In the event of any variation in the share capital of the Company, the Remuneration Committee may make such adjustments as it considers appropriate to the number of CYBG Shares under award.

22.32 **LTIP**

Awards may be granted to selected CYBG Group employees (including Executive Directors) at the discretion of the Remuneration Committee.

22.33 **Individual limits**

The Remuneration Committee will determine the value of awards to be granted to each participant in a financial year up to a maximum of 100 per cent. of base salary in normal circumstances, with the Remuneration Committee retaining discretion to grant awards in excess of this limit, subject always to the 2:1 cap on variable to fixed remuneration.

22.34 **Performance Condition**

The vesting of awards will be subject to the satisfaction of performance conditions which will be set by the Remuneration Committee before the grant of an award. The performance conditions will be disclosed to Shareholders in the Company's annual report and accounts.

22.35 **Vesting of awards**

In normal circumstances, an award will vest after a performance period (intended to be three years initially), subject to the achievement of satisfactory levels of performance up until the point of vesting.

22.36 **DEP**

The Remuneration Committee may select any CYBG Group employee, including any Executive Director, to participate in the DEP if the employee has earned an annual incentive over the previous performance year under the Short Term Incentive Plan.

The DEP may also be used to grant other types of award for recognition, commencement or retention purposes.

22.37 **Individual limits**

In normal circumstances, the overall annual incentive will be up to 100 per cent. of base salary. Awards will be granted under the DEP in line with the PRA Remuneration Code requirements for deferral of variable remuneration and the Remuneration Committee retain discretion to grant awards in excess of this limit, subject always to the 2:1 cap on variable to fixed remuneration.

22.38 **Vesting of awards**

Awards normally vest over a maximum of three years. The Remuneration Committee may set different vesting schedules for subsequent awards, depending on the regulatory requirements which may apply to CYBG Group in the future.

23. **PENSIONS**

Details of the CYBG Group's pensions scheme obligations can be found under the heading "*Pension risk*" on page 171 of the CYBG Annual Report 2017 (which is incorporated by reference into this Prospectus).

Defined Benefit Scheme ("**DB Scheme**")

Clydesdale Bank PLC is the sponsoring employer of the DB Scheme. Under the DB Scheme, benefits provided are based on employees' years of service using either a career average formula or final salary formula. Clydesdale Bank PLC is the only employer in the DB Scheme. The DB Scheme was closed to new entrants in 2004 and is now closed to the future build-up of benefits for the majority of colleagues. As of 1 August 2017, all future pension benefits for colleagues build-up through the defined contribution pension scheme, Total Pension!. A minority of members of the Yorkshire section of the DB Scheme, who did not consent to the changes, remain in the DB Scheme and are required to make a minimum contribution of 15 per cent. of base salary. As at 1 May 2018 there were approximately 50 active members left in the DB Scheme.

There are also a group of DB Scheme deferred members who remain on transitional terms following the closure of the DB Scheme to future accrual, who can take early retirement benefits with a lower actuarial reduction. Transition terms finish on 31 July 2020 and apply only to members who attain the age of 55 by 31 July 2020, are still employed by the CYBG Group and retire by 31 July 2020 at the latest.

The DB Scheme is operated separately from the CYBG Group; assets are held and the scheme managed by an independent corporate trustee, Yorkshire and Clydesdale Bank Pension Trustee Limited (the "**DB Trustee**"). The DB Trustee has the power to determine the investment strategy of the DB Scheme after consultation with Clydesdale Bank PLC. Regular actuarial valuations are held (at least every three years) to determine the funded status of the DB Scheme. Agreement was reached with the DB Trustee on the DB Scheme funding valuation at 30 September 2016, with a calculated deficit of £290 million. In the recovery plan dated 31 July 2017 the CYBG Group agreed to contribute £50 million per annum until 31 March 2022 and £55 million in the year to 31 March 2023 to eliminate this deficit. For future valuations it is open to the trustees of the DB Scheme to call for valuations at an earlier date. The assumptions used for the statutory valuation would generally need to be agreed between the CYBG Group and the trustees of the DB Scheme although the regulator established under Part 1 of the Pensions Act 2004 (as amended) in the UK has the power to set these in certain circumstances.

The DB Trustee has the power to determine the investment strategy of the DB Scheme after consultation with Clydesdale Bank PLC. In July 2017, the bank and DB Trustee agreed to the use of a contingent security arrangement which is intended to provide the DB Trustee with protection against the bank defaulting on its obligations under the recovery plan. An additional amount partially mitigates investment risk in the DB Scheme. The pension security arrangement is capital neutral for the bank and has no adverse impact on its liquidity position. The amount of security assets required will reduce as the CYBG Group makes contributions to the DB Scheme and the investment strategy is de-risked.

The following table sets out the CYBG Group's pension liability on an accounting basis and on a cash funding basis as at 31 March 2018:

	£ million
Value of assets	4,098
Value of liabilities	3,876
Surplus/(Deficit)	**222**
Funding Level	105.71%

Defined Contribution Scheme ("Total Pension!")

As of 1 August 2017, for the vast majority of colleagues all future pension benefits for colleagues will build-up through the defined contribution pension scheme, "Total Pension!". Core contributions are 2 per cent. employee, 8 per cent. employer with a further matching of 1 per cent. employee 1 per cent. employer up to a maximum of 5 per cent. employer.

24. GENERAL

24.1 Financial information

The financial information concerning CYBG contained in this Prospectus does not constitute statutory accounts within the meaning of section 434(3) of the 2006 Act.

The annual consolidated financial statements of the Company for the years ended 30 September 2016 and 30 September 2017 have been audited without qualification by EY and have been delivered to the Registrar of Companies. The interim financial information for the six months ended 31 March 2018 was reviewed by EY.

The historical financial information of the Company for the year ended 30 September 2015, incorporated by reference into this Prospectus, does not constitute statutory accounts within the meaning of section 434(3) of the 2006 Act. The historical financial information of the Company for the year ended 30 September 2015 has been reported on in accordance with Statements of Investment Reporting Standards issued by the Auditing Practices Board in the United Kingdom by EY. Full individual accounts of CYB Investments Limited (formerly National Australia Group Europe Limited) (the former holding company of the CYBG Group) and each of its subsidiary undertakings for the year ended 30 September 2015 and on which EY gave unqualified reports have been delivered to the Registrar of Companies.

24.2 Continuing obligations

CYBG remains subject to the continuing obligations of the Listing Rules with regard to the issue of securities for cash, and the provisions of section 561 of the 2006 Act (which confers on shareholders rights of pre-emption in respect of the allotment of equity securities which are, or are to be, paid up in cash) apply to any further issuances of share capital of CYBG.

CYBG will make an appropriate announcement(s) to a Regulatory Information Service if Completion occurs, which is expected to be in the fourth quarter of calendar year 2018. CYBG will also make an appropriate announcement(s) to the ASX and any other relevant exchange on which CYBG has a regulatory disclosure obligation.

24.3 Auditors

EY is registered to carry out audit work by the Institute of Chartered Accountants in England and Wales, and EY's registered address is 1 More London Place, London, SE1 2AF.

24.4 Costs and expenses

The aggregate costs and expenses of the Offer payable by CYBG are estimated to be approximately £34 million (excluding VAT), including stamp duty of approximately £9 million.

25. CONSENT

EY has given, and has not withdrawn, its written consent to the inclusion in this Prospectus of its report set out in Section A of Part VIII (*Unaudited Pro Forma Financial Information*), in the form and context in which it appears and has authorised the contents of this report for the purposes of Prospectus Rule 5.5.3R(2)(f).

26. SOURCES AND BASES OF FINANCIAL INFORMATION

Where information has been sourced from a third party, CYBG confirms that the information has been accurately reproduced and, as far as CYBG is aware and able to ascertain from information published by that third party, no facts have been omitted which would render the reproduced information inaccurate or misleading. Where third party information has been used, the source of such information has been identified wherever it appears in this Prospectus.

27. DOCUMENTS AVAILABLE FOR INSPECTION

Copies of the following documents will be available for inspection during normal business hours on Monday to Friday of each week (public holidays excepted) at the Company's registered office, 20 Merrion Way, Leeds, LS2 8NZ and at the offices of Clifford Chance LLP, 10 Upper Bank Street, London E14 5JJ up to and including the date of Admission:

(a) the CYBG Articles;

(b) the CYBG Interim Report 2018;

(c) the CYBG Annual Report 2017;

(d) the CYBG Annual Report 2016;

(e) the Virgin Money Interim Report 2018;

(f) the Virgin Money Annual Report 2017;

(g) the Virgin Money Annual Report 2016;

(h) the Virgin Money Annual Report 2015;

(i) the consent letter referred to in paragraph 25 of this Part XIII;

(j) the Circular;

(k) the CYBG IPO Prospectus; and

(l) this Prospectus.

PART XIV
DEFINITIONS

The definitions set out below apply throughout this Prospectus, unless the context requires otherwise.

"**2006 Act**"	means the Companies Act 2006 (as amended or re-enacted);
"**AAM**"	means Aberdeen Asset Management PLC, a company registered in Scotland, with registered number SC082015 and registered address 10 Queen's Terrace, Aberdeen, Aberdeenshire, United Kingdom, AB10 1XL;
"**AAM JVA**"	means the joint venture agreement to be entered into by Virgin Money, VMUTM and AAM upon completion of the AAM SPA;
"**AAM SPA**"	means the draft share sale and purchase agreement pursuant to which Virgin Money will sell 50 per cent. less one share of its shareholding in its wholly owned subsidiary, VMUTM to AAM;
"**Admission**"	means admission of the New CYBG Shares to the premium listing segment of the Official List and to trading on the Main Market;
"**Announcement**"	means the announcement in relation to the Offer made by CYBG pursuant to the Listing Rules on 18 June 2018;
"**API**"	means application programming interface;
"**ASI**"	means Aberdeen Standard Investments Limited, a company registered in Scotland, with registered number SC559529 and registered office at Standard Life House, 30 Lothian Road, Edinburgh, United Kingdom, EH1 2DH;
"**ASX Listing Rules**"	means the listing rules of the ASX as amended or replaced from time to time, except to the extent of any express written waiver or exemption given by ASX;
"**ASX**"	means the Australian Securities Exchange;
"**AT1 Resolutions**"	means Resolution 2 and Resolution 3 and "**AT1 Resolution**" means any one of them;
"**AT1 Securities**"	means CRD IV compliant additional tier 1 securities;
"**ATM**"	means automated teller machine;
"**Auditing Practices Board**"	means the Auditing Practices Board Limited, part of the Financial Reporting Council;
"**Australian Registrar**" . . .	means Computershare Investor Services PTY Limited;
"**Authorised Nominee**" . . .	CHESS Depositary Nominees Pty Ltd;
"**Banking Reform Act**" . . .	means the Financial Services (Banking Reform) Act 2013;
"**Basel Committee**"	means the Basel Committee on Banking Supervision;
"**Basel III reforms**"	means the new capital and liquidity requirements introduced by the Basel Committee from 2011 to 2013, including the final reform package issued in December 2017;
"**BCAs**"	means business current accounts;
"**Board**"	means the board of directors of CYBG from time to time;
"**Bonus Award**"	means a bonus payment of £1,026,000 in respect of the financial year ending 31 December 2018 to be awarded to the Virgin Money CEO by Virgin Money;
"**Brand Licence Agreement**"	means the Existing Brand Licence Agreement as novated from Virgin Money to CYBG, and as amended and restated, in each case by a deed of novation between Virgin Enterprises, Virgin Money and CYBG, dated 18 June 2018 and effective from Completion;

"**Brand Licence Resolutions**"	together: (a) Resolution 1 as set out in the Notice of Virgin Money General Meeting to approve the Brand Licence Agreement for the purposes of Rule 16 of the Takeover Code; and (b) Resolution 2 as set out in the Notice of Virgin Money General Meeting to approve the Brand Licence Agreement for the purpose of Chapter 11 of the Listing Rules and each a "**Brand Licence Resolution**";
"**BRRD**"	means the Bank Recovery and Resolution Directive (Directive 2014/59/EU);
"**Business Day**"	means a day (excluding Saturdays, Sundays and public holidays in England and Wales) on which banks generally are open for business in London for the transaction of normal banking business;
"**Capital Requirements Regulation**"	means the EU Capital Requirements Regulation implementing the Basel III reforms (Regulation (EU) No 575/2013);
"**Capped Indemnity**"	means the indemnity provided by NAB to the CYBG Group under the Capped Indemnity Deed;
"**Capped Indemnity Deed**"	means the conduct indemnity deed entered into between NAB and the CYBG Group on 2 December 2015;
"**CASS**"	means the industry standard current account switching service;
"**CBTL mortgages**"	means customer buy-to-let mortgages;
"**CCA**"	means the Consumer Credit Act 1974 and its related secondary legislation;
"**CDI Holders**"	means holders of CDIs from time to time;
"**CDI**"	means a CHESS depositary interest issued over ordinary shares in the capital of the Company as contemplated by the ASX Listing Rules;
"**CDI Voting Instruction Form**"	means the CDI Voting Instruction Form for use in connection with the CYBG General Meeting;
"**Certification Regime**"	means the Certification Regime introduced in March 2016 by the FCA;
"**CET1**"	means Common Equity Tier 1;
"**CHESS**"	means the clearing house electronic sub-register system of share transfer operated by ASX Settlement;
"**CIR**"	means cost to income ratio;
"**Circular**"	means the circular from CYBG to CYBG Shareholders dated 31 July 2018 in connection with the Offer, including the notice convening the CYBG General Meeting;
"**CMA**"	means the UK Competition and Markets Authority;
"**Combined Group**"	means the enlarged group of companies which will, following Completion, comprise the CYBG Group and the Virgin Money Group;
"**Completion**"	means completion of the Offer;
"**CONC**"	means the Consumer Credit sourcebook;
"**Condition(s)**"	means the conditions to the implementation of the Offer (including the scheme as set out in the Scheme Document);
"**Co-operation Agreement**"	means the co-operation agreement dated 18 June 2018 between CYBG and Virgin Money, as described in paragraph 9 of Part I (*Information about the Offer*) of this Prospectus;
"**Court Hearing**"	means the court hearing at which Virgin Money will seek an order sanctioning the Scheme pursuant to Part 26 of the 2006 Act;

“**Court Meeting**”	means the meeting or meetings of Virgin Money Shareholders to be convened at the direction of the High Court of Justice of England and Wales pursuant to Part 26 of the 2006 Act at which a resolution will be proposed to approve the Scheme, with or without modification, including any adjournment, postponement or reconvention thereof;
“**Court Order**”	means the order of the Court sanctioning the Scheme under Part 26 of the 2006 Act;
“**CPUT Amendment Regulations**”	means the Consumer Protection from Unfair Trading Amendment Regulations 2014;
“**CPUTR**”	means the Consumer Protection from Unfair Trading Regulations;
“**CRA Regulation**”	means Regulation (EU) No. 1060/2009;
“**CRA**”	means the Consumer Rights Act 2015;
“**CRD IV Directive**”	means the EU Capital Requirements (Directive 2013/36/EU);;
“**CRD IV**”	means the Capital Requirements Directive and the Capital Requirements Regulation;
“**CREST**”	means a computerised system for the paperless settlement of sales and purchases of securities and the holding of uncertificated securities operated by Euroclear in accordance with the CREST Regulations;
“**CREST Regulations**” . . .	means the Uncertificated Securities Regulations 2001 (SI 2001 No. 3755) as from time to time amended;
“**CYBG Annual Report 2016**”	means the CYBG Group’s annual report and accounts for the year ended 30 September 2016;
“**CYBG Annual Report 2017**”	means the CYBG Group’s annual report and accounts for the year ended 30 September 2017;
“**CYBG Articles**”	means the articles of association of CYBG;
“**CYBG Directors**” or “**Directors**”	means the directors of CYBG at the date of this Prospectus and “**director**” means one of them;
“**CYBG General Meeting**”	means the general meeting of the CYBG Shareholders, including any adjournments thereof, to be convened to consider and if thought fit approve, the CYBG Resolutions;
“**CYBG Group**”	means CYBG and its subsidiary undertakings from time to time;
“**CYBG Interim Report 2018**”	means the CYBG Group’s unaudited interim financial report for the six months ended 31 March 2018;
“**CYBG IPO Prospectus**” .	means the prospectus dated on 3 February 2016 in relation to the admission of the CYBG Shares to the premium listing segment of the Official List and to trading on the London Stock Exchange’s main market for listed securities;
“**CYBG Offer Resolution**”	means the ordinary resolution to be proposed at the CYBG General Meeting (and set out in the Circular) to, among other things, approve the Offer and to authorise the creation and allotment of the New CYBG Shares pursuant to the Offer;
“**CYBG Resolutions**”	means the CYBG Offer Resolution and the AT1 Resolutions and “**CYBG Resolution**” means any one of them;
“**CYBG Senior Managers**”	means those persons named as senior managers in Part XI (*CYBG Directors, CYBG Senior Managers and Corporate Governance*) of this Prospectus;

"**CYBG Shares**"	means the ordinary shares of £0.10 each in CYBG, including, where the context requires, the New CYBG Shares;
"**CYBG**" or "**Company**" . .	means CYBG PLC, a company incorporated in England and Wales, with registered number 9595911 and registered office at 20 Merrion Way, Leeds LS2 8NZ;
"**CYBI**"	CYB Investments Limited;
"**DB Scheme**"	means the CYBG Group's defined benefit pension scheme;
"**DB Trustee**"	means Yorkshire and Clydesdale Bank Pension Trustee Limited;
"**Deloitte**"	means Deloitte LLP;
"**DEP**"	means the CYBG Deferred Equity Plan;
"**Deutsche Bank**"	means Deutsche Bank AG, London Branch;
"**DGSD**"	means the EU Directive on deposit guarantee schemes (Directive 2014/49/EU);
"**Disclosure Guidance and Transparency Rules**" . .	means the disclosure guidance and transparency rules made by the FCA under Part VI of the FSMA (as set out in the FCA Handbook), as amended from time to time;
"**Dividend Shares**"	means any additional CYBG Shares bought by reinvesting dividends paid on DEP, LTIP, Free or Partnership Shares;
"**DPA**"	means the Data Protection Act 2018;
"**ECA**"	means the Virgin Money Essential Current Account;
"**EDIS**"	means the proposed European deposit insurance scheme;
"**EEA**"	means the European Economic Area;
"**Effective Date**"	means the date on which the Offer becomes Effective;
"**Effective**"	means, in the context of the Offer: (i) if the Offer is implemented by way of the Scheme, the Scheme having become effective pursuant to its terms; or (ii) if the Offer is implemented by way of the Takeover Offer, the Takeover Offer having been declared or having become unconditional in all respects in accordance with the requirements of the Takeover Code;
"**EIR**"	means effective interest rate;
"**EMIR**"	means the European Market Infrastructure Regulation;
"**Enlarged Issued Share Capital**"	means the CYBG Shares and the New CYBG Shares;
"**EU**"	means the European Union;
"**EU27**"	means the EU following the UK's exit;
"**Euroclear**"	means Euroclear UK & Ireland Limited, the operator of CREST;
"**Excluded Territory**"	means any jurisdiction in, into or from which the release, publication or distribution, directly or indirectly, in whole or in part, of this Prospectus would be restricted, unlawful or unauthorised;
"**Executive Directors**"	means each of the executive CYBG Directors as set out in Part XI of this Prospectus;
"**Executive Plans**"	means the LTIP and the DEP;
"**Existing Brand Licence Agreement**"	the trade mark licence deed between Virgin Enterprises and Virgin Money dated 1 October 2014, as amended and restated on 25 July 2016
"**Existing CYBG Shareholders**" . .	means holders of Existing CYBG Shares;

"**Existing CYBG Shares**"	means the CYBG Shares in issue at the date of the Prospectus;
"**Exit Fee**"	has the meaning given to it in paragraph 13.3 of Part XIII (*Additional Information*) of this Prospectus;
"**EY**"	means Ernst & Young LLP;
"**FATCA**"	means the Foreign Account Tax Compliance Act;
"**FCA**" or "**Financial Conduct Authority**" . . .	means the Financial Conduct Authority, granted powers as a regulator under the FSMA, or its successor from time to time;
"**FCA Handbook**"	means the FCA's handbook of rules and guidance;
"**Financial Advisers**"	means Morgan Stanley and Deutsche Bank;
"**Financial Services**"	has the meaning given to it in paragraph 13.3 of Part XIII (*Additional Information*) of this Prospectus;
"**Fitch**"	means Fitch Ratings Limited;
"**FLS**"	means the Bank of England Funding for Lending Scheme;
"**Form of Proxy**"	means the form of proxy for use at the CYBG General Meeting;
"**FOS**"	means the Financial Ombudsman Service;
"**FPC**"	means the Financial Policy Committee;
"**FRC**"	means the Financial Reporting Council;
"**Free Shares**"	means the shares awarded to a participant in the SIP up to a maximum of £3,600;
"**FSA**"	means the Financial Services Authority;
"**FSCS**"	means the Financial Services Compensation Scheme;
"**FSMA**"	means the Financial Services and Markets Act 2000, as amended;
"**FTE**"	means full-time equivalent employee;
"**GDPR**"	means the General Data Protection Regulation;
"**General Meeting**"	means the meeting of the Shareholders convened to consider, and if thought fit, approve the resolutions in relation to the Offer including any adjournment thereof;
"**Good Leaver**"	means an employee leaving employment due to injury, disability, redundancy, transfer of the employing business or company out of the CYBG Group, retirement or on death;
"**HMRC**"	means Her Majesty's Revenue & Customs;
"**HMSS**"	means the Homeowner Mortgage Support Scheme;
"**HMT**" or "**HM Treasury**"	means Her Majesty's Treasury;
"**Home Owner and Debtor Protection Act**"	means the Home Owner and Debtor Protection (Scotland) Act 2010;
"**IAS**"	means International Accounting Standards;
"**iB**"	means the digital platform powering CYBG's digital-only bank "B";
"**ICB**"	means the Independent Commission on Banking;
"**ICG**"	means institution specific individual capital guidance issued by the PRA;
"**ICO**"	means the UK Information Commissioner's Office;
"**IFRS**"	means the International Financial Reporting Standards as adopted for use by the European Union;

"**Incentivised Switching Scheme**"	means a scheme through which certain RBS SME customers will be financially incentivised to switch their BCAs from RBS to participating "challenger" banks;
"**Independent Virgin Money Directors**"	means the Virgin Money Directors who are independent of the Virgin Money Group in respect of the Offer, being any Virgin Money Director other than Patrick McCall and Amy Stirling and any other person from time to time appointed to the Virgin Money Board as a representative of or connected with Virgin Group or any member of its group;
"**IPO**"	means initial public offering;
"**IRB**"	means Internal Ratings Based;
"**IRHP**"	means interest rate hedging products;
"**ISA**"	means Individual Savings Account;
"**IT**"	means information technology;
"**ITS**"	means Implementing Technical Standards;
"**KIDs**"	means key information documents;
"**Latest Practicable Date**"	means 27 July 2018;
"**LDR**"	means loans-to-customer deposits ratio;
"**Leverage Ratio**"	means the capital measure (the numerator) divided by the exposure measure (the denominator) calculated in accordance with the relevant EU legislation;
"**Licensed Activities**"	means all banking or financial services and products offered by UK clearing banks or challenger banks, all investment or savings products and services, and all insurance products and services, each including all such services offered by CYBG prior to Completion, as well as other ancillary services;
"**Licensed Trade Marks**"	means the "Virgin Money" names and logos, as well as certain related non-exclusive rights to use the "Virgin" trade marks;
"**Liquidity Coverage Ratio**" or "**LCR**"	means the leverage ratio introduced by the Basel III reforms;
"**Listing Rules**"	means the listing rules made by the FCA under Part VI of the FSMA (as set out in the FCA Handbook), as amended from time to time;
"**London Stock Exchange**"	means London Stock Exchange plc together with any successors thereto;
"**Long Stop Date**"	means 31 January 2019 or such later date as may be agreed between CYBG and Virgin Money and, if required, the Panel and the Court may allow;
"**LTIP**"	means the CYBG Long Term Incentive Plan;
"**LTV**"	means loan-to-value;
"**Main Market**"	means the main market for listed securities of the London Stock Exchange;
"**Market Abuse Regulation**"	means the Market Abuse Regulation (2014/596/EU);
"**Matching Shares**"	means additional Shares awarded by the Board when a participant buys Partnership Shares;
"**MCD (Amendment) Order**"	means the Mortgage Credit Directive (Amendment) Order 2015;
"**MCD Order**"	means the Mortgage Credit Directive Order 2015;
"**MCD**"	means the Mortgage Credit Directive;

“**MCoB**”	means the Mortgages and Home Finance: Conduct of Business Sourcebook issued by the FSA;
“**MiFID II**”	means the Markets in Financial Instruments Directive II;
“**Minimum Royalty**”	means the minimum annual royalty fee payable after Year 4 under the terms of the Brand Licence Agreement;
“**Money Laundering Regulations 2017**”	means the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017;
“**Moody’s**”	means Moody’s Investors Service Limited;
“**Morgan Stanley**”	means Morgan Stanley & Co. International plc;
“**Mortgage Credit Directive**”	means the EU directive on credit agreements relating to residential immovable property for consumers;
“**Mortgage Sale Agreements**”	means the mortgage sale agreements entered into by Virgin Money Bank in connection with its securitisation arrangements;
“**MREL**”	means the minimum requirement for own funds and eligible liabilities;
“**NAB Group**”	means the NAB group of companies;
“**NAB**”	means National Australia Bank Limited;
“**Net Stable Funding Ratio**” or “**NSFR**”	means the short-term and longer-term standards for funding liquidity introduced by the Basel III reforms;
“**New CYBG Shares**”	means the 546,954,891 CYBG Shares, which are proposed to be issued by CYBG to the Virgin Money Shareholders pursuant to the Offer;
“**Non-Executive Directors**”	means the non-executive CYBG Directors as set out in Part XI of this Prospectus;
“**NPS**”	means Net Promoter Score;
“**NRAM**”	means NRAM plc, previously Northern Rock (Asset Management) plc;
“**NSFR**”	means net stable funding ratio;
“**Offer Shares**”	means shares subject to a takeover offer as defined in section 974 of the 2006 Act;
“**Offer**” or “**Combination**”	means the proposed acquisition of the entire issued share capital of Virgin Money;
“**Official List**”	means the list maintained by the FCA in accordance with section 74(1) of FSMA for the purposes of Part VI of FSMA;
“**OFT**”	means the Office of Fair Trading;
“**OpCo Notes**”	means the Virgin Money Bank £300,000,000 2.250 per cent. Senior Fixed Rate Notes due 21 April 2020;
“**Open Banking**”	means the use of open APIs that enable the secure sharing of user and financial services information with other financial services and third parties;
“**OTC**”	means over-the-counter;
“**PAD**”	means the Payment Accounts Directive;
“**Partnership Shares**”	means CYBG Shares bought using contributions from pre-tax salary under the employee Share Incentive Plan;
“**PCAs**”	means personal current accounts;
“**PD Regulation**”	means Regulation number 809/2004 of the European Commission;

"**Pensions Regulator**"	means the UK regulator of workplace pension schemes**;**
"**PEPs**"	means personal equity plans;
"**Plevin**"	means *Plevin v Paragon Personal Finance Ltd [2017] UKSC 23;*
"**Pounds Sterling**" or "**£**" or "**pence**"	means the lawful currency of the United Kingdom;
"**PPI**"	means Payment Protection Insurance;
"**PRA**"	means the UK Prudential Regulation Authority;
"**PRA Remuneration Code**"	means the remuneration rules set out in the remuneration part of the PRA's rule book;
"**Pre-Action Protocol**" . . .	means the pre-action protocol based on mortgage or home plan arrears in respect of residential property in England and Wales that came into force on 19 November 2008;
"**PRIIPs**"	means packaged retail and insurance-based investment products;
"**Proposed Directors**"	means the proposed directors of CYBG as set out in Part XI of this Prospectus;
"**Prospectus Rules**"	means the prospectus rules made by the FCA under Part VI of FSMA (as set out in the FCA Handbook), as amended;
"**PSD**"	means the Payment Services Directive (2007/64/EC);
"**PSD2**" or "**Payment Services Directive 2**" . . .	means the Second Payment Services Directive ((EU) 2015/2366), as amended from time to time which replaced the original Payment Services Directive;
"**PSR**"	means the Payment Systems Regulator;
"**Quantified Financial Benefits Statement**" . . .	means the statement described as such and set out in Part XII (*Quantified Financial Benefits Statement*) of this Prospectus;
"**RBS Alternative Remedies Scheme**"	means RBS's restructuring plan;
"**RBS**"	means The Royal Bank of Scotland;
"**Registrar**"	means Computershare Investor Services PLC, with registered office at The Pavilions, Bridgwater Road, Bristol BS13 8AE;
"**Regulatory Information Service**"	means one of the regulatory information services authorised by the FCA to receive, process and disseminate regulatory information from listed companies;
"**Representative Director**" .	means the one director of CYBG that VEL shall be entitled at all times during the term of the Brand Licence Agreement to nominate remove or reappoint;
"**Resolution 2**"	means the ordinary resolution to authorise the creation and allotment of equity securities in connection with a conversion of Virgin Money AT1 Securities into CYBG Shares should a Trigger Event occur and/or to comply with, or maintain compliance with, the regulatory capital requirements or targets applicable to the CYBG Group from time to time, to be proposed at the CYBG General Meeting (and set out in the Circular);
"**Resolution 3**"	means the special resolution to disapply pre-emption rights in connection with a conversion of Virgin Money AT1 Securities into CYBG Shares should a Trigger Event occur and/or to comply with, or maintain compliance with, the regulatory capital requirements or targets applicable to the CYBG Group from time to time, to be proposed at the CYBG General Meeting (and set out in the Circular);
"**RMBS**"	means residential mortgage backed securities;
"**RWAs**"	means risk weighted assets;

"**S&P**"	means Standard & Poor's Credit Market Services Europe Limited;
"**SAYE Plan**"	means the CYBG Save As You Earn Plan;
"**SBS**"	means the Strategic Business Services team within the CYBG Group's risk management function;
"**Scheme**"	means the proposed scheme of arrangement under Part 26 of the 2006 Act between Virgin Money and the holders of the Virgin Money Shares as set out in the Scheme Document, with or subject to any modification, addition or condition approved or imposed by the Court and agreed by Virgin Money and CYBG;
"**Scheme Document**"	means the document to be sent by Virgin Money to Virgin Money Shareholders and persons with information rights containing, amongst other things, the full terms and conditions of the Scheme and notices convening the Virgin Money Meetings and accompanied by proxy forms in respect of the Virgin Money Meetings;
"**Scheme Record Time**" . .	means the time and date specified in the Scheme Document, expected to be 6:00 p.m. on the Business Day immediately prior to the Effective Date;
"**SCV**"	means the Single Customer View;
"**SDRT**"	means stamp duty reserve tax;
"**Senior Managers Regime**"	means the Senior Managers Regime introduced in March 2016 by the FCA;
"**Settlement Agreement**" . .	means the settlement agreement dated 18 June 2018 entered into between Virgin Money Bank and the Virgin Money CEO which will take effect from Completion;
"**Share Plans**"	means the SAYE Plan, the DEP, the LTIP and the SIP;
"**Shareholders**" or "**CYBG Shareholders**" .	means holder(s) of the CYBG Shares;
"**SIP**"	means the CYBG Share Incentive Plan;
"**SME**"	means a small and medium-sized enterprise;
"**Sponsor**"	means Morgan Stanley;
"**Sponsor's Agreement**" . .	means the agreement dated 31 July 2018 between the Company and Morgan Stanley in which the Company appointed Morgan Stanley as sponsor in connection with the applications for Admission and the publication of this Prospectus and the Circular;
"**SREP**"	means the Virgin Money Group's 2018 Supervisory Review and Evaluation Process;
"**Standards for Investment Reporting**"	means investment reporting standards applicable to public reporting engagements on financial information reconciliations under the Listing Rules, published by the Auditing Practices Board;
"**stock account**"	means an account within a member account in CREST to which a holding of a particular share or other security in CREST is credited;
"**subsidiary undertaking**" .	has the meaning given in section 1162 of the 2006 Act;
"**subsidiary**"	has the meaning given in section 1159 of the 2006 Act;
"**Takeover Code**"	means the City Code on Takeovers and Mergers;
"**Takeover Offer**"	means, if, subject to the consent of the Panel, CYBG elects to effect the Offer by way of a takeover offer as defined in section 974 of the 2006 Act, the offer to be made by or on behalf of CYBG to acquire the entire issued and to be issued ordinary share capital of Virgin Money on the terms and subject to the

	conditions to be set out in the related offer document and, where the context admits, any subsequent revision, variation, extension or renewal of such offer;
"**Takeover Panel**" or "**Panel**"	means the UK Panel on Takeovers and Mergers;
"**Territory**"	means the United Kingdom;
"**TFS**"	means the Bank of England's Term Funding Scheme;
"**Threshold Amount**"	means the CYBG Group turnover of £2.1 billion in Year 3 following Completion;
"**Total Capital Ratio**"	means the percentage of capital against RWAs;
"**TPPs**"	means third party payment providers;
"**Trigger Event**"	means the common equity tier 1 ratio of the Issuer Group (as defined in the Virgin Money AT1 Securities Conditions) falling below a threshold specified in the Virgin Money AT1 Securities Conditions;
"**TSA**"	means the transitional services agreement entered into between NAB and the CYBG Group on 29 January 2016;
"**TUPE**"	means the Transfer of Undertakings (Protection of Employment) Regulation 2006, as amended;
"**UK Corporate Governance Code**"	means the UK Corporate Governance Code issued by the Financial Reporting Council in the UK dated April 2016;
"**UK Referendum**"	means the referendum held in the UK on 23 June 2016;
"**UK Registrar**"	means Computershare Investor Services PLC;
"**uncertificated**" or "**in uncertificated form**"	means in relation to shares, means recorded on the relevant register as being held in uncertificated form in CREST and title to which, by virtue of the CREST Regulations, may be transferred by means of CREST;
"**Unfair Practices Directive**"	means the EU Directive (2005/29/EC) regarding unfair business-to-consumer commercial practices;
"**United Kingdom**" or "**UK**"	means the United Kingdom of Great Britain and Northern Ireland;
"**United States**" or "**US**"	means the United States of America, its territories, its possessions and all areas subject to its jurisdiction;
"**US dollars**" or "**USD**" or "**cents**"	means the United States Dollars, the official currency of the United States of America;
"**US Securities Act**"	means the United States Securities Act of 1933, as amended from time to time;
"**UTCCR**"	means Unfair Terms in Consumer Contracts Regulations 1999;
"**VDPFS**"	means Virgin Money Direct Personal Financial Service Limited;
"**Virgin Enterprises**" or "**VEL**"	means Virgin Enterprises Limited;
"**Virgin Holdings**"	means Virgin Group Holdings Limited
"**Virgin Money**"	means Virgin Money Holdings (UK) plc, a company incorporated in England and Wales, with registered number 03087587 and its registered office at Jubilee House, Gosforth, Newcastle-Upon-Tyne, United Kingdom, NE3 4PL;
"**Virgin Money AT1 Securities**"	means the issued and outstanding £160,000,000 fixed rate resettable additional

	tier 1 securities and £230,000,000 fixed rate resettable additional tier 1 securities of Virgin Money;
"**Virgin Money AT1 Securities Conditions**" . .	means the terms and conditions of the Virgin Money AT1 Securities respectively;
"**Virgin Money Annual Report 2015**"	means the Virgin Money Group's annual report and accounts for the year ended 31 December 2015;
"**Virgin Money Annual Report 2016**"	means the Virgin Money Group's annual report and accounts for the year ended 31 December 2016;
"**Virgin Money Annual Report 2017**"	means the Virgin Money Group's annual report and accounts for the year ended 31 December 2017;
"**Virgin Money Bank**" . . .	means Virgin Money plc, a company incorporated in England and Wales, with registered number 06952311 and its registered office at Jubilee House, Gosforth, Newcastle Upon Tyne, NE3 4PL;
"**Virgin Money CEO**" . . .	means Jayne-Anne Gadhia;
"**Virgin Money Directors**" or "**Virgin Money Board**"	means the directors of Virgin Money as at the date of this Prospectus or, where the context so requires, the directors of Virgin Money from time to time;
"**Virgin Money Group**" . .	means Virgin Money and its subsidiary undertakings from time to time and where the context permits, each of them;
"**Virgin Money Interim Report 2018**"	means Virgin Money's interim financial report for the six months to 30 June 2018;
"**Virgin Money Resolutions**"	means the resolutions proposed to be passed at the Virgin Money General Meeting in connection with, inter alia, implementation of the Scheme and such other matters as may be necessary to implement the Scheme and the delisting of the Virgin Money Shares (including the Brand License Resolutions) and Virgin Money Resolution means any one of them;
"**Virgin Money Scheme Shareholders**"	means holders of Virgin Money Scheme Shares;
"**Virgin Money Scheme Shares**"	means Virgin Money Shares: a) in issue as at the date of the Scheme Document; b) (if any) issued after the date of the Scheme Document and prior to the Scheme Voting Record Time; and c) (if any) issued on or after the Scheme Voting Record Time and before the Scheme Record Time, either on terms that the original or any subsequent holders thereof shall be bound by the Scheme or in respect of which the holders thereof shall have agreed in writing to be bound by the Scheme, but in each case other than the Excluded Shares;
"**Virgin Money Share Plan**"	means the Virgin Money Long Term Incentive Plan and the Virgin Money Deferred Bonus Share Plan;
"**Virgin Money Shareholders**"	means holders of Virgin Money Shares;
"**Virgin Money Shares**" . .	means the ordinary shares of 0.01 pence each in the capital of Virgin Money;

"**Virgin Money Trade Marks**"	means the "Virgin Money" names and logos and several "Virgin Money" sub-brands including the "Virgin Money Giving" trade mark;
"**VMUTM**"	means Virgin Money Unit Trust Managers Limited, with its registered office at Jubilee House, Gosforth, Newcastle-Upon-Tyne, NE3 4PL;
"**VOA**"	means the Virgin Money One Account;
"**W&G**"	means Williams & Glyn;
"**Women in Finance Charter**"	means the women in finance charter pledge for gender balance across financial services published by HMT in March 2016; and
"**£**" or "**pence**"	means the lawful currency of the United Kingdom.

All times referred to are London time unless otherwise stated.

All references to legislation in this Prospectus are to the legislation of England and Wales unless the contrary is indicated. Any reference to any provision of any legislation shall include any amendment, modification, re-enactment or extension thereof.

Words importing the singular shall include the plural and *vice versa*, and words importing the masculine gender shall include the feminine or neutral gender.

Merrill Corporation Ltd, London
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