Registered No. 06952311

Virgin Money plc

Annual Report and Accounts 2016

Virgin Money plc

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Virgin Money plc

Company information

NON-EXECUTIVE DIRECTORS	Glen Moreno Norman McLuskie Colin Keogh Marilyn H Spearing Geeta Gopalan Eva Eisenschimmel
EXECUTIVE DIRECTORS	Jayne-Anne Gadhia CBE – Chief Executive Marian Martin – Chief Risk Officer Peter Bole – Chief Financial Officer
COMPANY SECRETARY	Katie Marshall
COMPANY NUMBER	06952311
REGISTERED OFFICE	Jubilee House Gosforth Newcastle-upon-Tyne NE3 4PL
AUDITORS	PricewaterhouseCoopers LLP Atria One 114 Morrison Street Edinburgh EH3 8EX

All information above is as at 27 February 2017. For changes to the composition of the board including former Directors who served in the year and up to the date of this report, refer to page 9.

Strategic report

Virgin Money plc (Virgin Money, the Company) is a wholly owned subsidiary of Virgin Money Holdings (UK) plc (Holdings, the Group). The Company is a UK based retail bank focused primarily on providing residential mortgages, savings and credit cards. The Company provides award-winning customer service through a range of channels, including digital (online and mobile), intermediaries, contact centres and a national network of 75 Stores and 7 customer Lounges.

Business Review

The financial results for the year ended 31 December 2016 reinforced the strength of the Company's business model, with significant progression across the three strategic objectives of growth, quality and returns.

The Company continued to achieve a market share of new lending exceeding existing share of stock, resulting in significant growth in loans and advances to customers. Secured and unsecured balances increased by 17 per cent and 55 per cent respectively. Growth in lending was managed carefully and funded predominantly through customer deposits, which saw growth of 12 per cent, and diversified long-term wholesale funding.

A disciplined approach to managing this growth was maintained, with consistently high underwriting standards leading to a low cost of risk. Whilst the low cost of risk has also benefited from the benign economic environment in the UK, all key credit metrics across the lending portfolios exhibit either stable or improving trends, and this is reflected in the low level of arrears experienced.

Capital resources increased through retained earnings and the issuance of £230.0 million of Additional Tier 1 securities in the fourth quarter, with associated increases in total capital and leverage ratios. The Company's liquidity and funding profile benefited from access to the Government's Term Funding Scheme (TFS) and additional long-term wholesale issuance.

The growth in income through higher lending, along with stringent cost control, resulted in improvement to the cost:income ratio of 7 percentage points and, combined with a low cost of risk, an increase in profit before tax of 38 per cent to £159.7 million and return on assets of 2 basis points to 0.33 per cent.

Summary Income Statement

	2016 £m	2015 £m	Change
Net interest income	**519.3**	457.2	14%
Other income	**7.0**	22.5	(69)%
Total income	**526.3**	479.7	10%
Costs	**(329.0)**	(333.4)	(1)%
Impairment	**(37.6)**	(30.3)	24%
Profit before tax	**159.7**	116.0	38%

Summary Balance Sheet

	At 31 Dec 2016 £m	At 31 Dec 2015 £m	Change
Assets			
Cash and balances at central banks	**786.3**	888.6	(12)%
Loans and receivables	**32,939.3**	27,512.3	20%
Available-for-sale financial assets	**858.8**	1,296.9	(34)%
Other	**330.8**	311.0	6%
Total assets	**34,915.2**	30,008.8	16%
Liabilities and equity			
Deposits from banks	**2,129.7**	1,283.8	66%
Customer deposits	**28,106.3**	25,145.3	12%
Amounts due to securitisation special purpose vehicles	**2,143.6**	1,553.1	38%
Other	**844.4**	697.9	21%
Total liabilities	**33,224.0**	28,680.1	16%
Total equity	**1,691.2**	1,328.7	27%
Total liabilities and equity	**34,915.2**	30,008.8	16%

Strong balance sheet growth

	At 31 Dec 2016 £m	At 31 Dec 2015 £m	Change
Loans and advances to customers	**32,708.9**	27,391.4	19.4%
Customer deposits	**28,106.3**	25,145.3	11.8%
Wholesale funding	**4,567.4**	3,125.5	46.1%
Wholesale funding <1 year maturity	**861.7**	1,413.6	(39.0)%
High Quality Liquid Assets[1]	**4,222.6**	4,238.6	(0.4)%

1 These include Funding for Lending drawings which are held off-balance sheet but are available for repo and hence count towards liquidity resources.

The Company achieved record gross mortgage lending of £8.4 billion during the year, up 11.9 per cent from 2015. As a result, the mortgage book increased by £4,292.6 million, or 16.9 per cent. The cards book increased by 55.0 per cent from 31 December 2015, to £2,447.1 million. Taken together, these factors increased total loans and advances to customers by 19.4 per cent to £32,708.9 million.

Asset growth was funded by growth in both retail and wholesale funding. Customer deposits grew by 11.8 per cent, which was well in excess of market growth at 3.2 per cent. The wholesale funding base was diversified further with the completion of the Gosforth Funding 2016-1 and 2016-2 Residential Mortgage Backed Securities (RMBS) transactions in January and May 2016. In addition, the Company accessed the TFS with £1,268.0 million drawn during the year to support lending growth and refinancing of maturing Funding for Lending Scheme (FLS) drawings.

The Company's liquidity position remains strong, with High Quality Liquid Assets of £4,222.6 million at 31 December 2016 compared to £4,238.6 million at 31 December 2015. High Quality Liquid Assets represent approximately 4.9 times wholesale funding with a maturity of less than one year, providing a substantial buffer in the event of a market dislocation. In addition, in the short-term, the Company has significant and immediately available funding capacity from the TFS.

Income benefited from growth in asset balances

	2016 £m	2015 £m	Change
Net interest income	**519.3**	457.2	13.6%
Fair value losses on financial instruments	**(26.2)**	(8.0)	227.5%
Other	**33.2**	30.5	8.9%
Total income	**526.3**	479.7	9.7%

During 2016 net interest income increased by 13.6 per cent to £519.3 million. This was driven by strong balance growth across mortgage and card lending. Growth in the credit card portfolio and optimisation of the funding base supported margins. Ongoing active management of retail funding and initial drawings from the TFS contributed to lower funding costs.

The Company uses derivative financial instruments to economically hedge its exposure to changes in interest or foreign exchange rates. Fair value losses on financial instruments reflect fair value movements on derivatives in economic hedges that do not meet the strict criteria for hedge accounting in addition to a modest amount of ineffectiveness in hedge accounting relationships. Volatility in swap curves during 2016 contributed to increased fair value losses on derivatives in economic hedges.

Other income (excluding fair value losses on financial instruments) increased by 8.9 per cent to £33.2 million. This included the gain on disposal of £5.3 million on the Company's shareholding in Visa Europe Limited.

Costs remain tightly controlled

		2016	2015	Change
Operating expenses	£m	**329.0**	333.4	(1.3)%
Cost:income ratio	%	**62.5**	69.5	(7.0)pp

The Company's disciplined management of costs delivered improvement to profitability. Set against the increase in income of 9.7 per cent, operating expenses decreased by 1.3 per cent resulting in a reduction to the cost:income ratio of 7.0 percentage points to 62.5 per cent.

Impairment reflects rigorous underwriting controls

		2016	2015	Change
Mortgages				
Impairment charge	£m	**2.8**	3.0	(6.7)%
Cost of risk	%	**0.01**	0.01	—
Cards				
Impairment charge	£m	**34.8**	27.3	27.5%
Cost of risk	%	**1.70**	2.00	(30)bps
Total				
Impairment charge	£m	**37.6**	30.3	24.1%
Cost of risk	%	**0.13**	0.12	1bp
Impaired loans as a % of loans and advances	%	**0.4**	0.4	—
Provisions as a % of impaired loans	%	**40.0**	35.6	4.4pp

The cost of risk for mortgages remained stable at 0.01 per cent with the mortgage impairment charge falling in absolute terms. This stability reflected the continued high asset quality of the loan portfolio and the Company's strategic approach to risk management, combined with the benign economic environment.

Set against growth of 55.0 per cent in credit card balances, the cards impairment charge increased by only 27.5 per cent to £34.8 million. The resulting cost of risk for credit cards decreased by 30 basis points to 1.70 per cent in 2016, from 2.00 per cent in 2015. This underlines the continued high credit quality of new and existing cards and the low rate of default during the early stages of card lives. Performance of individual cohorts of cards remains strong, with all cohorts showing a cost of risk in line with or better than expectations.

Impaired loans as a percentage of loans and advances of 0.4 per cent was unchanged at 31 December 2016. Provisions as a percentage of impaired loans increased to 40.0 per cent at 31 December 2016, from 35.6 per cent at 31 December 2015. This rise reflects increased card balances, where provisions as a percentage of impaired loans across the cards portfolio are higher than for secured mortgage lending.

Continued strong progression in returns

		2016	2015	Change
Return on assets	%	**0.33**	0.31	2bps

Balance sheet growth and improved operational leverage, combined with a rigorous approach to underwriting and asset quality, have driven enhanced returns in 2016. Return on assets grew by 2 basis points to 0.33 per cent in 2016, from 0.31 per cent in 2015.

Capital strength

		2016	2015	Change
Capital ratios and risk-weighted assets				
Common Equity Tier 1 (CET1) capital	**£m**	**1,356.8**	1,227.6	10.5%
Risk-weighted assets (RWAs)	**£m**	**7,603.0**	6,059.5	25.5%
Common Equity Tier 1 ratio	**%**	**17.8**	20.3	(2.5)pp
Tier 1 ratio	**%**	**20.9**	20.3	0.6pp
Total capital ratio	**%**	**21.0**	20.4	0.6pp
Leverage ratio	**%**	**4.4**	4.0	0.4pp

The Company continues to maintain strong capital ratios, in excess of both internal targets and regulatory requirements. The CET1 ratio reduced to 17.8 per cent at 31 December 2016 from 20.3 per cent at the prior year end, reflecting the strong lending growth in the year. This lending growth resulted in an increase in Risk Weighted Assets of 25.5 per cent.

The combination of strong earnings performance and the issuance of £230.0 million of AT1 capital to the parent undertaking meant that the total capital ratio increased from 20.4 per cent at 31 December 2015 to 21.0 per cent at 31 December 2016.

The leverage ratio was 4.4 per cent at the end of 2016, compared with 4.0 per cent at the end of 2015. The AT1 issuance provides significant capacity for future high credit quality mortgage growth that is, relative to other types of lending, leverage intensive.

Future developments

As a UK retail bank focused on serving domestic customers, the decision to exit the EU does not have a direct impact on the Company. Whilst the UK economy has been resilient since the vote to leave, the eventual timing and nature of the UK's exit from the EU remains unclear and the longer-term impact on the economy is uncertain.

The strategy of growth, quality and returns remains unchanged and the Company will continue to focus on providing outstanding service to customers, pursuing disciplined growth of the Balance Sheet within risk appetite, maintaining prudent underwriting standards to protect asset quality, and delivering strong and sustainable returns.

The Company will continue to grow assets at the right price and quality, maintain a target market share of 3.0 to 3.5 per cent of gross mortgage lending and growth to £3 billion of high-quality credit card balances at the end of 2017.

Principal Risks and Uncertainties

The most significant risks faced by the Company which could impact on the success of delivering its long-term strategic objectives are outlined below:

Principal risks	Key mitigating actions
Credit Risk	
The Company provides 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 our borrowers results in additional impairment losses thereby reducing profitability. Wholesale exposures arise through the use of derivative instruments to manage interest rate risk in addition to investments held in the liquid asset portfolio.	➢ the Company operates a well-defined Board approved credit risk appetite and applies risk limits reflected in the approved credit policy; ➢ a robust credit risk framework helps ensure that the credit quality and composition of portfolios remain within risk appetite limits. This is monitored and reported through governance committees regularly; ➢ stress and scenario testing allows the Company to confirm portfolio resilience; and ➢ risk arising from derivative and from secured financing transactions is mitigated by collateralising exposures on a daily basis.
Market Risk	
Market risk is the risk that unfavourable market movements lead to a reduction in earnings or value. The Company does not trade or make markets. Interest rate risk in the banking book is the only material category of market risk.	➢ the Company operates a well-defined Board approved risk appetite with associated limits and policy; ➢ exposures are mitigated through the use of natural offsets and derivatives; and ➢ stress and scenario testing focuses on the impacts of differing interest rate environments.
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 Company.	➢ risk appetite is focused on maturing the control environment and therefore managing operational risk; ➢ a programme of investment in security infrastructure is in place to mitigate threats including cyber-attack; ➢ continued investment in and development of risk management frameworks, systems and processes; and ➢ monitoring of external events impacting other financial services companies to inform stress testing.

Strategic report

Principal risks	Key mitigating actions
Conduct Risk and Compliance Conduct and compliance risk is defined as the risk that the Company'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 Company fails to design and implement operational processes, systems and controls and maintain compliance with all applicable regulatory requirements.	➢ compliance is maintained through an effective and timely response to changes in the regulatory environment; ➢ the customer is placed at the heart of decision making by ensuring fair outcomes through comprehensive risk assessment and testing; ➢ continued investment in and development of risk management frameworks, systems and processes; and ➢ focus on training to ensure employee performance aligns with customer accountabilities and provides awareness of vulnerable customers' needs.
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 concentration risk. Credit concentration risk is managed for retail and wholesale credit exposures at portfolio, product and counterparty levels.	➢ Board focus is on ensuring alignment of business development and planning with risk appetite; ➢ investment in processes, systems, recruitment and training to support new business developments; ➢ use of robust risk and project management disciplines to ensure that implementation of new initiatives is delivered safely; ➢ active focus on disciplined asset origination and portfolio management to eliminate inappropriate concentration risk; and ➢ regular validation and review of models is performed.
Funding and Liquidity Risk 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. Funding risk represents the inability to raise and maintain sufficient funding in quality and quantity to support the delivery of the business plan.	➢ the Company operates a well-defined Board approved risk appetite and applies limits defined in the funding and liquidity policy; ➢ liquid resources are maintained in adequate quantity and quality to meet stressed outflows; ➢ a prudent mix of funding sources is maintained with a maturity profile set in risk appetite and policy limits; and ➢ stress and scenario testing considers threats to funding plans and changes in consumer behaviour.

Financial Risk Management Objectives and Policies

Information regarding the financial risk management objectives and policies of the Company, in relation to the use of financial instruments, is given in note 31. Additional information can be found in the Annual Report and Accounts of Virgin Money Holdings (UK) plc, the Company's ultimate parent, which does not form part of this report.

The Strategic Report has been approved by the Board of Directors.

On behalf of the Board

Jayne-Anne Gadhia CBE
27 February 2017
Chief Executive

Directors' report

Results

The income statement shows a statutory profit before tax for the year ended 31 December 2016 of £159.7 million. This represents an increase of 38 per cent over the year ended 31 December 2015.

Dividends

The Directors do not propose to recommend a final dividend in respect of the year ended 31 December 2016.

Post balance sheet events

There have been no material post balance sheet events.

Going concern

The going concern status of the Company is dependent on successfully funding the balance sheet and maintaining adequate levels of capital. In order to satisfy themselves that the Company has adequate resources to continue to operate for a period of at least twelve months from the date of approval of this report, the Directors have considered a number of key dependencies which are set out in the Strategic Report under Principal Risks and Uncertainties and additionally have considered projections for the Company's capital and funding position.

Having considered these and made appropriate enquiries, the Directors consider that the Company has adequate reserves to continue in business for a period of at least twelve months from the date of approval of this report. As a result, it is appropriate to continue to adopt the going concern basis in preparing the accounts.

Future developments

Information about future developments of the Company can be found in the Strategic Report.

Financial risk management objectives and policies

Information in relation to financial reporting and financial risk management objectives and policies in relation to the use of financial instruments can be found in note 31.

Corporate Governance

Details of the corporate governance framework applying to the Company is set out in the Corporate Governance Report within the Annual Report and Accounts of the Group for the year ended 31 December 2016 (Group ARA).

Information included in the Group strategic report

The following information that would otherwise be disclosed in this report, and which is incorporated into this report by reference, can be found on the following pages of the Strategic Report in the Group ARA:

Subject matter	Page reference
Colleague engagement	36 and 37
Employment of disabled persons	36
Emissions reporting	42 and 43

Directors

The names of the Directors of the Company at the date of this report are shown on page 1.

Changes to the composition of the Board since 1 January 2016, and up to the date of this report, are shown in the table below:

Name	Date of Appointment	Role
Eva Eisenschimmel	25 January 2017	Independent Non-Executive Director
Peter Bole	30 January 2017	Executive Director

Directors' report

Appointment and retirement of Directors

The appointment, retirement and/or replacement of Directors is governed by the Company's articles of association (the articles), and the Companies Act 2006 (the Act). The Company's articles may only be amended by a special resolution of the shareholders in a general meeting.

The Company, as a public limited company, is required to hold an Annual General Meeting (AGM) at which one third of its Directors must retire from office every year. At the Company's 2016 AGM Colin Keogh, Marian Martin and Geeta Gopalan retired, submitted themselves for re-election and were duly re-elected.

Directors' indemnities

The Directors of the Company have entered into individual deeds of indemnity with the Company which constituted 'qualifying third party indemnity provisions' for the purposes of the Act. The deeds indemnify the Directors to the maximum extent permitted by law and remain in force for the duration of a Director's period of office and for a period of six years thereafter. The deeds were in force during the whole of the financial year and up to the date of approval of this report. Deeds for the Directors are available for inspection at the Company's registered office. In addition, the Company had appropriate Directors' and Officers' insurance cover in place throughout 2016.

Share capital, control and Directors' powers

Information about the share capital of the Company is shown in note 25 to the financial statements and is incorporated into this report by reference.

The powers of the Directors, including in relation to the issue or repurchase of the Company's shares, are set out in the Company's articles and the Act. The Company did not repurchase any of the issued Ordinary Shares during the year or up to the date of this report (2015: none).

There are no restrictions on the transfers of shares other than set out in the Company's articles or the Act. No shares are subject to a lien or charge.

Change of control

The Company is not a party to any significant contracts that are subject to change of control provisions in the event of a takeover bid, other than the Virgin Money Trademark Licence Agreement. This is the agreement under which Virgin Enterprises Limited (VEL) grants a perpetual licence to the Group providing the right to use the "Virgin" and "Virgin Money" trademarks. VEL has the right to terminate the agreement in the event of a change of control of the Group, other than a change of control pre-approved by VEL. VEL shall only be entitled to withhold consent in the event of a takeover by a third party who, in VEL's reasonable opinion is a direct competitor of VEL or any Virgin entity in the UK or whose reputation or financial standing is reasonably likely to materially damage the value or reputation of the "Virgin" marks.

There are no agreements between the Company and its Directors or employees providing compensation for loss of office or employment that occurs because of a takeover.

In the event of a takeover or other change of control (excluding an internal reorganisation), outstanding awards under the Group's share plans vest to the extent any applicable performance conditions have been met, and subject to applicable time pro-rating, in accordance with the rules of the plans.

Significant contracts

Details of related party transactions are set out in note 34 to the financial statements.

Research and development activities

The Company does not undertake formal research and development activities but does invest in the development of platforms and products.

Employees

The Company, as part of the Virgin Money Holdings (UK) plc Group, is committed to providing employment practices and policies which recognise the diversity of its workforce. The Company will not unfairly discriminate in the recruitment or employment practices on the basis of any factor which is not relevant to individuals' performance including sex, race, disability, age, sexual orientation or religious belief.

Directors' report

Statement of Directors' responsibilities

The Directors are responsible for preparing the Strategic Report, the Directors' Report and the financial statements in accordance with applicable law and regulations. Company law requires the Directors to prepare financial statements for each financial year. Under that law they have elected to prepare the financial statements in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU and applicable law.

Under company law, the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether they have been prepared in accordance with IFRS as adopted by the EU; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and to prevent and detect fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the corporate and financial information of the Company included on the Virgin Money Group website, www.virginmoney.com. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Responsibility statement of the Directors in respect of the Annual Financial Report

Each of the Directors confirms that to the best of his or her knowledge:

- the financial statements, prepared in accordance with the applicable set of accounting standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company; and
- the Strategic Report and Directors' Report includes a fair review of the development and performance of the business and the position of the Company together with a description of the principal risks and uncertainties that it faces.

Independent auditors and audit information

Each of the current Directors, who are in office at the date of approval of this report confirms that, to the best of his or her knowledge, there is no relevant audit information of which the Company's auditors are unaware and each Director has taken all the steps that he or she ought to have taken as a Director to make himself or herself aware of any relevant audit information and to establish that the auditors are also aware of that information. This confirmation is given and should be interpreted in accordance with the provisions of the Act.

Following a competitive tender process for the audit of Virgin Money Holdings (UK) plc and its subsidiaries that took place in 2015, the Group's Board recommended that PricewaterhouseCoopers LLP be appointed as auditors for the Virgin Money Group of entities effective for periods ending on or after 1 January 2016. The shareholder of the Company subsequently approved a resolution proposing the appointment of PricewaterhouseCoopers LLP as the Company's auditors.

As a result PricewaterhouseCoopers LLP have been appointed as the auditors of the Company in accordance with section 489 of the Companies Act 2006.

Katie Marshall
27 February 2017
Company Secretary
Virgin Money plc
Registered No. 06952311

Independent auditors' report

Independent auditors' report to the members of Virgin Money plc

Report on the financial statements

Our opinion
In our opinion, Virgin Money plc's financial statements (the "financial statements"):

- give a true and fair view of the state of the Company's affairs as at 31 December 2016 and of its profit and cash flows for the year then ended;
- have been properly prepared in accordance with International Financial Reporting Standards ("IFRSs") as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

What we have audited
The financial statements, included within the Annual Report and Accounts (the "Annual Report"), comprise:

- the balance sheet as at 31 December 2016;
- the income statement and statement of comprehensive income for the year then ended;
- the cash flow statement for the year then ended;
- the statement of changes in equity for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies and other explanatory information.

The financial reporting framework that has been applied in the preparation of the financial statements is IFRSs as adopted by the European Union, and applicable law.

In applying the financial reporting framework, the Directors have made a number of subjective judgements, for example in respect of significant accounting estimates. In making such estimates, they have made assumptions and considered future events.

Opinions on other matters prescribed by the Companies Act 2006

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

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

In addition, in light of the knowledge and understanding of the Company and its 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.

Other matters on which we are required to report by exception

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

We have no exceptions to report arising from this responsibility.

Independent auditors' report

Other matters on which we are required to report by exception (continued)

Directors' remuneration
Under the Companies Act 2006 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.

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, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) ("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 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
We conducted our audit in accordance with ISAs (UK & Ireland). 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 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 performing the 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

Virgin Money plc

Income statement

For the year ended 31 December

	Note	2016 £m	2015[1] £m
Interest and similar income		**951.7**	843.4
Interest and similar expense		**(432.4)**	(386.2)
Net interest income	2	**519.3**	457.2
Fee and commission income	3	**21.3**	21.8
Fair value losses on financial instruments	10	**(26.2)**	(8.0)
Other operating income	4	**11.9**	8.7
Other income		**7.0**	22.5
Total income		**526.3**	479.7
Operating expenses	5	**(329.0)**	(333.4)
Profit before tax from operating activities		**197.3**	146.3
Impairment	7	**(37.6)**	(30.3)
Profit before tax		**159.7**	116.0
Taxation	8	**(44.1)**	(23.1)
Profit for the year		**115.6**	92.9
Profit attributable to equity shareholders		**115.6**	92.9
Profit for the year		**115.6**	92.9

1 Restated (refer notes 1 and 39)

The accompanying notes are an integral part of these financial statements.

Virgin Money plc

Statement of comprehensive income

For the year ended 31 December

	Note	2016 £m	2015[1] £m
Profit for the year		**115.6**	92.9
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	27	**44.4**	25.1
Income statement transfers in respect of disposals	27	**(38.3)**	(32.2)
Taxation	27	**(1.7)**	1.2
Other comprehensive income/(expense) for the year, net of tax		**4.4**	(5.9)
Total comprehensive income for the year		**120.0**	87.0
Total comprehensive income attributable to equity shareholders		**120.0**	87.0

1 Restated (refer notes 1 and 39)

The accompanying notes are an integral part of these financial statements.

Virgin Money plc
Balance sheet

	Note	**31 Dec 2016 £m**	31 Dec 2015[1] £m	1 Jan 2015[1] £m
Assets				
Cash and balances at central banks		**786.3**	888.6	851.3
Derivative financial instruments	10	**35.2**	80.7	100.1
Loans and receivables:				
–Loans and advances to banks	11	**229.7**	119.6	136.4
–Loans and advances to customers	12	**32,708.9**	27,391.4	23,347.9
–Debt securities		**0.7**	1.3	11.0
		32,939.3	27,512.3	23,495.3
Available-for-sale financial assets	13	**858.8**	1,296.9	1,539.6
Intangible assets	16	**80.6**	63.0	45.0
Tangible fixed assets	17	**75.8**	74.6	72.0
Deferred tax assets	18	**21.8**	35.0	47.1
Other assets	19	**117.4**	57.7	68.2
Total assets		**34,915.2**	30,008.8	26,218.6
Liabilities				
Deposits from banks	20	**2,129.7**	1,283.8	845.5
Customer deposits	21	**28,106.3**	25,145.3	22,368.9
Derivative financial instruments	10	**225.3**	155.3	227.9
Amounts due to securitisation special purpose vehicles	12	**2,143.6**	1,553.1	1,294.9
Debt securities in issue	22	**305.8**	297.5	—
Provisions	23	**8.5**	8.2	9.1
Current tax liabilities		**16.8**	6.3	2.3
Other liabilities	24	**288.0**	230.6	248.6
Total liabilities		**33,224.0**	28,680.1	24,997.2
Equity				
Share capital	25	**1,400.0**	1,400.0	1,400.0
Other equity instruments	26	**230.0**	—	—
Other reserves	27	**4.1**	(0.3)	5.6
Retained earnings		**57.1**	(71.0)	(184.2)
Total equity		**1,691.2**	1,328.7	1,221.4
Total liabilities and equity		**34,915.2**	30,008.8	26,218.6

1 Restated (refer notes 1 and 39)

Investment in subsidiaries was £nil in all years presented, refer to note 15 for further details.

The accompanying notes are an integral part of these financial statements.

The financial statements on pages 14 to 86 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

Virgin Money plc

Statement of changes in equity

Attributable to equity holders

	Share capital £m	**Other equity instruments £m**	**Other reserves £m**	**Retained earnings £m**	**Total equity £m**
Balance at 1 January 2016	**1,400.0**	**—**	**(0.3)**	**(71.0)**	**1,328.7**
Comprehensive income					
Profit for the year	**—**	**—**	**—**	**115.6**	**115.6**
Other comprehensive income					
Net movement in available-for-sale reserve	**—**	**—**	**4.4**	**—**	**4.4**
Total comprehensive income for the year	**—**	**—**	**4.4**	**115.6**	**120.0**
Transactions with equity holders					
Issue of Additional Tier 1 securities (net)	**—**	**230.0**	**—**	**—**	**230.0**
Share based payments – charge for year	**—**	**—**	**—**	**12.8**	**12.8**
Deferred tax on share based payments	**—**	**—**	**—**	**(0.3)**	**(0.3)**
Total transactions with equity holders	**—**	**230.0**	**—**	**12.5**	**242.5**
Balance at 31 December 2016	**1,400.0**	**230.0**	**4.1**	**57.1**	**1,691.2**

	Share capital £m	Other equity instruments £m	Other reserves £m	Retained earnings[1] £m	Total equity £m
Balance at 1 January 2015	1,400.0	—	5.6	(184.2)	1,221.4
Comprehensive income					
Profit for the year	—	—	—	92.9	92.9
Other comprehensive expense					
Net movement in available-for-sale reserve	—	—	(5.9)	—	(5.9)
Total comprehensive income for the year	—	—	(5.9)	92.9	87.0
Transactions with equity holders					
Share based payments – charge for year	—	—	—	20.0	20.0
Deferred tax on share based payments	—	—	—	0.3	0.3
Total transactions with equity holders	—	—	—	20.3	20.3
Balance at 31 December 2015	1,400.0	—	(0.3)	(71.0)	1,328.7

1 Restated (refer notes 1 and 39)

Further details of movements in the Company's share capital and reserves are provided in notes 25 to 27.

Virgin Money plc

Cash flow statement

For the year ended 31 December

	Note	2016 £m	2015[1] £m
Profit before taxation		**159.7**	116.0
Adjustments for:			
Changes in operating assets	32a	**(5,374.4)**	(4,047.6)
Changes in operating liabilities	32b	**4,557.1**	3,390.4
Non-cash and other items	32c	**11.3**	64.0
Tax paid		**(22.1)**	(5.0)
Net cash used in operating activities		**(668.4)**	(482.2)
Cash flows from investing activities			
Purchase of securities		**(670.0)**	(659.2)
Proceeds from sale and redemption of available-for-sale financial assets		**1,150.0**	900.5
Purchase and investment in intangible assets		**(31.6)**	(29.6)
Purchase of tangible fixed assets		**(8.6)**	(10.2)
Disposal of tangible fixed assets		**0.7**	—
Net cash provided by investing activities		**440.5**	201.5
Cash flows from financing activities			
Net proceeds for issue of debt securities		**—**	297.5
Issue of Additional Tier 1 securities		**227.7**	—
Net cash provided by financing activities		**227.7**	297.5
Change in cash and cash equivalents		**(0.2)**	16.8
Cash and cash equivalents at beginning of year		**966.5**	949.7
Cash and cash equivalents at end of year	32d	**966.3**	966.5

1 Restated (refer notes 1 and 39)

The accompanying notes are an integral part of these financial statements.

Notes to the financial statements

Note 1: Basis of preparation and accounting policies

1.1 Reporting entity

Virgin Money plc (the Company) is a company incorporated and registered in England and Wales. The registered office is Jubilee House, Gosforth, Newcastle-upon-Tyne, NE3 4PL. The Company was incorporated as a private limited company with registered number 06952311.

1.2 Basis of preparation

The Company financial statements, which should be read in conjunction with the Strategic Report and 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 Company. The Directors are confident that they show that the Company 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.

As permitted by section 400 of the Companies Act 2006 the Company has not prepared consolidated financial statements.

1.3 Changes in accounting policy

New standards, amendments to standards or interpretations adopted

In 2016, the Company adopted a number of minor interpretations and amendments to standards, which were endorsed for adoption by the EU, and were 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 Company and did not result in any change in accounting policies. New accounting standards issued by the IASB that are relevant to the Company and effective in future periods are presented in note 37.

Prior period restatements

The Company raises wholesale funding through securitisation of mortgage loans and advances to customers, via the Gosforth securitisation Special Purpose Vehicles (SPVs) and retains a proportion of the loan notes issued by the SPVs, which can be used as collateral for repurchase or similar transactions. The Company applied the de-recognition criteria outlined in IAS 39 'Financial instruments: Recognition and measurement' to account for securitisation transactions and, as a result, retained recognition of the mortgages subject to securitisation on its Balance Sheet, since the Company retains substantially all of the risks and rewards associated with those assets. In 2016, the Company reconsidered the previous accounting treatments for retained notes and swaps between the Company and the SPVs, determining that they did not best reflect the substance of the Company's economic returns and exposures.

Previously, the Company recorded retained loan notes as debt securities within loans and receivables, and included obligations within the deemed loans to the SPVs to support repayment of those notes. This approach resulted in the Company recognising both the securitised mortgages and retained notes linked to those mortgages as assets on the Balance Sheet, and liabilities payable to itself on those notes within the deemed loans. The Company has now restated the financial statements to eliminate the retained notes from the Balance Sheet, reduce the deemed loan carrying values (removing the internal liabilities) and remove the associated interest income and expense on those balances.

In addition, the Company entered into basis rate swaps with the SPVs. The swaps hedge the interest rate risk between the interest to be paid by the Company in respect of fixed rate, tracker rate and standard variable rate securitised mortgages and the coupon rate on the notes issued by the SPVs. The Company previously presented the basis rate swaps as separately recognised derivative financial instruments, which were recorded at fair value with valuation movements recognised in the Income Statement.

To address a measurement mismatch between the deemed loans and the basis rate swaps that would arise from subsequent fair value movements on the basis rate swaps, the Company also previously elected to designate the deemed loans to be measured at fair value, with valuation movements on the swaps and the loans recorded in the Income Statement.

The Company has revised the accounting for the basis rate swaps, determining that, by setting the coupon rates on the deemed loans, they represent an integral element of those loans. As a result, the basis rate swap derivatives have been eliminated from the Balance Sheet and adjustments recorded to the deemed loans to reflect the impact of the swaps on their carrying values.

Note 1: Basis of preparation and accounting policies (continued)

In restating the financial statements to eliminate the basis rate swaps, the previous fair value measurement basis for the deemed loans is no longer valid. The Company's previous election to measure the loans at fair value was predicated on the existence of a measurement mismatch at the inception of those loans. No mismatch exists where the swaps are not separately recognised. Therefore the Company has restated the deemed loans to unwind all fair value movements recorded through the Income Statement since their inception, adjusting the carrying values accordingly.

In accordance with IAS 8 'Accounting policies, changes in accounting estimates and errors' the voluntary changes in accounting policies noted above required restatement to previously presented prior periods, which were adjusted through opening reserves. The impact of all required restatements are presented in note 39.

1.4 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 Company are included within note 1.6.

The accounting policies set out in note 1.6 have been applied consistently to all periods presented in these financial statements.

1.5 Foreign currency translation

The Company's financial statements are presented in sterling, which is the functional currency of the Company.

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.

1.6 Accounting policies

The accounting policies of the Company are set out below:

(a) 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 Company 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 Company 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 accrual 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.

Note 1: Basis of preparation and accounting policies (continued)

(b) *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.

(c) *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 credit cards.

(d) *Total operating expense*

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 (e).

> Staff costs

The Company accounts for the following 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 Company 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 Company pays fixed contributions and has no legal or constructive obligation to pay further amounts. Contributions are recognised as staff expenses in the income statement in the periods during which related employee services are fulfilled. The Company operates defined contribution pension schemes for its Directors and employees. The assets of the schemes are held separately from those of the Company in independently administered funds.

> Leases

If the lease agreement in which the Company 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.

(e) *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. Employees are employed by the Company but receive Virgin Money Holdings (UK) plc Ordinary Shares.

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.

Note 1: Basis of preparation and accounting policies (continued)

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 Virgin Money Holdings (UK) plc'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.

(f) Impairment losses

The Company 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 and only if there is a loss event (or events) that 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 that are 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 Company 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 Company 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 Company 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 Company 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 the 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 benefitting from forbearance and those in arrears. Refer to note 31 for details of the forbearance policy.

Note 1: Basis of preparation and accounting policies (continued)

> Available-for-sale financial assets

The Company 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.

(g) 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 Company 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.

(h) 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 Company commits to purchase or sell the asset.

> Loans and receivables at amortised cost

The Company'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 Company 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.

Note 1: Basis of preparation and accounting policies (continued)

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. 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 Company 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 (l)).

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 Company 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 Company 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 (l)). Borrowings, including deposits, debt securities in issue and amounts due to securitisation special purpose vehicles 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 Company 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 Company removes an asset or liability from its balance sheet. The Company's policy is to derecognise financial assets only when the contractual right to the cash flows from the financial asset expires or when the Company 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 Company has transferred substantially all the risks and rewards of ownership. Where the transfer does not result in the Company transferring the right to receive the cash flows of the financial assets, but it does result in the Company assuming a corresponding obligation to pay the cash flows to another recipient, the financial assets are also accordingly derecognised.

The Company 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 Company transferred financial assets that should have been derecognised in their entirety.

Note 1: Basis of preparation and accounting policies (continued)

(i) Loans and advances to banks

The Company's loans and advances to banks are classified as loans and receivables.

(j) Loans and advances to customers

The Company's loans and advances to customers are classified as loans and receivables.

(k) Available-for-sale financial assets

The Company's debt securities and equity investments not in subsidiary undertakings are held 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.

(l) Derivative financial instruments and hedge accounting

The Company 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 Company's derivative activities are entered into for the purpose of matching or eliminating risk from potential movements in interest rates and foreign exchange rates inherent in the Company'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 Company 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 Company 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 Company designates certain derivatives as:

> 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.

Note 1: Basis of preparation and accounting policies (continued)

(m) Investments in subsidiaries

Investments in subsidiaries are valued at cost less provision for impairment. Investments in subsidiaries are included in the Company's balance sheet, comprising equity investments in subsidiary entities. At each reporting date an assessment is undertaken to determine if there is any indication of impairment. This assessment can include reviewing factors such as the solvency, profitability and cash flows generated by the subsidiary. If there is an indication of impairment, an estimate of the recoverable amount is made. If the carrying value exceeds the recoverable amount then a provision for impairment is made to reduce the carrying value to the recoverable amount.

(n) Funding for Lending Scheme

The Company participates in the Funding for Lending Scheme (FLS). The scheme allows the Company 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 (h) 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.

(o) 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- 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 Company 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.

Note 1: Basis of preparation and accounting policies (continued)

> 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.

(p) 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 a fixed 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 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.

(q) Other assets

Other assets include prepayments and other amounts the Company is due to receive from third parties in the normal course of business.

(r) 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.

Note 1: Basis of preparation and accounting policies (continued)

(s) 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.

(t) 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 is met.

(u) Other liabilities

Deferred income represents amounts received in advance of the Company providing services, and will be recognised as income in profit or loss when the services have been provided.

Other creditors represent amounts the Company 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 Company is due to pay to third parties in the normal course of business.

(v) Share capital

> 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 Company; 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.

(w) 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.

(x) 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.

(y) 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.

(z) Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than three months maturity from the date of acquisition, including cash and non-restricted balances with central banks.

Note 1: Basis of preparation and accounting policies (continued)

(aa) 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 Company has access at that date. The fair value of a liability reflects its non-performance risk (the risk the Company will not fulfil an obligation), including the Company'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 29 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 Company does not apply a credit valuation adjustment (CVA) or debit valuation adjustment (DVA) to reflect the credit risk of its derivative exposures as the Company's portfolio is fully collateralised.

If an asset or a liability measured at fair value has a bid price and an ask price, the Company measures assets and long positions at bid price and liabilities and short positions at an ask price.

1.7 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 areas where assumptions and estimates are significant to the 2016 financial statements 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: £3.8 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.

Note 1: Basis of preparation and accounting policies (continued)

(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 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 situation 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; and

> 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).

Note 1: Basis of preparation and accounting policies (continued)

(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 (g). 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 £21.8 million (2015: £35.0 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 Company'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 £33.5 million (2015: £24.0 million) or decrease of £33.7 million (2015: £24.2 million) respectively.

1.8 Operating segments

The Company has issued debt securities which are traded in a public market and therefore falls within the scope of IFRS 8 'Operating Segments'. However, no discrete financial information on the performance of the Company is prepared nor regularly reviewed by the Company's chief operating decision maker (which has been determined to be the Group Executive Committee). The Company has therefore determined that it has no reportable operating segments and is not required to produce additional segmental disclosure.

Segmental performance disclosures of the Group, in which the financial statements of the Company are consolidated, are included in the consolidated financial statements of Virgin Money Holdings (UK) plc.

Notes to the financial statements

Note 2: Net interest income

	2016 £m	2015[1] £m
Interest and similar income:		
Loans and advances to customers	**936.6**	825.6
– *of which relates to securitisation subordinated loan*	*7.3*	*4.4*
Loans and advances to banks	**0.8**	0.6
Interest receivable on loans and receivables	**937.4**	826.2
Available-for sale financial assets	**8.9**	10.5
Cash and balances at central banks	**3.8**	4.0
Other interest	**1.6**	2.7
Total interest and similar income	**951.7**	843.4
Interest and similar expense:		
Deposits from banks	**(7.6)**	(6.8)
Customer deposits	**(370.2)**	(340.0)
Debt securities in issue	**(4.9)**	(3.5)
Securitisation special purpose vehicles	**(38.3)**	(26.6)
Other	**(11.4)**	(9.3)
Total interest and similar expense	**(432.4)**	(386.2)
Net interest income	**519.3**	457.2

1 Restated (refer notes 1 and 39)

Interest accrued on individually impaired assets was £5.8 million (2015: £6.8 million).

Note 3: Fee and commission income

	2016 £m	2015 £m
On loans and advances to customers	**19.5**	21.0
Other fee and commission income	**1.8**	0.8
Total fee and commission income	**21.3**	21.8

Note 4: Other operating income

	2016 £m	2015 £m
Gains on sale of available-for-sale financial assets (refer note 13)	**6.7**	5.0
Other	**5.2**	3.7
Total other operating income	**11.9**	8.7

Notes to the financial statements

Note 5: Operating expenses

	2016 £m	2015 £m
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	**13.9**	13.2
	18.5	17.8
Other expenses:		
Marketing costs	**21.0**	22.2
FSCS levy	**7.8**	12.5
Professional fees	**13.3**	10.5
Other	**52.3**	65.6
	94.4	110.8
Depreciation and amortisation:		
Depreciation of tangible fixed assets	**7.2**	7.5
Amortisation of intangible assets	**14.0**	11.6
	21.2	19.1
Total operating expenses	**329.0**	333.4

Average headcount

The monthly average number of persons (including Directors) employed by the Company 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 Company operates a defined contribution pension scheme, the Virgin Money (2011) Pension Scheme, for its Directors and employees. The assets of the schemes are held separately from those of the Company in independently administered funds.

The Company 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 Company obtained the following services from the Company's auditors as detailed below:

	2016 £m	2015 £m
Fees payable for the audit of the Company's current year annual report and accounts	**0.4**	0.5
Total fees payable to the auditors by the Company	**0.4**	0.5

Fees paid to the Company's auditors, PricewaterhouseCoopers LLP (2015: KPMG LLP), for services other than the statutory audit of the Company are not disclosed in these accounts. Instead they are required to be disclosed in the accounts of Virgin Money Holdings (UK) plc, the Company's parent, on a consolidated basis.

Note 6: 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. All share awards relate to Ordinary Shares in the Company's parent undertaking, Virgin Money Holdings (UK) plc.

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 Company 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 Company. 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 Company. Share awards for the deferred element of 2016 bonuses will be granted under this scheme in 2017.

During 2016, selected senior employees of the Company were granted up to a maximum of 1,695,266 Ordinary Shares in Virgin Money Holdings (UK) plc 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 Company. 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 late 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.

Note 6: Share based payments (continued)

(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 of Virgin Money Holdings (UK) plc. The award was a pre-determined percentage of the listing value of Virgin Money Holdings (UK) plc, which was then converted to a number of Ordinary Shares in Virgin Money Holdings (UK) plc 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).

(F) IPO share award

On listing of Virgin Money Holdings (UK) plc, 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 in Virgin Money Holdings (UK) plc of either 10% or 20% of salary. All other employees received an award over Ordinary Shares in Virgin Money Holdings (UK) plc 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 a different vesting schedule, 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

	Virgin Money Holdings (UK) plc 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]**
Outstanding 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 at 31 December 2016	**625,328**	**2,651,338**	**2,098,649**	**2,044,480**	**—**	**—**	**68,920**
Of which exercisable	**625,328**	**—**	**—**	**—**	**—**	**—**	**—**

	Virgin Money Holdings (UK) plc 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]
Outstanding 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 at 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.

Notes to the financial statements

Note 7: Allowance for impairment losses on loans and receivables

	2016			2015		
	On secured loans £m	**On unsecured Loans £m**	**Total £m**	On secured loans £m	On unsecured loans £m	Total £m
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 £m	2015 £m
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 8: Taxation

A. Analysis of the tax charge for the year

	2016 £m	2015[1] £m
UK corporation tax		
Current year corporation tax	**(33.0)**	(9.0)
Group relief payment	**(0.4)**	(0.4)
Charge attributable to available-for-sale reserve	**—**	(2.1)
Adjustments in respect of prior years	**0.5**	—
Current tax charge	**(32.9)**	(11.5)
Deferred tax (refer note 18)		
Origination and reversal of temporary differences	**(11.3)**	(13.4)
Adjustments in respect of prior years	**0.2**	(0.7)
Effect of changes in tax rates	**(0.1)**	2.5
Deferred tax charge	**(11.2)**	(11.6)
Tax charge	**(44.1)**	(23.1)

1 Restated (refer notes 1 and 39)

Analysis of tax (charge) / credit recognised in Other Comprehensive Income:

	2016 £m	2015 £m
Current tax		
Available-for-sale financial assets	**—**	2.1
Deferred tax		
Available-for-sale financial assets	**(1.7)**	(0.9)
Total (charge) / credit	**(1.7)**	1.2

Notes to the financial statements

Note 8: Taxation (continued)

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 £m	2015[1] £m
Profit before tax	**159.7**	116.0
Tax charge at standard tax rate of 20% (2015: 20.25%)	**(31.9)**	(23.5)
Factors affecting (charge) / credit:		
Disallowed items	**(0.9)**	(1.4)
Bank corporation tax surcharge	**(10.8)**	—
UK corporation tax rate change	**(0.1)**	2.5
Deferred tax charge in respect of share schemes	**(1.1)**	—
Adjustments in respect of prior years	**0.7**	(0.7)
Total tax charge	**(44.1)**	(23.1)

1 Restated (refer notes 1 and 39)

During the year the Company resolved an open HMRC enquiry regarding 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 Company (less a £25.0 million allowance against those profits).

Notes to the financial statements

Note 9: Analysis of financial assets and financial liabilities by measurement basis

	Held at amortised cost £m	Fair value through profit or loss £m	Loans and receivables £m	Available for sale securities £m	Derivatives not designated as hedging instruments £m	Derivatives designated as Fair value hedges £m	Total £m
2016							
Financial assets							
Cash and balances at central banks	—	—	786.3	—	—	—	786.3
Derivative financial instruments	—	—	—	—	14.1	21.1	35.2
Loans and receivables:							
Loans and advances to banks	—	—	229.7	—	—	—	229.7
Loans and advances to customers	—	—	32,708.9	—	—	—	32,708.9
Debt securities	—	—	0.7	—	—	—	0.7
Available-for-sale financial assets	—	—	—	858.8	—	—	858.8
Other assets	—	—	62.9	—	—	—	62.9
Total financial assets	—	—	33,788.5	858.8	14.1	21.1	34,682.5
Non financial assets							232.7
Total assets							34,915.2
Financial liabilities							
Deposits from banks	2,129.7	—	—	—	—	—	2,129.7
Customer deposits	28,106.3	—	—	—	—	—	28,106.3
Derivative financial instruments	—	—	—	—	18.5	206.8	225.3
Amounts due to securitisation special purpose vehicles	2,143.6	—	—	—	—	—	2,143.6
Debt securities in issue	305.8	—	—	—	—	—	305.8
Other liabilities	185.6	—	—	—	—	—	185.6
Total financial liabilities	32,871.0	—	—	—	18.5	206.8	33,096.3
Non financial liabilities							127.7
Total liabilities							33,224.0
Equity							1,691.2
Total liabilities and equity							34,915.2

Notes to the financial statements

Note 9: Analysis of financial assets and financial liabilities by measurement basis (continued)

	Held at amortised cost £m	Fair value through profit or loss £m	Loans and receivables £m	Available for sale securities £m	Derivatives not designated as hedging instruments £m	Derivatives designated as Fair value hedges £m	Total £m
2015							
Financial assets							
Cash and balances at central banks	—	—	888.6	—	—	—	888.6
Derivative financial instruments	—	—	—	—	17.2	63.5	80.7
Loans and receivables:							
Loans and advances to banks	—	—	119.6	—	—	—	119.6
Loans and advances to customers	—	—	27,391.4	—	—	—	27,391.4
Debt securities	—	—	1.3	—	—	—	1.3
Available-for-sale financial assets	—	—	—	1,296.9	—	—	1,296.9
Other assets	—	—	19.4	—	—	—	19.4
Total financial assets	—	—	28,420.3	1,296.9	17.2	63.5	29,797.9
Non financial assets							210.9
Total assets							30,008.8
Financial liabilities							
Deposits from banks	1,283.8	—	—	—	—	—	1,283.8
Customer deposits	25,145.3	—	—	—	—	—	25,145.3
Derivative financial instruments	—	—	—	—	15.7	139.6	155.3
Amounts due to securitisation special purpose vehicles	1,553.1	—	—	—	—	—	1,553.1
Debt securities in issue	297.5	—	—	—	—	—	297.5
Other liabilities	152.7	—	—	—	—	—	152.7
Total financial liabilities	28,432.4	—	—	—	15.7	139.6	28,587.7
Non financial liabilities							92.4
Total liabilities							28,680.1
Equity							1,328.7
Total liabilities and equity							30,008.8

Notes to the financial statements

Note 10: Derivative financial instruments

	As at 31 December 2016			As at 31 December 2015[1]		
	Contract/ notional amount £m	**Asset fair value £m**	**Liability fair value £m**	Contract/ notional amount £m	Asset fair value £m	Liability fair value £m
Derivatives in accounting hedge relationships						
Designated as fair value hedges:						
Interest rate derivatives	**21,584.8**	**21.1**	**(206.8)**	23,421.6	63.5	(139.6)
Total derivative assets/(liabilities)—in accounting hedge relationships	**21,584.8**	**21.1**	**(206.8)**	23,421.6	63.5	(139.6)
Derivatives in economic hedging relationships but not in accounting hedge relationships						
Interest rate derivatives	**8,676.6**	**10.5**	**(14.7)**	3,861.1	17.2	(15.7)
Currency derivatives	**56.0**	**3.6**	**(3.8)**	—	—	—
Equity and other options	**1.2**	—	—	—	—	—
Total derivative assets/(liabilities)—in economic hedging relationship but not in accounting hedge relationships	**8,733.8**	**14.1**	**(18.5)**	3,861.1	17.2	(15.7)
Total recognised derivative assets/(liabilities)	**30,318.6**	**35.2**	**(225.3)**	27,282.7	80.7	(155.3)

1 Restated (refer notes 1 and 39)

The principal amount of the contracts does not represent the Company's real exposure to credit risk which is limited to the current cost of replacing contracts with a positive value to the Company should the counterparty default. To reduce credit risk the Company uses a variety of credit enhancement techniques such as netting and collateralisation, where security is provided against the exposure. Further details are provided in notes 30 and 31.

Fair value losses on financial instruments

	2016 £m	2015[1] £m
Derivatives designated as fair value hedges	**(70.0)**	53.6
Fair value movement attributable to hedged risk	**81.8**	(50.7)
Gain from fair value hedges[2]	**11.8**	2.9
Fair value losses from other derivatives[3]	**(38.0)**	(10.9)
Fair value losses on financial instruments	**(26.2)**	(8.0)

1 Restated (refer notes 1 and 39)

2 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 dedesignated from the IAS 39 hedge accounting relationship and in the following months leads to amortisation of existing balance sheet positions.

3 Other derivatives are those used for economic hedging but which are not in an IAS 39 hedge accounting relationship.

Note 11: Loans and advances to banks

	2016 £m	2015 £m
Cash collateral pledged to banks (refer note 14)	**179.1**	94.0
Other lending to banks	**50.6**	25.6
Total loans and advances to banks	**229.7**	119.6

Note 12: Loans and advances to customers

	2016 £m	2015[1] £m
Advances secured on residential property not subject to securitisation	**19,375.2**	17,386.3
Advances secured on residential property subject to securitisation	**4,907.8**	3,669.5
	24,283.0	21,055.8
Residential buy-to-let loans not subject to securitisation	**5,468.4**	4,401.1
Total loans and advances to customers secured on residential property	**29,751.4**	25,456.9
Unsecured receivables not subject to securitisation	**2,486.6**	1,610.0
Amounts due from group companies	**341.8**	278.7
Total loans and advances to customers before allowance for impairment losses	**32,579.8**	27,345.6
Allowance for impairment losses on loans and receivables (refer note 7)	**(50.1)**	(39.9)
Total loans and advances to customers excluding portfolio hedging	**32,529.7**	27,305.7
Fair value of portfolio hedging	**179.2**	85.7
Total loans and advances to customers	**32,708.9**	27,391.4

1 Restated (refer notes 1 and 39)

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 Company from interest rate risk on fixed rate products (refer note 10).

For collateral held in respect of the values included in the table above, please refer to note 31.

Securitisation

Securitisation is a means used by the Company 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 carrying value to SPVs and have been funded through the issue of amortising mortgage backed securities to investors with a proportion retained by the Company. The transfers do not meet the criteria for asset derecognition in IAS 39 'Financial Instruments: Recognition and Measurement' as the Company has retained the risks and rewards of the assets.

The following table sets out the carrying amount of financial assets that did not qualify for derecognition and their associated liabilities. The table also sets out the fair value of financial assets where the counterparty to the associated liabilities has recourse to those financial assets. There were no transactions in the year where the Company transferred financial assets that should have been derecognised in their entirety.

	2016		2015[1]	
	Carrying value £m	**Fair value £m**	Carrying value £m	Fair value £m
Transferred assets	**4,907.8**	**4,982.7**	3,669.5	3,727.5
Associated liabilities	**2,143.6**	**2,143.6**	1,553.1	1,553.1

1 Restated (refer notes 1 and 39)

Notes to the financial statements

Note 13: Available-for-sale financial assets

	2016 £m	2015 £m
At 1 January	**1,296.9**	1,539.6
Additions	**670.0**	659.2
Disposals (sales and redemptions)	**(1,111.1)**	(859.9)
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**	(33.0)
At 31 December	**858.8**	1,296.9

1 Represents investments in unquoted equity securities relating to the Company's participation in banking and credit card operations, previously recognised within other assets.

Gains on sale of available-for-sale financial assets amounted to £6.7 million (2015: £5.0 million).

Further analysis of the composition of debt securities categorised as available-for-sale financial assets is set out in note 31. All available-for-sale assets have been individually assessed for impairment and following this assessment no write down of assets was required.

Note 14: Collateral pledged and received

The Company receives and accepts collateral in the form of cash and marketable securities in respect of the following transactions:

> derivatives;

> sales and repurchase and reverse sale and repurchase agreements; and

> secured loans.

Collateral in respect of derivatives is subject to the standard industry terms of International Swaps and Derivatives Association (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 £233.0 million had been pledged by the Company, comprising £179.1 million recognised within loans and advances to banks and £53.9 million within other assets (2015: £94.3 million, comprising £94.0 million recognised within loans and advances to banks and £0.3 million within other assets) and £11.1 million (2015: £8.9 million) has been received as cash collateral by the Company and recognised within deposits from banks.

At 31 December 2016 available-for-sale financial assets of £10.6 million (2015: £nil) had been 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 15: Investments in subsidiary undertakings

The following were subsidiaries of the Company during the year:

Name	Class of share	Holding
Direct holdings		
Virgin Card Limited[1]	Ordinary	100%
Eagle Place Covered Bonds LLP[2]	N/A[3]	N/A[3]
Northern Rock Limited[2]	Ordinary	100%

1 Dissolved 5 April 2016.

2 Dormant entities.

3 The entity does not have share capital.

The following companies are Special Purpose Vehicles (SPVs) established in connection with the Company's securitisation programme. Judgement has been used to determine whether the Company has control over these entities and should account for them as subsidiaries. Although the Company has no direct or indirect ownership interest in these companies, they are accounted for as subsidiaries, because they are principally engaged in providing a source of long-term funding to the Company. This means the Company is exposed to the rights of variable returns from its involvement in the activities of the SPVs and has the ability to affect those returns through its power over these entities.

Name	Nature of business
Gosforth Funding 2011-1 plc	Issue of securitised notes
Gosforth Funding 2012-1 plc	Issue of securitised notes
Gosforth Funding 2012-2 plc	Issue of securitised notes
Gosforth Funding 2014-1 plc	Issue of securitised notes
Gosforth Funding 2015-1 plc	Issue of securitised notes
Gosforth Funding 2016-1 plc	Issue of securitised notes
Gosforth Funding 2016-2 plc	Issue of securitised notes
Gosforth Mortgages Trustee 2011-1 Limited	Trust
Gosforth Mortgages Trustee 2012-1 Limited	Trust
Gosforth Mortgages Trustee 2012-2 Limited	Trust
Gosforth Mortgages Trustee 2014-1 Limited	Trust
Gosforth Mortgages Trustee 2015-1 Limited	Trust
Gosforth Mortgages Trustee 2016-1 Limited	Trust
Gosforth Mortgages Trustee 2016-2 Limited	Trust
Gosforth Holdings 2011-1 Limited	Holding company
Gosforth Holdings 2012-1 Limited	Holding company
Gosforth Holdings 2012-2 Limited	Holding company
Gosforth Holdings 2014-1 Limited	Holding company
Gosforth Holdings 2015-1 Limited	Holding company
Gosforth Holdings 2016-1 Limited	Holding company
Gosforth Holdings 2016-2 Limited	Holding company

Eagle Place Covered Bonds LLP and Northern Rock Limited are incorporated in England with their registered office being Jubilee House, Gosforth, Newcastle upon Tyne, NE3 4PL.

All of the SPVs are incorporated in England with their registered office being Fifth Floor, 100 Wood Street, London, EC2V 7EX.

Notes to the financial statements

Note 16: Intangible assets

	Software £m	Core banking platform £m	Total £m
Cost:			
At 1 January 2015	92.9	19.9	112.8
Additions	27.9	1.7	29.6
Disposals	(24.9)	—	(24.9)
At 31 December 2015	**95.9**	**21.6**	**117.5**
Additions	**31.6**	**—**	**31.6**
Disposals	**(2.1)**	**—**	**(2.1)**
At 31 December 2016	**125.4**	**21.6**	**147.0**
Accumulated amortisation:			
At 1 January 2015	67.8	—	67.8
Charge for the year	8.7	2.9	11.6
Disposals	(24.9)	—	(24.9)
At 31 December 2015	**51.6**	**2.9**	**54.5**
Charge for the year	**10.4**	**3.6**	**14.0**
Disposals	**(2.1)**	**—**	**(2.1)**
At 31 December 2016	**59.9**	**6.5**	**66.4**
Balance sheet amount at 31 December 2016	**65.5**	**15.1**	**80.6**
Balance sheet amount at 31 December 2015	44.3	18.7	63.0

Note 17: Tangible fixed assets

	Land and buildings £m	Plant, equipment, fixtures, fittings and vehicles £m	Total £m
Cost:			
Cost at 1 January 2015	58.3	45.8	104.1
Additions	2.1	8.1	10.2
Disposals	—	(10.2)	(10.2)
Cost at 31 December 2015	**60.4**	**43.7**	**104.1**
Additions	**1.8**	**6.8**	**8.6**
Disposals	**(0.6)**	**(3.0)**	**(3.6)**
At 31 December 2016	**61.6**	**47.5**	**109.1**
Accumulated depreciation and impairment:			
Accumulated depreciation and impairment at 1 January 2015	4.9	27.2	32.1
Depreciation charge for the year	1.7	5.8	7.5
Disposals	—	(10.1)	(10.1)
Accumulated depreciation and impairment at 31 December 2015	**6.6**	**22.9**	**29.5**
Depreciation charge for the year	**1.7**	**5.5**	**7.2**
Disposals	**(0.5)**	**(2.9)**	**(3.4)**
At 31 December 2016	**7.8**	**25.5**	**33.3**
Balance sheet amount at 31 December 2016	**53.8**	**22.0**	**75.8**
Balance sheet amount at 31 December 2015	53.8	20.8	74.6

Note 18: Deferred tax

Deferred tax assets / (liabilities)	2016 £m	2015[1] £m
Accelerated capital allowances	**11.7**	13.7
Tax losses carried forward	**12.6**	21.9
Change in accounting basis on adoption of IFRS	**(4.1)**	(5.0)
Other temporary differences	**4.2**	5.3
Revaluation reserve in respect of available-for-sale financial assets	**(2.6)**	(0.9)
Total deferred tax assets	**21.8**	35.0

1 Restated (refer notes 1 and 39)

The movement in the net deferred tax balance is as follows:

	2016 £m	2015[1] £m
At 1 January	**35.0**	47.1
Income statement (charge)/credit (refer note 8)		
Accelerated capital allowances	**(2.0)**	8.1
Tax losses carried forward	**(9.3)**	(18.4)
Other temporary differences	**0.1**	(1.3)
	(11.2)	(11.6)
Deferred tax balance transferred in	**—**	0.1
Amounts (charged)/credited to equity:		
Share based payments	**(0.3)**	0.3
Available-for-sale financial assets	**(1.7)**	(0.9)
	(2.0)	(0.6)
At 31 December	**21.8**	35.0

1 Restated (refer notes 1 and 39)

Note 19: Other assets

	2016 £m	2015[1] £m
Trade debtors	**14.6**	6.8
Prepayments and accrued income	**27.7**	22.1
Amounts owed from related parties	**3.9**	6.3
Other	**71.2**	22.5
Total other assets	**117.4**	57.7

1 Restated (refer notes 1 and 39)

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 20: Deposits from banks

	2016 £m	2015 £m
Liabilities in respect of securities sold under repurchase agreements	**850.0**	1,274.9
Secured loans	**1,268.0**	—
Other deposits from banks	**11.7**	8.9
Total deposits from banks	**2,129.7**	1,283.8

Notes to the financial statements

Note 21: Customer deposits

	2016 £m	2015 £m
Savings and investment accounts	**27,762.7**	24,915.0
Personal current accounts	**343.6**	230.3
Total customer deposits	**28,106.3**	25,145.3

Note 22: Debt securities in issue

On 16 April 2015, the Company 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 Company's £3 billion Global Medium Term Note programme. The difference between the nominal value of the Notes and the carrying value on the Balance Sheet represents unamortised issue costs and hedge accounting adjustments.

Note 23: Provisions

	FSCS £m	Other £m	Total £m
At 1 January 2016	**6.6**	**1.6**	**8.2**
Provisions applied	**(6.7)**	**(0.8)**	**(7.5)**
Charge for the year	**7.8**	**—**	**7.8**
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 Company 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 Company depends on a number of factors including the amounts recovered by the FSCS from asset sales, the Company's participation in the deposit-taking market at 31 December, the level of protected deposits and the population of deposit taking participants.

Note 24: Other liabilities

	2016 £m	2015 £m
Trade creditors and accruals	**57.3**	53.4
Deferred income	**2.9**	4.9
Accrued interest	**124.4**	128.4
Amounts owed to subsidiary undertakings	**0.9**	—
Other liabilities	**102.5**	43.9
Total other liabilities	**288.0**	230.6

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 25: Share capital

	2016 £m	2015 £m
Share capital (allotted, called up and fully paid)[1]	**1,400.0**	1,400.0
At 31 December	**1,400.0**	1,400.0

1 Total Ordinary Shares by number 1,400 million with a nominal value of £1, amounting to £1,400 million.

The holders of Ordinary Shares are entitled to one vote per share at meetings of the Company. 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.

No dividends were paid in 2016 or 2015.

Note 26: Other equity instruments

The Company issued £230.0 million of Fixed Rate Resettable Additional Tier 1 (AT1) securities to its parent company on 10 November 2016. 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 £nil. 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 8.75% until the first reset date on 10 November 2021;

> 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 are subject to an automatic write-down to £nil, should the Common Equity Tier 1 ratio of the Company, or its parent company, fall below 7.0% as specified in the terms. Following such write-down the securities will convey no rights to repayment of the principal amount or any unpaid interest.

Note 27: Other reserves

Revaluation reserve in respect of available-for-sale financial assets	2016 £m	2015 £m
At 1 January	**(0.3)**	5.6
Net gains/(losses) from changes in fair value	**52.8**	(0.8)
Net gains on disposal transferred to net income	**(38.3)**	(32.2)
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)

Note 28: Contingent liabilities and commitments

Contingent liabilities

The Board is not aware of any significant contingent liabilities as at 31 December 2016 (2015: £nil). 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 Company.

Loan commitments

Contractual amounts to which the Company is committed for extension of credit to customers.

	2016 £m	2015 £m
Not later than 1 year	**4,854.3**	3,980.7
Later than 1 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 £m	2015 £m
Not later than 1 year	**6.7**	6.7
Later than 1 year and not later than 5 years	**23.5**	23.5
Later than 5 years	**20.0**	23.8
Total operating lease commitments – land and buildings	**50.2**	54.0

Operating lease commitments – other operating leases

Minimum future lease payments under non-cancellable operating leases.

	2016 £m	2015 £m
Not later than 1 year	**4.6**	4.6
Later than 1 year and not later than 5 years	**4.6**	9.2
Later than 5 years	**—**	—
Total operating lease commitments – other operating leases	**9.2**	13.8

Capital commitments

Capital commitments for the acquisition of buildings and equipment.

	2016 £m	2015 £m
Not later than 1 year	**1.0**	2.9
Later than 1 year and not later than 5 years	**—**	—
Later than 5 years	**—**	—
Total capital commitments	**1.0**	2.9

Notes to the financial statements

Note 29: Fair value of financial assets and financial liabilities

(1) 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 Company's balance sheet at their fair value, by the level in the fair value hierarchy into which each fair value measurement is categorised. Accounting policy (h) in note 1 sets out the key principles for estimating the fair values of the financial instruments.

	Level 1 £m	Level 2 £m	Level 3 £m	Total fair value £m	Total carrying value £m
2016					
Cash and balances at central banks	**—**	**786.3**	**—**	**786.3**	**786.3**
Loans and advances to banks	**—**	**229.7**	**—**	**229.7**	**229.7**
Loans and advances to customers	**—**	**341.8**	**32,514.0**	**32,855.8**	**32,708.9**
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	**—**	**62.9**	**—**	**62.9**	**62.9**
Total financial assets	**0.7**	**1,420.7**	**32,514.3**	**33,935.7**	**33,788.8**
Deposits from banks	**—**	**2,129.7**	**—**	**2,129.7**	**2,129.7**
Customer deposits	**—**	**28,222.7**	**—**	**28,222.7**	**28,106.3**
Debt securities in issue	**310.7**	**—**	**—**	**310.7**	**305.8**
Amounts due to securitisation special purpose vehicles	**—**	**2,143.6**	**—**	**2,143.6**	**2,143.6**
Other liabilities	**—**	**185.6**	**—**	**185.6**	**185.6**
Total financial liabilities	**310.7**	**32,681.6**	**—**	**32,992.3**	**32,871.0**

	Level 1 £m	Level 2 £m	Level 3 £m	Total fair value £m	Total carrying value £m
2015					
Cash and balances at central banks	—	888.6	—	888.6	888.6
Loans and advances to banks	—	119.6	—	119.6	119.6
Loans and advances to customers	—	278.7	27,243.2	27,521.9	27,391.4
Debt securities classified as loans and receivables	1.2	—	—	1.2	1.3
Available-for-sale financial assets	—	—	1.3	1.3	1.3
Other assets	—	19.4	—	19.4	19.4
Total financial assets	1.2	1,306.3	27,244.5	28,552.0	28,421.6
Deposits from banks	—	1,283.8	—	1,283.8	1,283.8
Customer deposits	—	25,162.5	—	25,162.5	25,145.3
Debt securities in issue	292.1	—	—	292.1	297.5
Amounts due to securitisation special purpose vehicles	—	1,553.1	—	1,553.1	1,553.1
Other liabilities	—	152.7	—	152.7	152.7
Total financial liabilities	292.1	28,152.1	—	28,444.2	28,432.4

Fair value hierarchy

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 on the following page:

Note 29: Fair value of financial assets and financial liabilities (continued)

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 Company 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 Company. 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 Company's policy is to hedge fixed rate loans in respect of interest rate risk, this does not indicate that the Company has an exposure to this difference in value.

Loans and advances to customers are categorised as level 3 as unobservable prepayment rates are applied.

Debt securities classified as loans and receivables

Fair values are based on quoted prices where available or estimated by discounting cash flows using market rates.

Available-for-sale financial assets

These are unquoted equity securities held by the Company 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

This includes amounts owed from/to related undertakings (excluding securitisation special purpose vehicles). Fair value is deemed to approximate to 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 Company 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.

Amounts due to securitisation special purpose vehicles

Fair value was estimated by discounting cash flows using market rates where practicable or rates offered by other financial institutions for loans with similar characteristics.

Note 29: Fair value of financial assets and financial liabilities (continued)

(2) 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. Accounting policy (h) in note 1 sets out the key principles for estimating the fair values of financial instruments.

2016	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets				
Derivative financial instruments	**—**	**35.2**	**—**	**35.2**
Available-for-sale financial assets	**850.9**	**—**	**7.6**	**858.5**
Financial liabilities				
Derivative financial instruments	**—**	**225.3**	**—**	**225.3**

2015	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets				
Derivative financial instruments	—	80.7	—	80.7
Available-for-sale financial assets	1,233.3	59.0	3.3	1,295.6
Financial liabilities				
Derivative financial instruments	—	155.3	—	155.3

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 financial assets were calculated using valuation techniques, including discounted cash flow models.

Level 3 Valuations

Level 3 available-for-sale financial assets represent the Company'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 Company'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 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.

Notes to the financial statements

Note 30: Offsetting of financial assets and financial liabilities

2016	Gross amounts of assets and liabilities £m	Amounts offset in the balance sheet[1] £m	Net amounts presented in the balance sheet £m	Related amounts where set off in the balance sheet not permitted[2]		Potential net amounts if offset of related amounts permitted £m
				Subject to master netting agreements £m	Collateral received/ pledged £m	
Financial assets						
Derivative financial instruments	**54.9**	**(19.7)**	**35.2**	**(23.5)**	**(7.9)**	**3.8**
Loans and advances to banks	**229.7**	**—**	**229.7**	**—**	**(166.1)**	**63.6**
Other assets	**66.1**	**(3.2)**	**62.9**	**—**	**—**	**62.9**
Financial liabilities						
Deposits from banks	**2,129.7**	**—**	**2,129.7**	**—**	**(7.9)**	**2,121.8**
Derivative financial instruments	**249.7**	**(24.4)**	**225.3**	**(23.5)**	**(166.1)**	**35.7**
Other liabilities	**184.1**	**1.5**	**185.6**	**—**	**—**	**185.6**

2015	Gross amounts of assets and liabilities £m	Amounts offset in the balance sheet[1] £m	Net amounts presented in the balance sheet £m	Related amounts where set off in the balance sheet not permitted[2]		Potential net amounts if offset of related amounts permitted £m
				Subject to master netting agreements £m	Collateral received/ pledged £m	
Financial assets						
Derivative financial instruments	81.0	(0.3)	80.7	(70.4)	(8.9)	1.4
Loans and advances to banks	119.6	—	119.6	—	(72.1)	47.5
Other assets	19.5	(0.1)	19.4	—	—	19.4
Financial liabilities						
Deposits from banks	1,283.8	—	1,283.8	—	(8.9)	1,274.9
Derivative financial instruments	155.7	(0.4)	155.3	(70.4)	(72.1)	12.8
Other liabilities	152.7	—	152.7	—	—	152.7

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 Company enters into derivatives with various counterparties which are governed by industry standard master netting agreements. The Company 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 tables.

Note 31: Financial risk management

The principal risks faced by the Company through the use of financial instruments are: market risk, which includes interest rate mismatch risk and foreign currency risk; credit risk; and liquidity risk.

(1) Market risk

The Company uses various market risk measures for risk reporting and setting risk appetite limits and triggers. These measures include Capital at Risk and Earnings at Risk.

A. Interest Rate Risk in the Banking Book (IRRBB)

Interest rate mismatch risk arises from the different repricing characteristics of the assets and liabilities and off-balance sheet positions. The Company monitors interest rate exposures through consideration of Capital at Risk (CaR) and Earnings at Risk (EaR).

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 Company's capital position.

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 CaR and EaR are controlled by a defined risk appetite limit and supporting metrics.

The Company calculates both CaR and EaR sensitivities on a regulated entity basis, being the consolidated interest rate exposures of the Company and the SPVs detailed in note 15. This aligns to the basis of calculation of the Company's capital resources, as detailed in note 33.

The following tables show CaR and EaR measurements based on a two per cent parallel stress for interest rate mismatch risk, subject to a floor of 0%, with complimentary stress scenarios in other risk categories.

Capital at Risk	**2016**		2015	
(unaudited)	**Positive rate shock £m**	**Negative rate shock[1] £m**	Positive rate shock £m	Negative rate shock[1] £m
Interest rate mismatch risk	**(8.8)**	**1.5**	(9.1)	6.8
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	**27.0**	**16.3**	26.9	23.8

1 Market rate (BBR, LIBOR and swaps) stresses are subject to a contractual rate floor of 0%

CaR as at 31 December 2016 decreased to £16.3 million from £23.8 million at 31 December 2015 in a negative rate shock scenario. The impact of a negative rate shock has reduced due to the lower rate environment, particularly the 25 basis point cut to Bank Base Rate that was made in August 2016. Therefore, the impact of further potential rate cuts is lower, assuming rates do not go below 0%. CaR in a positive rate shock scenario is broadly consistent across all sources of IRRBB risk.

Notes to the financial statements

Note 31: Financial risk management (continued)

Earnings at Risk	**2016**		2015	
	Positive rate shock	**Negative rate shock[1]**	Positive rate shock	Negative rate shock[1]
(unaudited)	**£m**	**£m**	£m	£m
Interest rate mismatch risk	**(1.4)**	**1.8**	1.8	3.9
Basis risk	**10.6**	**18.0**	(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	**20.8**	**22.4**	13.7	6.5

1 Market rate (BBR, LIBOR and swaps) stresses are subject to a contractual rate floor of 0%

EaR has increased year on year by £7.1 million in a positive rate shock scenario and by £15.9 million in a negative rate shock scenario due to changes made in the way the Company measures the exposure to basis risk. The scenarios used have been updated to better capture basis risk in the current low rate environment. The Company's underlying IRRBB risk exposure, after removing the impact of changes to basis risk stress scenarios, is materially unchanged.

The following tables provide an analysis of the repricing periods of assets and liabilities on the balance sheet. Mismatches in the repricing timing of assets, liabilities, and off-balance sheet positions create interest rate risk quantified in CaR and EaR.

2016 Interest rate repricing of assets and liabilities[1]	**Within 3 months £m**	**After 3 months and within 6 months £m**	**After 6 months and within 1 year £m**	**After 1 year and within 5 years £m**	**After 5 years £m**	**Non-interest bearing instruments £m**	**Total £m**
Assets							
Cash and balances at central banks	**732.0**	**—**	**—**	**—**	**—**	**54.3**	**786.3**
Loans and receivables:							
Loans and advances to banks	**224.2**	**—**	**—**	**—**	**—**	**5.5**	**229.7**
Loans and advances to customers	**8,289.3**	**1,871.1**	**3,425.2**	**18,365.2**	**298.5**	**459.6**	**32,708.9**
Debt securities	**0.7**	**—**	**—**	**—**	**—**	**—**	**0.7**
Available-for-sale financial assets	**212.9**	**—**	**—**	**154.5**	**426.0**	**65.4**	**858.8**
Other assets	**53.9**	**—**	**—**	**—**	**—**	**276.9**	**330.8**
Total assets	**9,513.0**	**1,871.1**	**3,425.2**	**18,519.7**	**724.5**	**861.7**	**34,915.2**
Liabilities							
Deposits from banks	**2,129.7**	**—**	**—**	**—**	**—**	**—**	**2,129.7**
Customer deposits	**18,027.5**	**1,157.1**	**4,081.4**	**4,810.2**	**—**	**30.1**	**28,106.3**
Amounts due to securitisation special purpose vehicles	**2,203.7**	**—**	**—**	**—**	**—**	**(60.1)**	**2,143.6**
Debt Securities in issue	**—**	**—**	**—**	**300.0**	**—**	**5.8**	**305.8**
Other liabilities	**—**	**—**	**—**	**—**	**—**	**538.6**	**538.6**
Equity	**—**	**—**	**—**	**230.0**	**—**	**1,461.2**	**1,691.2**
Total liabilities and equity	**22,360.9**	**1,157.1**	**4,081.4**	**5,340.2**	**—**	**1,975.6**	**34,915.2**
Notional values of derivatives affecting interest rate sensitivity	**10,956.3**	**(548.2)**	**1,388.0**	**(10,555.5)**	**(1,240.6)**	**—**	**—**
Total interest rate sensitivity gap	**(1,891.6)**	**165.8**	**731.8**	**2,624.0**	**(516.1)**	**(1,113.9)**	**—**
Cumulative interest rate sensitivity gap	**(1,891.6)**	**(1,725.8)**	**(994.0)**	**1,630.0**	**1,113.9**	**—**	**—**

1 Items are allocated to time bands in the table above by reference to the earlier of the next contractual interest rate repricing date and the residual maturity date.

Note 31: Financial risk management (continued)

2015 Interest rate repricing of assets and liabilities[1]	Within 3 months £m	After 3 months and within 6 months £m	After 6 months and within 1 year £m	After 1 year and within 5 years £m	After 5 years £m	Non-interest bearing instruments £m	Total £m
Assets							
Cash and balances at central banks	835.5	—	—	—	—	53.1	888.6
Loans and receivables:							
Loans and advances to banks	115.1	—	—	—	—	4.5	119.6
Loans and advances to customers	7,315.6	1,710.6	3,132.4	14,407.3	516.9	308.6	27,391.4
Debt securities	1.3	—	—	—	—	—	1.3
Available-for-sale financial assets	373.2	4.7	59.0	177.9	612.7	69.4	1,296.9
Other assets	—	99.1	—	—	—	211.9	311.0
Total assets	8,640.7	1,814.4	3,191.4	14,585.2	1,129.6	647.5	30,008.8
Liabilities							
Deposits from banks	1,283.8	—	—	—	—	—	1,283.8
Customer deposits	14,679.3	1,661.6	3,443.6	5,348.4	—	12.4	25,145.3
Amounts due to securitisation special purpose vehicles	1,623.4	—	—	—	—	(70.3)	1,553.1
Debt Securities in issue	-	-	-	300.0	—	(2.5)	297.5
Other liabilities	—	—	—	—	—	400.4	400.4
Equity	—	—	—	—	—	1,328.7	1,328.7
Total liabilities and equity	17,586.5	1,661.6	3,443.6	5,648.4	—	1,668.7	30,008.8
Notional values of derivatives affecting interest rate sensitivity	7,858.6	199.8	591.2	(7,263.3)	(1,386.3)	—	—
Total interest rate sensitivity gap	(1,087.2)	352.6	339.0	1,673.5	(256.7)	(1,021.2)	—
Cumulative interest rate sensitivity gap	(1,087.2)	(734.6)	(395.6)	1,277.9	1,021.2	—	—

1 Items are allocated to time bands in the table above by reference to the earlier of the next contractual interest rate repricing date and the residual maturity date.

The interest rate re-pricing tables shown above reflect the repricing of assets and liabilities without adjustments to the repricing profile that reflect future pricing assumptions or taking into account expected future business that the Company hedges ahead of becoming contractually bound. The Company 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.

B. Foreign currency risk

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 Company has minimal appetite for foreign currency risk.

At 31 December 2016 the Company had negligible net foreign exchange risk positions. 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.

Assets and liabilities in foreign currency at sterling carrying values	**2016**		2015	
	US$ in £m	**€ in £m**	US$ in £m	€ 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				
Other liabilities	**0.1**	**0.4**	0.1	0.1
Total liabilities	**0.1**	**0.4**	0.1	0.1
Notional value of derivatives affecting currency exposures	**1.5**	**—**	—	—
Net position	**0.7**	**1.0**	—	3.3

Note 31: Financial risk management (continued)

(2) Credit risk

Credit risk is the risk that a borrower or counterparty fails to pay the interest or capital due on a loan or other financial instrument (both on and off-balance sheet).

The Company has appetite for high-quality credit exposures including affordable retail lending and liquid wholesale investments. The Company uses a range of approaches to mitigate credit risk, using risk appetite to set out the credit policy for each type of credit risk, obtaining collateral and using master netting agreements to permit the offset of exposures.

Loans and advances to customers comprise:

Loans and advances to customers	**2016 £m**	2015 £m
Advances secured on residential property not subject to securitisation	**19,375.2**	17,386.3
Advances secured on residential property subject to securitisation	**4,907.8**	3,669.5
	24,283.0	21,055.8
Residential buy to let loans not subject to securitisation	**5,468.4**	4,401.1
Total loans and advances secured on residential property	**29,751.4**	25,456.9
Impairment allowance – secured	**(10.6)**	(8.7)
Loans and advances – secured	**29,740.8**	25,448.2
Credit cards not subject to securitisation	**2,486.5**	1,609.8
Overdrafts not subject to securitisation	**0.1**	0.2
Total 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
Amounts due from group companies	**341.8**	278.7
Total loans and advances to customers excluding fair value of portfolio hedging	**32,529.7**	27,305.7

A. Maximum credit exposure

The maximum credit risk exposure of the Company 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 Company, subject to product notice requirements.

2016 Maximum exposure to credit risk by credit quality	**Low risk £m**	**Medium risk £m**	**Higher risk £m**	**Total exposures £m**	**Low risk %**	**Medium risk %**	**Higher risk %**
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**	**—**	**—**
Loans and advances to banks	**229.7**	**—**	**—**	**229.7**	**100.0**	**—**	**—**
Derivative financial instruments	**35.2**	**—**	**—**	**35.2**	**100.0**	**—**	**—**
Loans and advances to customers – amounts due from group companies	**341.8**	**—**	**—**	**341.8**	**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	**2,451.2**	**2.9**	**32.5**	**2,486.6**	**98.6**	**0.1**	**1.3**
Total on-balance sheet	**31,526.0**	**1,874.5**	**1,090.0**	**34,490.5**	**91.4**	**5.4**	**3.2**
Off-balance sheet							
Loan commitments (pipeline and undrawn commitments)	**5,289.1**	**—**	**—**	**5,289.1**	**100.0**	**—**	**—**

Note 31: Financial risk management (continued)

2015 Maximum exposure to credit risk by credit quality	Low risk £m	Medium risk £m	Higher risk £m	Total exposures £m	Low risk %	Medium risk %	Higher risk %
On-balance sheet							
Wholesale							
Cash and balances at central banks	888.6	—	—	888.6	100.0	—	—
Debt securities classified as loans and receivables	1.3	—	—	1.3	100.0	—	—
Available-for-sale financial assets	1,296.9	—	—	1,296.9	100.0	—	—
Loans and advances to banks	119.6	—	—	119.6	100.0	—	—
Derivative financial instruments	80.7	—	—	80.7	100.0	—	—
Loans and advances to customers – amounts due from group companies	278.7	—	—	278.7	100.0	—	—
Retail							
Gross loans and advances to customers – secured	22,911.8	1,652.4	892.7	25,456.9	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	27,157.3	1,655.3	920.1	29,732.7	91.3	5.6	3.1
Off-balance sheet							
Loan commitments (pipeline and undrawn commitments)	4,479.8	—	—	4,479.8	100.0	—	—

B. Retail secured credit risk concentration

The table below shows the geographical concentration of the mortgage portfolio

Geographical concentration	**2016 £m**	**%**	2015 £m	%
East Anglia	**726.0**	**2.6**	605.6	2.5
East Midlands	**1,556.4**	**5.2**	1,287.6	5.1
North	**1,025.3**	**3.4**	956.8	3.8
Yorkshire & Humberside	**1,640.3**	**5.5**	1,412.7	5.5
North West	**2,209.3**	**7.4**	1,890.4	7.4
West Midlands	**1,560.9**	**5.2**	1,302.0	5.1
South West	**2,320.6**	**7.8**	1,935.8	7.6
South East	**7,365.7**	**24.8**	6,138.1	24.1
Greater London	**8,365.9**	**28.1**	7,228.5	28.4
Wales	**673.9**	**2.3**	597.3	2.3
Scotland	**1,828.0**	**6.1**	1,685.2	6.6
Northern Ireland	**478.3**	**1.6**	416.4	1.6
Other	**0.8**	**—**	0.5	**—**
Total	**29,751.4**	**100.0**	25,456.9	100.0

The geographic split of the portfolio remains broadly stable.

The table below shows retail secured credit concentrations by loan size

Retail secured credit concentrations by loan size	**2016 £m**	**%**	2015 £m	%
0-£100k	**5,169.8**	**17.5**	4,940.5	19.4
£100k-£250k	**13,989.6**	**47.0**	11,875.6	46.6
£250k-£500k	**7,835.2**	**26.3**	6,076.8	23.9
£500k-£1m	**2,536.2**	**8.5**	2,333.8	9.2
£1m-£2.5m	**207.4**	**0.7**	211.3	0.8
>£2.5m	**13.2**	**—**	18.9	0.1
Total	**29,751.4**	**100.0**	25,456.9	100.0

As at 31 December 2016, 0.7% (2015: 0.9%) of mortgage balances consisted of loans in excess of £1.0 million.

Loans with balances of up to £250,000 increased by £2,343.3 million during 2016. This represents 54.6% of the total secured loans portfolio growth of £4,294.5 million.

Note 31: Financial risk management (continued)

The tables below show retail secured credit concentrations by loan type

2016 Retail secured credit concentrations by loan type	**Residential mortgage loans**		**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 Retail secured credit concentrations by loan type	Residential mortgage loans		Buy-to-let mortgage loans		Total	
	£m	%	£m	%	£m	%
Capital repayment	15,797.3	75.0	760.9	17.3	16,558.2	65.0
Part-and-part	1,235.2	5.9	26.5	0.6	1,261.7	5.0
Interest only	4,023.3	19.1	3,613.7	82.1	7,637.0	30.0
Total	21,055.8	100.0	4,401.1	100.0	25,456.9	100.0

The tables below show the retail secured loan-to-value (LTV)% of the portfolio using the indexed values at the financial year ends.

2016 Retail secured loan to value LTV (%) – indexed value at financial year end	**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 loan-to-value of stock - indexed[1]		**55.6**		**54.8**		**55.4**
Average loan-to-value of new business		**69.8**		**60.5**		**68.0**

2015 Retail secured loan to value LTV (%) – indexed value at financial year end	Residential mortgage loans		Residential buy-to-let mortgage loans		Total	
	£m	%	£m	%	£m	%
<50%	8,124.2	38.6	1,443.1	32.8	9,567.3	37.6
50%-<60%	4,679.6	22.2	1,202.7	27.3	5,882.3	23.1
60%-<70%	4,025.3	19.1	1,069.6	24.3	5,094.9	20.0
70%-<80%	2,247.2	10.7	680.4	15.5	2,927.6	11.5
80%-<90%	1,719.7	8.2	3.4	0.1	1,723.1	6.8
90%-<100%	250.4	1.2	1.4	—	251.8	1.0
>100%	9.4	—	0.5	—	9.9	—
Total	21,055.8	100.0	4,401.1	100.0	25,456.9	100.0
Average loan-to-value of stock - indexed[1]		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.

The average indexed LTVs of the overall mortgage portfolio have increased by 0.4% as at 31 December 2016. This reflects overall book growth, with an increased proportion of new residential lending. The average indexed LTVs for new business lending in 2016 has remained at 68.0%.

Notes to the financial statements

Note 31: Financial risk management (continued)

C. Credit quality of assets

Loans and receivables

The Company 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 probability of default (PD). The point in time PD is an internal parameter used within the Company's Advanced Internal Ratings Based (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% but 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 Company's wholesale exposures, excluding certain derivative financial instruments between the Company and Gosforth Funding securitisation special purpose vehicles, are investment grade and therefore classified as low risk.

No wholesale loans and receivables credit exposures are past due or impaired as at 31 December 2016 or 31 December 2015.

The categorisation of credit risk is detailed in the table below:

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 is treated as impaired at one day past due. All fraud and operational risk loans are categorised as impaired irrespective of the expected recoverable amount.

Notes to the financial statements

Note 31: Financial risk management (continued)

The credit quality of retail assets is detailed in the tables below

2016 Gross loans and advances to customers by credit quality	**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	**24,047.8**	**99.1**	**5,441.8**	**99.5**	**2,454.0**	**98.7**	**0.1**	**100.0**	**31,943.7**	**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**	**32.5**	**1.3**	—	—	**125.4**	**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**

2015 Gross loans and advances to customers by credit quality	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	20,833.0	98.9	4,379.1	99.5	1,582.4	98.3	0.2	100.0	26,794.7	99.0
– *of which in receipt of forbearance*[1]	*238.5*	*1.1*	*8.8*	*0.2*	*2.9*	*0.2*	—	—	*250.2*	*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	21,055.8	100.0	4,401.1	100.0	1,609.8	100.0	0.2	100.0	27,066.9	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.

The criteria that the Company uses to determine that there is objective evidence of an impairment loss are disclosed in accounting policy (f) in note 1. 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. The table below shows the details of the credit quality for neither past due nor impaired secured loans.

2016 Credit quality for neither past due nor impaired loans	**Residential mortgage loans £m**	**%**	**Residential buy-to-let mortgage loans £m**	**%**	**Total £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 Credit quality for neither past due nor impaired loans	Residential mortgage loans **£m**	**%**	Residential buy-to-let mortgage loans **£m**	**%**	Total **£m**	**%**
PD by internal ratings						
Low risk	18,677.0	89.6	4,234.8	96.7	22,911.8	90.8
Medium risk	1,518.7	7.3	133.7	3.1	1,652.4	6.6
Higher risk	637.3	3.1	10.6	0.2	647.9	2.6
Total neither past due nor impaired	20,833.0	100.0	4,379.1	100.0	25,212.1	100.0

Notes to the financial statements

Note 31: Financial risk management (continued)

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, comprising 0.6% of secured loans (2015: 0.6%). All unsecured assets which are past due are treated as impaired.

2016 **Past due and not impaired loans**	**Residential mortgage loans £m**	**%**	**Residential buy-to-let mortgage loans £m**	**%**	**Total £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 Past due and not impaired loans	Residential mortgage loans £m	%	Residential buy-to-let mortgage loans £m	%	Total £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.

	Secured		**Unsecured**	
2016 **Reconciliation of impaired loans**	**Residential mortgage loans £m**	**Residential buy-to-let mortgage loans £m**	**Credit cards £m**	**Total £m**
As at 1 January 2016	**77.6**	**7.0**	**27.4**	**112.0**
Classified as impaired during the year	**132.3**	**20.4**	**83.3**	**236.0**
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)**	**(7.6)**	**(20.6)**
As at 31 December 2016	**83.9**	**9.0**	**32.5**	**125.4**

	Secured		Unsecured	
2015 Reconciliation of impaired loans	Residential mortgage loans £m	Residential buy-to-let mortgage loans £m	Credit cards £m	Total £m
As at 1 January 2015	68.8	7.6	27.4	103.8
Classified as impaired during the year	174.7	22.2	81.6	278.5
Transferred from impaired to unimpaired	(150.9)	(21.6)	(42.4)	(214.9)
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

Note 31: Financial risk management (continued)

Impaired assets increased by £13.4 million in the year to 31 December 2016. This increase reflects growth in the book, despite improved arrears performance. Further details of the Company's impaired assets and provisions are provided in the tables below.

2016 Impaired assets and impairment provisions	Gross balances £m	Impaired balances £m	Impaired balances as a % of gross balances %	Impairment provisions £m	Impairment provisions as a % of impaired balances %
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**	**32.5**	**1.3**	**39.4**	**121.2**
Overdrafts	**0.1**	**—**	—	**0.1**	—
Total unsecured	**2,486.6**	**32.5**	**1.3**	**39.5**	**121.5**
Wholesale treasury assets	**2,217.3**	—	—	—	—
Derivative financial instruments	**35.2**	—	—	—	—
Total	**34,490.5**	**125.4**	**0.4**	**50.1**	**40.0**

2015 Impaired assets and impairment provisions	Gross balances £m	Impaired balances £m	Impaired balances as a % of gross balances %	Impairment provisions £m	Impairment provisions as a % of impaired balances %
Residential mortgage loans	21,055.8	77.6	0.4	7.7	9.9
Residential buy-to-let mortgage loans	4,401.1	7.0	0.2	1.0	14.3
Total secured	25,456.9	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	2,585.1	—	—	—	—
Derivative financial instruments	80.7	—	—	—	—
Total	29,732.7	112.0	0.4	39.9	35.6

An analysis of impaired assets by overdue term and secured loan assets where the borrower's property is in possession is provided in the tables below.

2016 Impaired assets by overdue term and possession status – secured	Residential mortgage loans £m	%	Residential buy-to-let mortgage loans £m	%	Total £m	%
Up to one month	**55.7**	**66.4**	**6.2**	**69.0**	**61.9**	**66.7**
One to three months	**19.9**	**23.7**	**2.2**	**24.4**	**22.1**	**23.8**
Three to six months	**4.1**	**4.9**	**0.3**	**3.3**	**4.4**	**4.7**
Over six months	**3.9**	**4.6**	**0.2**	**2.2**	**4.1**	**4.4**
Possession	**0.3**	**0.4**	**0.1**	**1.1**	**0.4**	**0.4**
Total impaired assets	**83.9**	**100.0**	**9.0**	**100.0**	**92.9**	**100.0**

Note 31: Financial risk management (continued)

2015 Impaired assets by overdue term and possession status – secured	Residential mortgage loans £m	%	Residential buy-to-let mortgage loans £m	%	Total £m	%
Up to one month	50.7	65.3	4.5	64.3	55.2	65.3
One to three months	13.7	17.7	1.4	20.0	15.1	17.8
Three to six months	5.2	6.7	0.3	4.3	5.5	6.5
Over six months	7.2	9.3	0.7	10.0	7.9	9.3
Possession	0.8	1.0	0.1	1.4	0.9	1.1
Total impaired assets	77.6	100.0	7.0	100.0	84.6	100.0

2016 **Impaired assets by overdue term – unsecured**	**£m**	**%**
Credit cards		
Up to one month	**13.1**	**40.4**
One to three months	**9.3**	**28.6**
Three to six months	**9.7**	**29.8**
Over six months	**0.4**	**1.2**
Total	**32.5**	**100.0**

2015 Impaired assets by overdue term – unsecured	£m	%
Credit cards		
Up to one month	11.8	43.1
One to three months	7.6	27.7
Three to six months	7.7	28.1
Over six months	0.3	1.1
Total	27.4	100.0

The table below shows the reconciliation of retail impairment provisions during the year.

	Secured		**Unsecured**		
Impairment provisions on loans and advances	**Residential mortgage loans**	**Residential buy-to-let property**	**Credit cards**	**Overdrafts**	**Total**
	£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 statement	3.2	(0.2)	34.2	—	37.2
As at 31 December 2015	**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).

Note 31: Financial risk management (continued)

D. Wholesale credit risk and concentration

Wholesale credit exposures	**2016 £m**	2015 £m
Loans and advances to banks	**229.7**	119.6
Bank of England	**786.3**	888.6
Debt securities classified as loans and receivables	**0.7**	1.3
Debt securities classified as available-for-sale financial assets	**850.9**	1,292.3
Gross positive fair value of derivative contracts	**35.2**	80.7
Loans and advances to customers – amounts due from group companies	**341.8**	278.7
Total	**2,244.6**	2,661.2

The Company's wholesale credit risk exposures reduced by £416.6 million during 2016 due to a reduction of debt securities held and cash deposited at the Bank of England.

At 31 December 2016 the single largest exposure to any single counterparty which is not a sovereign, a supranational or a Gosforth Funding securitisation vehicle was £85.8 million (2015: £117.6 million). The exposure was to a large UK bank.

The table below shows the credit ratings of loans and advances to banks excluding the Bank of England.

Loans and advances to banks excluding Bank of England	**2016 £m**	2015 £m
AA-	**70.6**	23.8
A+	**18.7**	15.9
A	**77.4**	33.3
A-	**35.0**	6.1
BBB+	**28.0**	40.5
Total	**229.7**	119.6

The tables below show the composition of debt securities classified as loans and receivables and debt securities classified as available-for-sale financial assets and their credit ratings.

	2016		2015	
	Debt securities classified as loans and receivables £m	**Debt securities classified as available-for-sale financial assets £m**	Debt securities classified as loans and receivables £m	Debt securities classified as available-for-sale financial assets £m
UK sovereign exposures	**—**	**317.3**	—	409.5
Supranational	**—**	**129.3**	—	203.7
Residential mortgage-backed securities	**0.7**	**52.2**	1.3	59.4
Covered bonds	**—**	**327.1**	—	535.3
Debt securities issued by banks	**—**	**25.0**	—	84.4
Total	**0.7**	**850.9**	1.3	1,292.3

Credit rating on debt securities	**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**	1.3
Total	**851.6**	1,293.6

Note 31: Financial risk management (continued)

The credit ratings of the debt securities remains high, with 97.0% having a rating of AA or better compared to 95.3% 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.

Concentration risk for wholesale credit exposures is managed for both individual counterparties and for country of exposure. The Company does not set a limit to exposures to the Bank of England and the UK sovereign. The table below shows exposures by country.

Exposures by country	2016 £m	2015 £m
Australia	**19.3**	14.4
Canada	**25.0**	30.0
France	**36.4**	12.7
UK	**2,022.0**	2,356.2
Germany	**—**	10.9
Netherlands	**—**	25.3
USA	**12.6**	8.0
Supranational	**129.3**	203.7
Total	**2,244.6**	2,661.2

E. Derivative financial instruments

An analysis of derivative assets is given in note 10. The Company reduces exposure to credit risk through central clearing for eligible derivatives and daily posting of cash collateral on such transactions, as detailed in note 30. For over-the-counter (OTC) transactions exposure is reduced by use of master netting agreements and by obtaining collateral in the form of cash or highly liquid securities. In respect of the Company's maximum credit risk relating to derivative assets of £35.2 million (2015: £80.7 million), cash collateral of £7.9 million (2015: £8.9 million) was held.

The Company 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 OTC 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 liabilities under the same title.

Cash collateral received is shown as deposits from banks, with cash collateral posted shown as loans and advances to banks (refer note 14). The table below details OTC derivative exposures.

OTC derivative exposures	2016 £m	2015 £m
Gross positive fair value of derivative contracts	**35.2**	80.7
Netting with gross negative fair value of derivative contracts[1]	**(23.5)**	(70.4)
Potential future incremental exposure	**24.7**	48.0
Collateral received (deposits from banks)	**(7.9)**	(8.9)
Net OTC derivative exposures	**28.5**	49.4

OTC derivative liabilities	2016 £m	2015 £m
Gross negative fair value of derivative contracts	**(218.0)**	(150.3)
Netting with gross positive fair value of derivative contracts[1]	**23.5**	70.4
Collateral pledged (loans and advances to banks)	**166.1**	72.1
Net OTC derivative liability	**(28.4)**	(7.8)

1 The use of netting allows positions on all bilateral transactions with any given counterparty to be offset.

Note 31: Financial risk management (continued)

The only netting agreements in place are in relation to derivative financial instruments. 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.

	2016		2015	
Gross OTC derivative exposures by credit rating	**£m**	**%**	£m	%
AA-	**3.9**	**11.2**	20.6	25.5
A+	**0.6**	**1.6**	6.8	8.4
A	**13.6**	**38.6**	42.0	52.1
A-	**12.7**	**36.2**	6.3	7.8
BBB+	**0.8**	**2.1**	5.0	6.2
Not rated	**3.6**	**10.3**	-	-
Total	**35.2**	**100.0**	80.7	100.0

Gross OTC derivative exposures reported as 'Not rated' relate to currency derivative transactions between Gosforth Funding securitisation special purpose vehicles and the Company.

F. Collateral held as security for financial assets

The Company holds collateral against loans and receivables on the mortgage portfolio. Quantitative and, where appropriate, qualitative information is provided in respect of this collateral below.

Loans and receivables to customers

The Company holds collateral in respect of secured loans and advances to customers as set out below. The Company does not hold collateral against debt securities, comprising asset-backed securities and corporate and other debt securities, which are classified as loans and receivables.

Collateral held in relation to secured loans is capped to the amount outstanding on an individual loan basis. The percentages in the table below represent the value of collateral, capped at loan amount, divided by the total loan amount in each category.

2016

Fair value of collateral against secured loans – capped at loan value[1]	**Residential mortgage loans £m**	**%**	**Residential buy-to-let mortgage loans £m**	**%**	**Total £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 look fully collateralised due to immaterial balances in negative equity. Due to rounding these do not change the overall collateralised percentage shown.

Note 31: Financial risk management (continued)

2015 Fair value of collateral against secured loans – capped at loan value[1]	Residential mortgage loans £m	%	Residential buy-to-let mortgage loans £m	%	Total £m	%
Neither past due nor impaired	20,832.4	100.0	4,379.1	100.0	25,211.5	100.0
– *of which in receipt of forbearance*	*238.5*	*100.0*	*8.8*	*100.0*	*247.3*	*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*	*0.8*	*100.0*	*0.1*	*100.0*	*0.9*	*100.0*
Total	21,054.9	100.0	4,401.1	100.0	25,456.0	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 the collateral value where the indexed LTV is greater than 100%.

2016 **Negative equity on secured loans**	**Residential mortgage loans £m**	**Residential buy-to-let mortgage loans £m**	**Total £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 Negative equity on secured loans	Residential mortgage loans £m	Residential buy-to-let mortgage loans £m	Total £m
Neither past due nor impaired	0.6	—	0.6
– *of which in receipt of forbearance*	—	—	—
Past due and not impaired	—	—	—
Impaired	0.3	—	0.3
– *of which in possession*	—	—	—
Total	0.9	—	0.9

The proportion of secured balances in negative equity equated to 0.1% at 31 December 2016 (2015: below 0.1%). This relates to £15.2 million of asset balances in the mortgage portfolio that are exposed to negative equity (2015: £9.9 million). The amount of negative equity has increased from £0.9 million at 31 December 2015 to £1.5 million as at 31 December 2016. This is mainly attributed to negative house price movements in Northern Ireland during the year.

Loans and advances to banks

The Company requires collateral posting arrangements to be in place as part of entering into a derivative transaction with another bank, depending on the type of financial product and the counterparty involved, and netting arrangements are obtained. The Company's derivative exposures to Gosforth Funding securitisation special purpose vehicles are an exception to collateral requirements.

Other

No collateral is held in respect of retail credit cards or overdrafts. 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 a portfolio of financial assets.

Note 31: Financial risk management (continued)

G. Collateral repossessed

The Company 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 Company will obtain the best price that might reasonably be paid taking into account factors such as property and market conditions.

The Company 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 Company had six repossessed properties as at 31 December 2016 compared to twelve at 31 December 2015.

H. Debt management for customers in financial difficulty

The Company's aim in offering forbearance and other assistance to retail customers in financial distress is to benefit both the customer and the Company by discharging the Company'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.

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.

Forbearance and provisioning

The Company's approach is to ensure that provisioning models, supported by management judgement, appropriately reflect the incurred loss risk of exposures. The Company 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.

The Company operates a number of treatments to assist borrowers who are experiencing financial distress. In defining the treatments, the Company 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 £279.0 million at 31 December 2016, representing a 3.3% (£8.9 million) increase on 31 December 2015. This increase is reflective of book growth, as forbearance as a percentage of total loans and advances to customers has reduced for both secured and unsecured lending.

Note 31: Financial risk management (continued)

2016 **Forbearance stock**	**Neither past due nor impaired £m**	**%**	**Past due not impaired £m**	**%**	**Impaired £m**	**%**	**Total £m**	**%**
Secured								
Payment arrangement	**0.1**	**0.1**	**0.6**	**9.7**	**0.2**	**6.9**	**0.9**	**0.3**
Transfer to interest only	**20.9**	**8.1**	**1.8**	**29.0**	**0.6**	**20.7**	**23.3**	**8.7**
Term extension	**177.0**	**68.8**	**2.3**	**37.1**	**1.4**	**48.3**	**180.7**	**67.9**
Payment holiday	**59.2**	**23.0**	**1.5**	**24.2**	**0.7**	**24.1**	**61.4**	**23.1**
Total secured forbearance	**257.2**	**100.0**	**6.2**	**100.0**	**2.9**	**100.0**	**266.3**	**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 unsecured forbearance	**2.9**	**100.0**	**—**	**—**	**9.8**	**100.0**	**12.7**	**100.0**
Total forbearance	**260.1**	**100.0**	**6.2**	**100.0**	**12.7**	**100.0**	**279.0**	**100.0**

2015 Forbearance stock	Neither past due nor impaired £m	%	Past due not impaired £m	%	Impaired £m	%	Total £m	%
Secured								
Payment arrangement	3.0	1.2	0.3	3.1	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	54.9	22.2	0.8	8.3	0.6	25.0	56.3	21.7
Total secured forbearance	247.3	100.0	9.7	100.0	2.4	100.0	259.4	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 unsecured forbearance	2.9	100.0	—	—	7.8	100.0	10.7	100.0
Total forbearance	250.2	100.0	9.7	100.0	10.2	100.0	270.1	100.0

At 31 December 2016, £266.3 million (31 December 2015: £259.4 million) of retail secured loans and advances were subject to forbearance. Loans which are forborne are grouped with other assets with similar risk characteristics and assessed collectively for impairment as described below. The loans are not considered as impaired loans unless they meet the Company’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 probabilities of default (PD) for various behavioural and arrears status segments, measuring the likelihood of default and the probability of charge-off given default.

Note 31: Financial risk management (continued)

(3) Funding and Liquidity risk

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.

Internal and regulatory liquidity requirements are quantified on a daily basis, with holdings assessed against a full suite of liquidity stresses weekly.

The Company 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 the composition of the liquidity portfolio.

Composition of the liquidity portfolio	2016 £m	2016 Average £m	2015 £m	2015 Average £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**	—	3.7
Certificates of deposit	**—**	**44.5**	59.0	4.5
Floating rate notes	**25.0**	**9.6**	—	—
Fixed rate bonds	**—**	**—**	—	17.0
Total other liquidity resources	**38.6**	**66.9**	74.0	27.5
Self-issued RMBS	**1,306.4**	**550.8**	326.7	197.6
Total liquidity	**5,567.6**	**5,066.5**	4,639.3	4,301.5

The Company holds sufficient liquidity to meet all internal and regulatory liquidity requirements.

Note 31: Financial risk management (continued)

The tables below analyse assets and liabilities of the Company into relevant maturity groupings based on the remaining contractual period at the balance sheet date. The Company'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 Company'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.

2016 **Assets and liabilities by maturity profile**	**Within 3 months £m**	**3-12 months £m**	**1-5 years £m**	**After 5 years £m**	**Total £m**
Assets					
Cash and balances at central banks	**737.2**	**—**	**—**	**49.1**	**786.3**
Derivative financial instruments	**1.4**	**1.1**	**31.2**	**1.5**	**35.2**
Loans and receivables:					
Loans and advances to banks	**229.7**	**—**	**—**	**—**	**229.7**
Loans and advances to customers	**2,901.9**	**720.1**	**3,910.6**	**25,176.3**	**32,708.9**
Debt securities	**—**	**—**	**—**	**0.7**	**0.7**
Available-for-sale financial assets	**—**	**25.0**	**283.2**	**550.6**	**858.8**
Other assets	**94.0**	**26.1**	**9.5**	**166.0**	**295.6**
Total assets	**3,964.2**	**772.3**	**4,234.5**	**25,944.2**	**34,915.2**
Liabilities					
Deposits from banks	**511.7**	**75.0**	**1,543.0**	**—**	**2,129.7**
Customer deposits	**24,540.2**	**1,883.6**	**1,682.5**	**—**	**28,106.3**
Derivative financial instruments	**8.3**	**6.2**	**183.6**	**27.2**	**225.3**
Amounts due to securitisation special purpose vehicles	**161.5**	**125.2**	**685.6**	**1,171.3**	**2,143.6**
Debt securities in issue	**—**	**—**	**305.8**	**—**	**305.8**
Other liabilities	**241.7**	**62.8**	**5.0**	**3.8**	**313.3**
Total liabilities	**25,463.4**	**2,152.8**	**4,405.5**	**1,202.3**	**33,224.0**
Net liquidity (gap)/surplus	**(21,499.2)**	**(1,380.5)**	**(171.0)**	**24,741.9**	**1,691.2**

2015 Assets and liabilities by maturity profile	Within 3 months £m	3-12 months £m	1-5 years £m	After 5 years £m	Total £m
Assets					
Cash and balances at central banks	846.9	—	—	41.7	888.6
Derivative financial instruments	16.1	13.2	46.0	5.4	80.7
Loans and receivables:					
Loans and advances to banks	119.6	—	—	—	119.6
Loans and advances to customers	1,919.6	572.6	3,335.1	21,564.1	27,391.4
Debt securities	—	—	—	1.3	1.3
Available-for-sale financial assets	47.5	4.7	424.4	820.3	1,296.9
Other assets	45.5	20.4	11.7	152.7	230.3
Total assets	2,995.2	610.9	3,817.2	22,585.5	30,008.8
Liabilities					
Deposits from banks	758.8	525.0	—	—	1,283.8
Customer deposits	20,776.8	2,630.3	1,738.2	—	25,145.3
Derivative financial instruments	6.0	12.1	102.5	34.7	155.3
Amounts due to securitisation special purpose vehicles	52.5	86.2	487.7	926.7	1,553.1
Debt securities in issue	—	—	297.5	—	297.5
Other liabilities	154.1	47.1	39.5	4.4	245.1
Total liabilities	21,748.2	3,300.7	2,665.4	965.8	28,680.1
Net liquidity (gap)/surplus	(18,753.0)	(2,689.8)	1,151.8	21,619.7	1,328.7

Note 31: Financial risk management (continued)

The table below shows the Company's sources of wholesale funding.

Source of wholesale funding	2016 £m	2015 £m
Amounts due to securitisation special purpose vehicles	**2,143.6**	1,553.1
Debt securities in issue	**305.8**	297.5
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	**4,567.4**	3,125.5
Treasury bills raised through FLS	**2,683.7**	2,960.0
Total	**7,251.1**	6,085.5

The tables below show the residual maturity of the wholesale funding book based on contractual terms.

2016 **Residual maturity of the wholesale funding book**	**Within 3 months £m**	**3-12 months £m**	**1-5 years £m**	**After 5 years £m**	**Total £m**
Amounts due to securitisation special purpose vehicles	**161.5**	**125.2**	**685.6**	**1,171.3**	**2,143.6**
Debt securities in issue	**—**	**—**	**305.8**	**—**	**305.8**
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	**661.5**	**200.2**	**2,534.4**	**1,171.3**	**4,567.4**
Treasury bills raised through FLS	**—**	**649.2**	**2,034.5**	**—**	**2,683.7**
Total	**661.5**	**849.4**	**4,568.9**	**1,171.3**	**7,251.1**

2015 Residual maturity of the wholesale funding book	Within 3 months £m	3-12 months £m	1-5 years £m	After 5 years £m	Total £m
Amounts due to securitisation special purpose vehicles	52.5	86.2	487.7	926.7	1,553.1
Debt securities in issue	—	—	297.5	—	297.5
Liabilities in respect of securities sold under repurchase agreements	749.9	525.0	—	—	1,274.9
Total on-balance sheet sources of funds	802.4	611.2	785.2	926.7	3,125.5
Treasury bills raised through FLS	—	510.0	2,450.0	—	2,960.0
Total	802.4	1,121.2	3,235.2	926.7	6,085.5

Notes to the financial statements

Note 31: Financial risk management (continued)

Encumbered assets

The Company'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.

2016	**Encumbered assets**		**Unencumbered assets**		**Total**
Asset encumbrance	**Pledged as collateral[2] £m**	**Other[3] £m**	**Available as collateral[4] £m**	**Other[5] £m**	**£m**
Cash 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	**—**	**—**	**—**	**35.2**	**35.2**
Loans and advances to banks	**179.1**	**—**	**—**	**50.6**	**229.7**
Loans and advances to customers	**9,425.6**	**—**	**2,932.9**	**20,350.4**	**32,708.9**
Other assets	**53.9**	**—**	**—**	**241.7**	**295.6**
Total assets	**9,669.2**	**168.1**	**3,773.9**	**21,304.0**	**34,915.2**
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	**9,669.2**	**168.1**	**6,457.6**	**21,304.0**	**37,598.9**

2015[1]	Encumbered assets		Unencumbered assets		Total
Asset encumbrance	Pledged as collateral[2] £m	Other[3] £m	Available as collateral[4] £m	Other[5] £m	£m
Cash balances at central banks	—	160.5	—	728.1	888.6
Debt securities classified as loans and receivables	—	—	1.3	—	1.3
Available-for-sale financial assets	—	—	1,292.3	4.6	1,296.9
Derivative financial assets	—	—	—	80.7	80.7
Loans and advances to banks	94.0	—	—	25.6	119.6
Loans and advances to customers	7,524.1	—	3,153.5	16,713.8	27,391.4
Other assets	0.3	—	—	230.0	230.3
Total assets	7,618.4	160.5	4,447.1	17,782.8	30,008.8
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	8,404.4	160.5	6,621.1	17,782.8	32,968.8

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 Company's collateral arrangements. The restatement has not impacted the Company's total encumbrance ratio as at 31 December 2015.

2 Encumbered assets pledged as collateral include amounts to OTC derivative counterparties of £179.1 million (2015: £94.0 million) and amounts in respect of centrally cleared derivatives of £53.9 million (2015: £0.3 million). Encumbered loans and advances to customers of £9,425.6 million (2015: £7,524.1 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 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 14).

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.

4 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.

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 Company through FLS which are not recognised on the balance sheet. The Company 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 Company has used them in repurchase transactions or unencumbered where it has not.

Note 31: Financial risk management (continued)

The Company's total level of asset encumbrance increased by £1,272.4 million to 26.2% compared with 26.0% at 31 December 2015, as a result of using wholesale funding to support increased lending. Encumbrance of assets predominantly arises from the use of Bank of England funding and liquidity facilities. The Company manages the volume of available unencumbered collateral to meet requirements arising from current and future secured funding transactions.

Cash flow profile

The tables below allocate the Company'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 Maturity groupings for non-derivative cash outflows	**Within 3 months £m**	**3-6 months £m**	**6-12 months £m**	**1-5 years £m**	**Over 5 years £m**	**Total £m**
Deposits from banks	**513.5**	**76.7**	**3.1**	**1,556.8**	**—**	**2,150.1**
Customer deposits	**24,638.0**	**703.8**	**1,393.7**	**1,835.9**	**—**	**28,571.4**
Amounts due to securitisation special purpose vehicles	**507.2**	**386.3**	**632.7**	**807.5**	**—**	**2,333.7**
Debt securities in issue	**—**	**—**	**6.8**	**320.3**	**—**	**327.1**
Total	**25,658.7**	**1,166.8**	**2,036.3**	**4,520.5**	**—**	**33,382.3**

2015 Maturity groupings for non-derivative cash outflows	Within 3 months £m	3-6 months £m	6-12 months £m	1-5 years £m	Over 5 years £m	Total £m
Deposits from banks	760.9	526.3	—	—	—	1,287.2
Customer deposits	21,229.0	895.0	1,604.5	1,962.0	—	25,690.5
Amounts due to securitisation special purpose vehicles	309.9	411.9	243.3	962.5	—	1,927.6
Debt securities in issue	—	—	6.8	326.0	—	332.8
Total	22,299.8	1,833.2	1,854.6	3,250.5	—	29,238.1

Growth in customer deposits has primarily been achieved through the defined access product, providing access to depositors on demand, shown in the 'within 3 months' category above. As a result, the Company's contractual cash flow profile of customer deposits has shortened. This has been partially offset by a lengthening of the wholesale funding profile.

The tables below divide the 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 this table are not intended to be identical to tables on OTC derivatives or other notes to the financial statements by definition.

2016 Maturity groupings for derivative cash outflows	**Within 3 months £m**	**3-6 months £m**	**6-12 months £m**	**1-5 years £m**	**Over 5 years £m**	**Total £m**
Settled on a net basis						
Derivatives in economic and not accounting hedges	**(1.7)**	**(0.5)**	**(2.2)**	**(10.2)**	**(0.2)**	**(14.8)**
Derivatives in accounting hedge relationships	**(26.1)**	**(21.2)**	**(37.6)**	**(110.0)**	**(6.2)**	**(201.1)**
	(27.8)	**(21.7)**	**(39.8)**	**(120.2)**	**(6.4)**	**(215.9)**
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	**(27.9)**	**(22.1)**	**(40.1)**	**(123.5)**	**(6.4)**	**(220.0)**

Notes to the financial statements

Note 31: Financial risk management (continued)

2015 Maturity groupings for derivative cash outflows	Within 3 months £m	3-6 months £m	6-12 months £m	1-5 years £m	Over 5 years £m	Total £m
Settled on a net basis						
Derivatives in economic and not accounting hedges	(1.3)	—	(1.0)	(12.0)	(0.9)	(15.2)
Derivatives in accounting hedge relationships	(30.9)	(25.0)	(35.8)	(41.6)	(3.2)	(136.5)
	(32.2)	(25.0)	(36.8)	(53.6)	(4.1)	(151.7)
Settled on a gross basis						
Outflows	—	—	—	—	—	—
Inflows	—	—	—	—	—	—
Total	(32.2)	(25.0)	(36.8)	(53.6)	(4.1)	(151.7)

External credit ratings

The Company'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	3 October 2016	Affirmed

In October 2016 the rating agency Fitch revised the Company's outlook to Stable from Positive and affirmed the Company's 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 £m	Cumulative adjustment for a two-notch downgrade £m
31 December 2016	**—**	**10.0**
31 December 2015	—	10.0

Notes to the financial statements

Note 32: Cash flow statements

(a) Change in operating assets

	2016 £m	2015[1] £m
Change in loans and advances to customers	**(5,355.1)**	(4,073.8)
Change in derivative financial assets	**45.5**	19.4
Change in other operating assets	**(64.8)**	6.8
Change in operating assets	**(5,374.4)**	(4,047.6)

1 Restated (refer notes 1 and 39)

(b) Change in operating liabilities

	2016 £m	2015[1] £m
Changes in customer deposits	**2,961.0**	2,776.4
Change in derivative financial liabilities	**70.0**	(72.6)
Change in other operating liabilities	**1,526.1**	686.6
Change in operating liabilities	**4,557.1**	3,390.4

1 Restated (refer notes 1 and 39)

(c) Non-cash and other items

	2016 £m	2015[1] £m
Depreciation and amortisation	**21.2**	19.1
Other non-cash items	**(9.9)**	44.9
Total non-cash and other items	**11.3**	64.0

1 Restated (refer notes 1 and 39)

(d) Analysis of cash and cash equivalents as shown in the balance sheet

	2016 £m	2015 £m
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	**229.7**	**119.6**
Deposits by banks	**(2,129.7)**	**(1,283.8)**
Less: amounts not repayable on demand	**2,129.1**	**1,283.8**
	(0.6)	—
Total cash and cash equivalents	**966.3**	**966.5**

1 Mandatory reserves with central banks are not available for use in day to day operations.

Notes to the financial statements

Note 33: Capital resources

Capital is a regulatory measure held by the Company 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 Company considers its risk appetite, the material risks to which it is exposed and the appropriate strategies required to manage those risks.

The Company manages capital in accordance with prudential rules issued by the PRA, 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 Company 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 analyse the composition of the regulatory capital resources of the Company on a CRD IV basis in both 2016 and 2015.

For regulatory capital purposes, the special purpose vehicles detailed in note 15 form part of the Virgin Money plc regulated entity. As such, these companies have been consolidated within these capital disclosures.

Own funds

	2016 £m	2015 £m
Ordinary share capital	**1,400.0**	1,400.0
Other equity instruments	**230.0**	—
Other reserves	**4.1**	(0.3)
Retained earnings	**57.1**	(71.0)
Total equity	**1,691.2**	1,328.7
Regulatory capital adjustments (unaudited)		
Net assets of special purpose vehicles	**28.6**	15.3
Foreseeable distribution on AT1 securities	**(2.8)**	—
Other equity instruments	**(230.0)**	—
Intangible assets	**(80.6)**	(63.0)
Excess of expected loss over impairment	**(41.1)**	(35.4)
Deferred tax on tax losses carried forward[1]	**(7.3)**	(18.0)
Prudential valuation adjustment	**(1.2)**	—
Common Equity Tier 1 capital (unaudited)	**1,356.8**	1,227.6
Additional Tier securities	**230.0**	—
Tier 1 capital (unaudited)	**1,586.8**	1,227.6
Tier 2 capital (unaudited)		
General credit risk adjustments	**11.9**	7.6
Tier 2 capital	**11.9**	7.6
Total own funds (unaudited)	**1,598.7**	1,235.2

1 After consolidation of special purpose vehicles

Movements in Common Equity Tier 1 capital are summarised below.

(unaudited)	**2016 £m**	2015 £m
Common Equity Tier 1 capital at 1 January	**1,227.6**	1,113.6
Movement in retained earnings	**128.1**	113.2
Movement in available-for-sale reserve	**4.4**	(5.9)
Foreseeable distribution on AT1 securities	**(2.8)**	—
Movement in net assets of SPVs	**13.3**	6.6
Movement in intangible assets	**(17.6)**	(18.0)
Movement in excess of expected loss over impairment	**(5.7)**	(2.0)
Movement in deferred tax on tax losses carried forward	**10.7**	20.1
Movement in prudential valuation adjustment	**(1.2)**	—
Common Equity Tier 1 capital at 31 December	**1,356.8**	1,227.6

Note 33: Capital resources (continued)

Risk-weighted assets – Pillar 1

(unaudited)	**2016 £m**	2015 £m
AIRB mortgages	**4,764.5**	3,952.9
Other standardised lending	**1,847.4**	1,192.7
Other standardised assets	**374.3**	486.3
Credit valuation adjustment	**21.7**	13.9
Operational risks	**595.1**	413.7
Total risk-weighted assets	**7,603.0**	6,059.5

The Company 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 Company.

(unaudited)	**2016 %**	2015 %
Common Equity Tier 1 ratio	**17.8**	20.3
Tier 1 ratio	**20.9**	20.3
Total capital ratio	**21.0**	20.4

Note 34: Related party transactions

(a) Key Management personnel

Key Management personnel refer to the Executive Team and Non-Executive Directors of the Company and its parent undertaking.

Compensation	**2016 £m**	2015 £m
Salaries and other short-term benefits	**6.7**	7.9
Share based payments	**6.8**	12.2
Pension contributions	**0.8**	0.9
Total compensation	**14.3**	21.0

Aggregate contributions in respect of Key Management personnel to defined contribution pension schemes £0.8 million (2015: £0.9 million).

Deposits	**2016 £m**	2015 £m
At 1 January	**2.0**	0.7
Placed	**1.4**	2.0
Withdrawn	**(2.2)**	(0.7)
Deposits outstanding at 31 December	**1.2**	2.0

Deposits placed by Key Management personnel attracted interest rates of up to 3.0% (2015: 2.8%). At 31 December 2016, the Company did not provide any guarantees in respect of Key Management personnel (2015: none).

At 31 December 2016, transactions, arrangements and agreements entered into with Key Management personnel included amounts outstanding in respect of loans and credit card transactions of £0.7 million with 5 Key Management personnel (2015: £0.3 million with 5 Key Management personnel).

Note 34: Related party transactions (continued)

(b) Directors' emoluments

Aggregate compensation in respect of the Company's directors were £4.7 million (2015: £9.2 million) comprising salary and other short-term benefits of £2.1 million (2015: £3.6 million), share-based payments of £2.3 million (2015: £5.2 million) and contributions to defined contribution pensions schemes £0.3 million (2015: £0.4 million).

The total compensation of the highest paid director was £3.0 million (2015: £3.5 million) comprising salaries and other short-term benefits of £1.1 million (2015: £1.0 million), share-based payments of £1.7 million (2015: £2.3 million) and contributions to defined contribution pensions schemes £0.2 million (2015: £0.2 million).

(c) Group Companies and other transactions

Details of subsidiaries are presented in note 15.

Transaction value for the year ended:

	2016 £m	2015 £m
Amounts owed by parent company	**5.0**	5.2
Amounts owed by fellow Group Companies	**11.5**	8.9
Amounts owed to parent company	**—**	—
Amounts owed to fellow Group Companies	**1.4**	—
Trademark licence fees to Virgin Enterprises Limited	**5.6**	4.8
Virgin Atlantic Airways Limited	**0.2**	—
Other costs to Virgin Management Group Companies	**1.5**	0.4

Balance outstanding at year end:

	2016 £m	2015 £m
Amounts owed by parent company	**78.0**	100.6
Amounts owed by fellow Group Companies	**0.4**	5.4
Amounts owed to parent company	**0.5**	0.5
Amounts owed to fellow Group Companies	**0.9**	—
Trademark licence fees to Virgin Enterprises Limited	**—**	0.4
Virgin Atlantic Airways Limited	**—**	—
Other balances with Virgin Management Group Companies	**0.1**	0.1

A. Amounts owed by parent company and by fellow Group Companies

Interest is accrued on monies loaned to the parent company and fellow Group Companies at a margin of 1.5% over 3 Month Sterling LIBOR, and has been since October 2015. Prior to this, interest was accrued on these balances at a 2% margin over 6 Month Sterling LIBOR.

B. Virgin Enterprises Limited

The Company paid licence fees to Virgin Enterprises Limited for use of the Virgin Money brand trademark.

C. Virgin Atlantic Airways Limited

The Company incurs credit card commissions and air mile charges to Virgin Atlantic Airways Limited (VAA) in respect of an agreement between the two parties.

Note 34: Related party transactions (continued)

D. Other costs to Virgin Management Group Companies

These relate to transactions with other companies in the Virgin Group.

(d) Securitisation special purpose vehicles

The following transactions were carried out with the securitisation special purpose vehicles established in connection with the Company's securitisation programme:

2016	**Interest income £m**	**Interest expense £m**	**Amounts due from SPVs £m**	**Amounts due to SPVs £m**
Gosforth Funding 2011-1 plc	**0.2**	**1.1**	**—**	**—**
Gosforth Funding 2012-1 plc	**0.6**	**1.0**	**—**	**—**
Gosforth Funding 2012-2 plc	**—**	**0.3**	**—**	**—**
Gosforth Funding 2014-1 plc	**1.3**	**9.3**	**68.9**	**572.5**
Gosforth Funding 2015-1 plc	**1.5**	**7.7**	**32.7**	**507.5**
Gosforth Funding 2016-1 plc	**2.5**	**12.8**	**107.1**	**687.1**
Gosforth Funding 2016-2 plc	**1.2**	**6.1**	**58.9**	**376.5**
Total	**7.3**	**38.3**	**267.6**	**2,143.6**

2015[1]	Interest income £m	Interest expense £m	Amounts due from SPVs £m	Amounts due to SPVs £m
Gosforth Funding 2011-1 plc	0.7	5.0	20.3	116.7
Gosforth Funding 2012-1 plc	0.6	2.5	17.3	32.5
Gosforth Funding 2012-2 plc	0.1	1.6	26.8	—
Gosforth Funding 2014-1 plc	1.8	11.8	70.7	739.2
Gosforth Funding 2015-1 plc	1.2	5.7	43.9	664.7
Total	4.4	26.6	179.0	1,553.1

1 Restated (refer notes 1 and 39)

Note 35: 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 36: Parent undertaking

The Company is a subsidiary of Virgin Money Holdings (UK) plc, a company registered in England and Wales.

Virgin Money Holdings (UK) plc is the largest and smallest group in which the financial statements of the Company are consolidated. The consolidated financial statements of Virgin Money Holdings (UK) plc may be obtained from Companies House, Crown Way, Cardiff, CF4 3ZU.

The Company's direct and ultimate controlling party is Virgin Money Holdings (UK) plc.

Notes to 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 Company. Those which may be relevant to the Company are set out below.

Pronouncement	Nature of change	IASB effective date
IFRS 9 'Financial Instruments'	IFRS 9 'Financial Instruments' replaces the existing 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 Company 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 allowance is a subjective feature of the IFRS 9 impairment model. The Company'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 Company's balance sheet provisions for credit losses and may therefore negatively impact the Company's regulatory capital position, though the regulatory capital transition 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 Company'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 Company currently expects to continue applying IAS 39 hedge accounting in accordance with this accounting policy choice.	1 January 2018 (endorsed on 22 November 2016)

Pronouncement	Nature of change	IASB effective date
	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 Company 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 Company 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 Company 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 Company is currently testing and refining the models in line with the Company's delivery plans. The Company 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.	
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 Company has reviewed the requirements of the new standard and it is not expected to have a significant impact, as a substantial proportion of the Company's income is generated from financial instruments.	1 January 2018 (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 Company is currently assessing the impact of the new standard.	1 January 2019 (has not been EU endorsed)

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.

Refer to Virgin Money Holdings (UK) plc Group's annual report and accounts for country by country reporting disclosures.

Note 39: Restatement of prior period information

As explained in note 1.3, the comparative financial statements for 31 December 2015 have been restated to reflect a reassessment of the accounting for Gosforth securitisation SPV issued notes held by the Company, and accounting for loans and swaps between the Company and those SPVs.

The impact of the restatements on the Income Statement and Statement of Comprehensive Income for the year ended 31 December 2015 is as follows:

Income Statement Year ended 31 December 2015	As previously stated £ million	Internally held SPV notes £ million	Basis rate swap/ deemed loan fair values £ million	Restated £ million
Interest and similar income	864.2	(20.8)[1]	—	843.4
Interest and similar expense	(407.0)	20.8[1]	—	(386.2)
Net interest income	**457.2**	—	—	**457.2**
Fee and commission income	21.8	—	—	21.8
Fair value losses on financial instruments	(13.7)	—	5.7[2]	(8.0)
Other operating income	8.7	—	—	8.7
Other income	**16.8**	—	**5.7**	**22.5**
Total income	**474.0**	—	**5.7**	**479.7**
Total operating expenses	(333.4)	—	—	(333.4)
Profit before tax from operating activities	**140.6**	—	**5.7**	**146.3**
Impairment	(30.3)	—	—	(30.3)
Profit before tax	**110.3**	—	**5.7**	**116.0**
Taxation	(22.0)	—	(1.1)[3]	(23.1)
Profit for the year	**88.3**	—	**4.6**	**92.9**
Profit attributable to equity shareholders	88.3	—	4.6	92.9
Profit for the year	**88.3**	—	**4.6**	**92.9**

1 Representing Interest and similar income and Interest and similar expense relating to notes issued by SPVs held by the Company, amounting to £20.8 million in the period.

2 Representing the fair value movement in the period on basis rate swaps of £13.1 million and the change in fair value of deemed loans to SPVs of £(7.4) million.

The basis rate swaps are not separately recognised in the Restated Balance Sheet and the deemed loans are not recognised at fair value through profit and loss. Refer to the Restated Balance Sheet for further information.

3 Representing the deferred tax impact, amounting to £1.1 million in aggregate, of the above restatements.

Statement of Comprehensive Income Year ended 31 December 2015	As previously stated £ million	Adjustments £ million	Restated £ million
Profit for the year	**88.3**	**4.6**	**92.9**
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	25.1	—	25.1
Income statement transfers in respect of disposals	(32.2)	—	(32.2)
Taxation	1.2	—	1.2
Other comprehensive expense for the year, net of tax	**(5.9)**	**—**	**(5.9)**
Total comprehensive income for the year	**82.4**	**4.6**	**87.0**
Total comprehensive income attributable to equity shareholders	**82.4**	**4.6**	**87.0**

Note 39: Restatement of prior period information (continued)

The impact of the restatements on the previously published Balance Sheets as at 31 December 2015 and 1 January 2015 is as follows:

Balance Sheet – 31 December 2015	As previously stated £ million	Internally held SPV notes £ million	Basis rate swap/ deemed loan fair values £ million	Restated £ million
Assets				
Cash and balances at central banks	888.6	—	—	888.6
Derivative financial instruments	143.5	—	(62.8)[1]	80.7
Loans and receivables:				
–Loans and advances to banks	119.6	—	—	119.6
–Loans and advances to customers	27,368.6	22.8[5]	—	27,391.4
–Debt securities	1,723.9	(1,722.6)[2]	—	1.3
	29,212.1	(1,699.8)	—	27,512.3
Available-for-sale financial assets	1,296.9	—	—	1,296.9
Intangible assets	63.0	—	—	63.0
Tangible fixed assets	74.6	—	—	74.6
Deferred tax assets	34.9	—	0.1[3]	35.0
Other assets	60.1	(2.4)[4]	—	57.7
Total assets	**31,773.7**	**(1,702.2)**	**(62.7)**	**30,008.8**
Liabilities				
Deposits from banks	1,283.8	—	—	1,283.8
Customer deposits	25,145.3	—	—	25,145.3
Derivative financial instruments	155.3	—	—	155.3
Amounts due to securitisation special purpose vehicles	3,318.4	(1,702.2)[5]	(63.1)[6]	1,553.1
Debt securities in issue	297.5	—	—	297.5
Provisions	8.2	—	—	8.2
Current tax liabilities	6.3	—	—	6.3
Other liabilities	230.6	—	—	230.6
Total liabilities	**30,445.4**	**(1,702.2)**	**(63.1)**	**28,680.1**
Equity				
Share capital	1,400.0	—	—	1,400.0
Other reserves	(0.3)	—	—	(0.3)
Retained earnings	(71.4)	—	0.4	(71.0)
Total equity	**1,328.3**	**—**	**0.4**	**1,328.7**
Total liabilities and equity	**31,773.7**	**(1,702.2)**	**(62.7)**	**30,008.8**

1 Representing elimination of the previously reported carrying value of basis rate swaps, transacted between the Company and the SPVs, of £62.8 million now considered an integral element of the carrying value of the deemed loans to the SPVs.

2 Representing elimination of the previously reported carrying value of SPV notes held by the Company of £1,722.6 million.

3 Representing the deferred tax impact, amounting to £0.1 million in aggregate, of all of the other restatements to the Balance Sheet.

4 Representing removal of accrued interest income on retained SPV notes held by the Company of £2.4 million.

5 Representing removal from deemed loan liabilities to SPVs of amounts supporting the repayment of notes retained by the Company of £1,725.0 million. As noted previously, the Company has no economic cash flow exposure on retained notes.

In removing the liability for internally held notes issued by Gosforth Funding 2012-2 plc, the net position between the Company and that entity was an asset due to the Company of £22.8 million. This has been reclassified to amounts due from group companies within loans and advances to customers.

6 Representing elimination of cumulative fair value adjustments within the carrying value of the deemed loans of £56.0 million and accrued interest on basis rate swaps of £7.1 million.

Note 39: Restatement of prior period information (continued)

Balance Sheet – 1 January 2015	As previously stated £ million	Internally held SPV notes £ million	Basis rate swap/ deemed loan fair values £ million	Restated £ million
Assets				
Cash and balances at central banks	851.3	—	—	851.3
Derivative financial instruments	178.0	—	(77.9)[1]	100.1
Loans and receivables:				
–Loans and advances to banks	136.4	—	—	136.4
–Loans and advances to customers	23,347.9	—	—	23,347.9
–Debt securities	1,407.4	(1,396.4)[2]	—	11.0
	24,891.7	(1,396.4)	—	23,495.3
Available-for-sale financial assets	1,539.6	—	—	1,539.6
Intangible assets	45.0	—	—	45.0
Tangible fixed assets	72.0	—	—	72.0
Deferred tax assets	46.0	—	1.1[3]	47.1
Other assets	71.2	(3.0)[4]	—	68.2
Total assets	**27,694.8**	**(1,399.4)**	**(76.8)**	**26,218.6**
Liabilities				
Deposits from banks	845.5	—	—	845.5
Customer deposits	22,368.9	—	—	22,368.9
Derivative financial instruments	227.9	—	—	227.9
Amounts due to securitisation special purpose vehicles	2,766.9	(1,399.4)[5]	(72.6)[6]	1,294.9
Debt securities in issue	—	—	—	—
Provisions	9.1	—	—	9.1
Current tax liabilities	2.3	—	—	2.3
Other liabilities	248.6	—	—	248.6
Total liabilities	**26,469.2**	**(1,399.4)**	**(72.6)**	**24,997.2**
Equity				
Share capital	1,400.0	—	—	1,400.0
Other reserves	5.6	—	—	5.6
Retained earnings	(180.0)	—	(4.2)	(184.2)
Total equity	**1,225.6**	**—**	**(4.2)**	**1,221.4**
Total liabilities and equity	**27,694.8**	**(1,399.4)**	**(76.8)**	**26,218.6**

1 Representing elimination of the previously reported carrying value of basis rate swaps, transacted between the Company and the SPVs, of £77.9 million now considered an integral element of the carrying value of the deemed loans to the SPVs.

2 Representing elimination of the previously reported carrying value of SPV notes held by the Company of £1,396.4 million.

3 Representing the deferred tax impact, amounting to £1.1 million in aggregate, of all of the other restatements to the Balance Sheet.

4 Representing removal of accrued interest income on retained SPV notes held by the Company of £3.0 million.

5 Representing removal from deemed loan liabilities to SPVs of amounts supporting the repayment of notes retained by the Company of £1,399.4 million. As noted previously, the Company has no economic cash flow exposure on retained notes.

6 Representing elimination of cumulative fair value adjustments within the carrying value of the deemed loans of £63.4 million and accrued interest on basis rate swaps of £9.2 million.

Notes to the financial statements

Note 39: Restatement of prior period information (continued)

The impact of the restatements on the previously published Cash Flow Statement for the year ended 31 December 2015 is as follows:

Cash Flow Statement Year ended 31 December 2015	As previously stated £ million	Adjustments £ million	Restated £ million
Profit before taxation	110.3	5.7	116.0
Adjustments for:			
Changes in operating assets	(4,009.1)	(38.5)	(4,047.6)
Changes in operating liabilities	3,674.2	(283.8)	3,390.4
Non-cash and other items	73.7	(9.7)	64.0
Tax paid	(5.0)	—	(5.0)
Net cash used in operating activities	**(155.9)**	(326.3)	**(482.2)**
Cash flows from investing activities			
Net investment in securities	(1,298.1)	638.9	(659.2)
Proceeds from sale and redemption of available-for-sale financial assets	1,213.1	(312.6)	900.5
Net investment in intangible assets	(29.6)	—	(29.6)
Purchase of tangible fixed assets	(10.2)	—	(10.2)
Disposal of tangible fixed assets	—	—	—
Net cash (used in) / provided by investing activities	**(124.8)**	**326.3**	**201.5**
Cash flows from financing activities			
Net proceeds from issue of debt securities	297.5	—	297.5
Net cash provided by financing activities	**297.5**	**—**	**297.5**
Change in cash and cash equivalents	16.8	—	16.8
Cash and cash equivalents at beginning of year	949.7	—	949.7
Cash and cash equivalents at end of year	**966.5**	**—**	**966.5**