Annual report & financial statements

Virgin Money PLC

For the year ended 31 December 2018

Company Number: 06952311

Virgin Money PLC

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For the year ended 31 December 2018

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

The forward-looking statements disclaimer can be found on page 118.

Officers and professional advisers

Directors	James Pettigrew (appointed 15 October 2018) David Duffy (appointed 15 October 2018) Ian Smith (appointed 15 October 2018) Clive Adamson (appointed 15 October 2018) David Bennett (appointed 15 October 2018) Paul Coby (appointed 15 October 2018) Geeta Gopalan Darren Pope Adrian Grace (appointed 15 October 2018) Fiona Macleod (appointed 15 October 2018) Teresa Robson-Capps (appointed 15 October 2018) Amy Stirling (appointed 15 October 2018) Timothy Wade (appointed 15 October 2018) Glen Moreno (resigned 31 March 2018) Irene Dorner (appointed 1 March, resigned 15 October 2018) Dame Jayne-Anne Gadhia (resigned 15 October 2018) Peter Bole (resigned 15 October 2018) Norman McLuskie (resigned 15 October 2018) Colin Keogh (resigned 15 October 2018) Eva Eisenschimmel (resigned 15 October 2018) Marian Martin (resigned 15 October 2018) Debbie Crosbie (appointed 15 October 2018 resigned 19 November 2018)
Secretary	Katie Marshall
Registered office	Jubilee House Gosforth Newcastle upon Tyne NE3 4PL
Independent auditors	Ernst & Young LLP Bridgewater Place 1 Water Lane Leeds LS11 5QR

Strategic Report

The Directors of Virgin Money PLC (the 'Company') present their Strategic Report for the year ended 31 December 2018.

Principal activities

The Company is a wholly-owned subsidiary of Virgin Money Holdings (UK) PLC, which together with its subsidiaries and controlled entities is referred as the 'Group' in this Annual report. The Company's ultimate parent company is CYBG PLC ('CYBG').

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 Stores and customer Lounges.

On 18 June 2018, the Boards of Virgin Money Holdings (UK) PLC and CYBG announced that they had reached agreement on the terms of a recommended all-share offer by CYBG for the entire issued and to be issued share capital of the Virgin Money Holdings (UK) PLC. The Offer was implemented by means of a scheme of arrangement under Part 26 of the UK Companies Act 2006 and sanctioned by the Court. The Court's sanction of the Scheme was granted at a Court Hearing held on 12 October 2018. On 15 October 2018 Virgin Money Holdings (UK) PLC and CYBG announced that all the conditions set out in the scheme document published by Virgin Money Holdings (UK) PLC on 31 July 2018 had been satisfied, or waived, and the Scheme had become effective in accordance with its terms. As a result, Virgin Money Holdings (UK) PLC was delisted from the London Stock Exchange on 15 October 2018. Following completion, Clydesdale Bank PLC, a wholly-owned subsidiary of CYBG, acquired all of the voting rights in Virgin Money Holdings (UK) PLC.

Please refer to the Report of the Directors for full details of the acquisition.

Basis of presentation

Statutory basis
Statutory information is set out in the condensed consolidated financial statements section of this announcement.

Alternative performance measures
A number of alternative performance measures (APMs) are used in the analysis and discussion of the Company's financial performance and position. APMs do not have standardised definitions and may not be directly comparable to any measures defined within International Financial Reporting Standards (IFRS). Details of all APMs, including the rationale for their use and their bases of calculation, are set out on page 112.

Strategic Report (continued)

Summary of results

Summary balance sheet as at 31 December	**2018 £m**	2017 £m
Customer loans	**38,594.9**	36,696.5
Other financial assets	**5,958.9**	4,081.1
Other non-financial assets	**237.1**	241.3
Total assets	**44,790.9**	41,018.9
Customer deposits	**32,429.9**	30,808.4
Wholesale funding	**10,252.6**	7,969.2
Other liabilities	**310.1**	362.1
Total liabilities	**42,992.6**	39,139.7
Ordinary shareholders' equity	**1,568.3**	1,649.2
AT1 equity instruments	**230.0**	230.0
Total equity	**1,798.3**	1,879.2
Total liabilities and equity	**44,790.9**	41,018.9

Summary income statement for the year ended 31 December	**2018 £m**	2017 £m
Net interest income	**601.2**	594.7
Non-interest income	**51.1**	44.7
Total operating income	**652.3**	639.4
Total operating and administrative expenses	**(472.4)**	(332.1)
Operating profit before impairment losses	**179.9**	307.3
Impairment losses on credit exposures(1)	**(71.3)**	(44.2)
Profit on ordinary activities before tax	**108.6**	263.1
Tax expense	**(37.6)**	(70.8)
Profit on ordinary activities after tax	**71.0**	192.3

Key performance indicators

Following the acquisition and de-listing of the Group, the key performance indicators now used to monitor the Company are shown below:

	2018	2017
Profitability:		
Statutory cost:income ratio	**72.4%**	51.9%
Impairment charge to average customer loans (cost of risk)	**0.19%**	0.13%
Return on assets	**0.16%**	0.47%

As at 31 December:	**2018**	2017
Regulatory capital:		
Total capital ratio	**20.3%**	19.1%
Common Equity Tier 1 ratio	**17.5%**	16.4%
Leverage ratio	**3.7%**	4.1%

(1) Impairment losses on credit exposures in 2018 reflect expected credit loss basis in accordance with IFRS 9. The comparative figures reflect impairment charges on an incurred credit loss basis under IAS 39, as previously reported in 2017.

Strategic Report (continued)

Financial Review

Disciplined balance sheet growth

	2018 £m	2017 £m
Customer loans[1]	**38,594.9**	36,696.5
- of which mortgages	**35,330.7**	33,672.4
- of which credit cards	**3,264.2**	3,024.1
Customer deposits	**32,429.9**	30,808.4
Wholesale funding	**10,252.6**	7,969.2
Wholesale funding <1 year maturity	**1,214.7**	1,215.8
High quality liquid assets	**5,508.6**	5,264.4

[1] Customer loan balances exclude fair value of portfolio hedging and amounts due from group companies.

Customer loan growth was managed in 2018 in order to protect returns in a competitive environment. Customer loan balances increased by 5.2% compared to 14.0% in 2017. The Company experienced strong credit performance and continued to maintain a high-quality balance sheet.

Mortgage balances grew to £35.3bn as the Company balanced its share of gross lending with a focus on returns, delivering net lending of £1.7bn (2017: £3.9bn).

Credit card balances grew to £3.3bn during 2018, benefitting from diversification of the portfolio through the successful launch of new Virgin Atlantic credit cards.

The performance of the savings franchise underpinned growth, with balances increasing by 5.3% during the year. Total customer deposits grew to £32.4bn, supported by strong performance in cash ISAs and SME deposits following the launch of the Company's new proposition in early 2018.

The Company continued to optimise the mix and duration of the funding base during 2018. In early 2018, the Company repaid remaining Funding for Lending Scheme (FLS) balances in full, using the final drawing from the Term Funding Scheme (TFS). TFS drawings totalled £6.4bn at the closure of the scheme at the end of February 2018 and a schedule for the staged repayment of TFS drawings ahead of contractual maturity is in place. In wholesale funding, the Company completed a subordinated note issuance to its parent of £350.0m in April.

The Company maintained a strong liquidity position throughout 2018. At the balance sheet date high quality liquid assets stood at £5.5bn. The repayment in full of off-balance sheet FLS drawings with the final TFS drawing, which is held on-balance sheet, resulted in an increase in on balance sheet liquidity. At 173.8%, the Company's liquidity coverage ratio (LCR) remained significantly above the regulatory minimum of 100%.

Income benefitted from growth in interest earning assets

	2018 £m	2017 £m
Net interest income	**601.2**	594.7
Non-interest income	**51.1**	44.7
Operating income	**652.3**	639.4

Operating income increased by 2.0% to £652.3m, supported by growth in net interest income and a 14.3% increase in non-interest income, which reflected growth in fee-generating credit card balances and higher fair value gains on financial instruments compared to the prior year.

Net interest income increased by 1.1% to £601.2m, driven by growth in customer loans of 5.2% over the past year, set against a lower net interest margin. Pressure from lower mortgage spreads was partially offset by further optimisation of the funding base that reduced cost of funds, and by a decision to moderate balance growth in the competitive market environment. The use of additional drawings under the TFS, which is held on-balance sheet, to repay off-balance sheet FLS balances also impacted margins.

During 2018 a significant volume of credit card customers came off their zero per cent promotional periods. A detailed review of customer behaviours performed at 30 June resulted in a net adjustment to income of £(7.8)m, which was recognised in the interim results and is reflected in the lower net interest margin for 2018. Behaviours in the second half of 2018 have been broadly in line with those revised expectations and no additional adjustments have been made.

The strong customer response to the new Virgin Atlantic credit cards which offer rewards for customer spending, and a general shift towards greater sales of retail-led credit cards over the last two years have had two impacts upon income. Firstly, the proportion of cash income from credit cards has increased to 69%, from 57% in the prior year. Secondly, there is a higher level of fee-generating retail spending within the cards portfolio. This, alongside the significant numbers of new Virgin Atlantic customers choosing a card with an annual fee, has increased the proportion of non-interest income within credit card and overall revenues.

Financial Review (continued)

Costs reflected exceptional items related to the acquisition of the Group

	2018 £m	2017 £m
Costs	**472.4**	332.1
Personnel expenses	**241.1**	198.2
Depreciation and amortisation expense	**31.7**	29.7
Other operating and administrative expenses	**199.6**	104.2
Statutory cost:income ratio	**72.4%**	51.9%

Costs in 2018 were impacted by a range of exceptional items predominantly relating to the acquisition of the Group by CYBG. These included £48m of costs incurred in relation to the transaction, £77m in relation to the closure of the Company's digital bank project and £18m of other non-recurring costs (including initial integration spend). These items also contributed to the increase in personnel expenses.

After adjusting for these non-recurring costs, operating costs within the business remained tightly controlled, reflecting the continued benefit of the Company's scalable platform and disciplined cost management across the business.

Impairments reflected rigorous credit risk management

	2018	2017
Impairment charge (£m)	**71.3**	44.2
Cost of risk	**0.19%**	0.13%
% of loans classified as Stage 2[(1)]	**5.7%**	4.9%
% of Stage 2 loans not past due[(1)]	**89.9%**	88.6%

[(1)] The figures for 2017 are as at 1 January 2018 to reflect IFRS 9; please see the Risk Report for further detail.

Credit performance remained strong in 2018, reflecting the Company's established risk appetite framework, ongoing focus on underwriting rigour and continuing origination of high credit quality customers and prime assets. Along with the prevailing economic environment, this led to a continuing low level of defaults.

The impairment charge relating to credit cards increased reflecting an IFRS 9 basis, but remained in line with expectations for this prime portfolio. Unsecured 2 month plus arrears remained low compared to industry benchmarks at 1.08% (2017: 0.88%).

Mortgage impairments remained low, reflecting robust underwriting standards and the prevailing economic environment. The percentage of mortgages over three months in arrears was 0.13% at year end (31 December 2017: 0.12%).

The proportion of loans classified as stage 2 under IFRS 9 has increased slightly over the year, reflecting the seasoning of portfolios as the rate of asset growth slowed compared to prior periods. Around 90% of stage 2 loans are not past due. IFRS 9 transitional disclosures are available in note 5.4 to the financial statements.

The proportion of credit-impaired assets as a percentage of total loans and advances to customers remained low at 0.4% (1 January 2018: 0.5%).

Taxation

The Company recognised a corporation tax charge of £37.6m for 2018. The effective tax rate was 34.6% (2017: 26.9%). The higher tax rate reflects CYBG related acquisition costs that are not eligible for deduction from taxable profits.

Statutory profit

The statutory profit after tax of £71.0m (2017: £192.3m) was lower as a result of strategic costs incurred during the year.

Strategic Report (continued)

Financial Review (continued)

Capital ratios supported by risk-weight model improvements

		2018	2017
Capital ratios and risk-weighted assets			
Common Equity Tier 1 (CET1) capital	£m	**1,471.2**	1,489.1
Risk-weighted assets (RWAs)	£m	**8,394.1**	9,093.4
- of which mortgage credit risk RWAs	£m	**4,594.1**	5,790.5
- of which credit card credit risk RWAs	£m	**2,486.5**	2,282.9
- of which all other RWAs	£m	**1,313.5**	1,020.0
Common Equity Tier 1 ratio	%	**17.5**	16.4
Tier 1 ratio	%	**20.3**	18.9
Total capital ratio	%	**20.3**	19.1
Leverage ratio	%	**3.7**	4.1

The Prudential Regulation Authority (PRA) approved the Company's application for a reduction in mortgage risk-weights in June 2018. This reflected the excellent credit quality of the mortgage portfolio and led to an increase in the Company's Common Equity Tier 1 (CET1) ratio, which finished 2018 at 17.5%, from 16.4% at the beginning of the year.

Capital resources
During 2018 the Company generated profit attributable to equity shareholders (after AT1 distributions) of £56.3m and paid dividends of £120.0m to its parent company. After taking account of movements in intangible assets and other regulatory items, there was a small net decrease in CET1 capital of £17.9m.

Risk-weighted assets
The PRA's approval of the Company's application in June supported a decrease in mortgage risk-weight density, to 13.0% at 31 December 2018 from 17.2% at 31 December 2017. After taking growth in balances into account, mortgage RWAs at 31 December 2018 were £4.6bn, a £1.2bn reduction from £5.8bn at 31 December 2017. Credit card RWAs increased to £2.5bn, principally in line with balance growth as credit card RWAs are calculated using the standardised approach. Other RWAs increased to £1.3bn, including an increase in operational risk RWAs which were recalibrated in line with the standardised approach during the first half of the year to reflect the growth in average income over the past three years. Total RWAs at 31 December 2018 were 7.7% lower than at 31 December 2017 at £8.4bn.

Capital ratios
Capital ratios improved during 2018 as a result of the reduction in risk-weighted assets (RWAs) which more than offset the small reduction in CET1 capital. The total capital ratio increased by 1.2 percentage points to 20.3% and the CET1 ratio increased by 1.1 percentage points to 17.5% as at 31 December 2018. On a fully loaded basis, excluding IFRS 9 transitional arrangements, the total capital ratio was 19.8% and the CET1 ratio was 17.1% as at 31 December 2018.

The leverage ratio at 31 December 2018 reduced to 3.7% which reflected the growth in lending portfolios and higher levels of on-balance sheet liquidity as FLS was repaid in full and replaced with TFS funding.

The Company has significant headroom against minimum regulatory capital requirements.

Strategic Report (continued)

Operational Review

Mortgages

Mortgages are sold primarily through intermediary partners, supplemented by direct distribution and supported by excellent service. The Company had over 365,000 mortgage customers at the end of 2018.

Mortgage balances grew by £1.7bn in 2018 as the Company moderated gross lending in the year to £6.8bn (2017: £8.4bn), focusing on growing assets at the right margin and quality. The Company successfully retained 72% of customers with maturing fixed rate or tracker mortgage products, consistent with prior periods. This disciplined focus resulted in growth in balances of 4.9% in the year, higher than market growth of 3.0%. The Company's market share of balances increased from 2.45% to 2.49%.

The Company continued using its innovative Mortgage Lab to deliver new products, support intermediary partners and develop the customer proposition. The Company expanded its reach into new customer segments with significant improvements to the buy-to-let offering, including the launch of a portfolio landlord proposition, new 7 and 10 year residential fixed rate products and the extension of shared ownership lending nationwide. These initiatives enabled the Company to optimise margins and mitigate some of the competitive pressures. The improvements to the buy-to-let proposition were reflected in a shift in the mix of the mortgage book, with buy-to-let increasing to 20.5% of the book from 18.9% at the end of 2017.

Asset quality remained strong with both the average loan-to-value (LTV) of new lending (68.3%), and the average portfolio LTV (56.2%) remaining stable compared to the prior year. Three month plus arrears were 0.13% at the end of 2018, compared to the latest industry average of 0.79%.

The Company's intermediary partners gave the Company a 4.4 out of 5 rating for service in real-time feedback, reflecting the continued focus on delivering a high-quality proposition to the intermediary market. The Company was also the highest rated large bank in the Mortgage Lender Benchmark survey in December 2018, which draws feedback from intermediaries on their experience of lenders' service and products.

Deposits

The Company offers its 1.3m savings and current account customers a range of instant access and fixed term products. These are also available as ISAs and are distributed primarily through digital channels, supplemented by Stores and contact centres.

Total deposit balances grew by £1.6bn in 2018 or 5.3% as retention levels on fixed rate maturities remained strong at 87% and the Company enhanced its proposition and broadened its reach, including the launch of SME and Virgin Atlantic deposit products. SME deposit balances reached £603m by year end. The new Virgin Atlantic deposit product offers customers Flying Club miles rather than interest. The uniqueness of this proposition within the UK market was recognised as the account was shortlisted for the 2018 Financial Innovation Awards.

The Company's well-established Cash ISA proposition also performed strongly, achieving £2.7bn of inflows across 2018. Customers valued the Company's consistently competitive Cash ISA proposition, which was also recognised by winning Best Cash ISA provider at both the Moneyfacts and Savings Champion Awards.

The strength of the Company's overall proposition was recognised through winning Best High Street Savings Provider at the Moneyfacts Awards.

Credit Cards

The Company provides credit card products, predominantly online, to over 1.45m customers. The portfolio is a mix of balance transfer and retail credit cards, and continued to develop with the launch of Virgin Atlantic products in the first half of 2018.

Credit card balances grew to £3.3bn, an increase of 7.9%, benefitting from the diversification of the portfolio. Customer response to the new range of Virgin Atlantic credit cards was strong, driving high quality new customer acquisition and increased levels of retail spend, with almost 100,000 new Virgin Atlantic cards issued by the end of the year.

A significant proportion of those customers chose a card with an annual fee, supporting non-interest income, which has also benefitted from increased retail spending volumes in the portfolio as a whole. Just under 340,000 new accounts were opened in total in 2018, of which more than two-thirds were retail-led, compared to circa 40% in 2017. Spend per active account across the portfolio was 87% higher than in 2017.

As expected, the credit quality of the new Virgin Atlantic card customers is superior to that of the existing portfolio reflecting the more affluent nature of the customer base. This has supported the already high-quality credit characteristics of the cards book, and unsecured 2 month plus arrears remained low at 1.08% (2017: 0.88%), better than industry benchmarks, with the small increase reflecting the maturing of the portfolio.

The very favourable customer response to the Company's proposition was demonstrated by consumers voting the Company as "Best Credit Card Provider" for the second year running at the British Bank Awards.

Strategic Report (continued)

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

Principal risks	Key mitigating actions
Credit risk is the risk of loss resulting from a borrower or counterparty failing to pay amounts due. 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 borrowers results in additional impairment losses, thereby reducing profitability. Wholesale exposures arise through the liquid asset portfolio and the use of derivative instruments to manage interest rate risk.	• 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; • stress and scenario testing allows the Company to confirm portfolio resilience; • customer behaviour is closely monitored with timely action taken in response to any adverse change; and • credit risk arising from derivatives and from secured financing transactions is mitigated by collateralising exposures each day.
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 is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, including legal risk. Integration activity, as a result of the combination with CYBG introduces uncertainty and capacity risk as well as the risk of business interruption as a result of a poorly implemented migration. 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; • The impact of integration activity on critical projects, processes, systems and resources will be monitored; • an ongoing programme of investment in security infrastructure is in place to mitigate threats including cyber-attack; • the Company will continue to invest in and develop risk management frameworks, systems and processes to strengthen resilience; and • the Company monitors external events impacting other financial services companies to inform stress testing and recovery plans.
Conduct and Compliance risk is defined as the risk that the Company's operating model, culture or actions result in unfair outcomes for customers. This could result in regulatory sanction, material financial loss or reputational damage if the Company fails to design and implement effective operational processes, systems and controls which 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; and • the Company focuses on training to ensure colleague performance is aligned with regulatory responsibilities and to enable an awareness of good customer outcomes.
Strategic and Financial risk covers strategic risk, 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 and financial risk, which is focused on concentration risk. Credit concentration risk is managed for retail and wholesale credit exposures at portfolio, product and counterparty levels. Financial performance can be impacted by adverse changes in customer behaviour.	• Board focus is on ensuring alignment of business development and planning with risk appetite, to continue to support the Company's ultimate parent; • investment in processes, systems, recruitment and training to support new business developments; • use of robust risk and project management disciplines to ensure that implementation is delivered safely; • active focus on asset origination and portfolio management to manage margins and eliminate inappropriate concentration risk; • the Company maintains pricing discipline across the product range, ensuring that risk is appropriately rewarded within the Board approved risk appetite; • regular validation and review of models is performed; and • the Company continually monitors customer behaviour metrics to identify adverse trends.
Balance Sheet & Prudential Regulation Risks cover a number of categories of risk, which affect the manner in which the Company can support its customers in a safe and sound manner. The risks include the need to accommodate liability maturities and withdrawals, fund asset growth, and otherwise meet contractual obligations to make payments as they fall due (liquidity risk), the inability to raise and maintain sufficient funding in quality and quantity to support the delivery of the business plan (funding risk) and the risk that the Company has a sub-optimal amount or quality of capital or that capital is deployed inefficiently across the Company (capital risk).	• The Company operates a well-defined Board approved risk appetite and applies limits defined in funding and liquidity policies; • 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; • stress and scenario testing considers threats to funding plans and changes in consumer behaviour. • the capital management policy sets out minimum standards for the management of capital; • ensuring the Company holds capital in excess of regulatory requirements; • capital procedures are subject to independent oversight; and • stress and scenario testing assesses capital adequacy under a range of severe market-wide stress scenarios and idiosyncratic stress events.

Strategic Report (continued)

Outlook

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

The Strategic Report was approved by the Board of Directors on 27 February 2019 and was signed on its behalf by:

David Duffy

Chief Executive Officer

Virgin Money PLC

Risk Report

Risk management is at the heart of the Company's strategy to enable profitable, long-term growth. This is achieved through a clearly defined risk appetite and informed risk decision-making, supported by a consistent risk-focused culture across the Company.

Risk culture and values

The Company has a customer-focused business model built on a prudent risk culture that reinforces accountability. The Company's risk values of Do The Right Thing, Challenge The Status Quo and Understand Your Responsibilities, describe how all colleagues, suppliers and partners are expected to operate.

Risk appetite

Risk appetite is the amount and type of risk that the Company is prepared to seek, accept or tolerate. It is reflected in frameworks and policies that either limit or, where appropriate, prohibit activities that could be detrimental to the Company. The Company's strategy is developed in conjunction with risk appetite. The Company's risk appetite is approved by the Board with each strategic planning cycle.

Risk governance and control

Delegation of authority from the Board to Executive Committees and Senior Management establishes governance and control. Issues are escalated promptly and remediation plans are initiated where required.

The key responsibilities of the Board and Senior Management include setting risk appetite, agreeing the risk management framework, and approving policies and practices.

Three lines of defence

The Company uses a 'Three Lines of Defence' model which defines clear responsibilities and accountabilities. This ensures effective independent assurance over key business activities.

- line management (first line) have primary responsibility for risk decisions; measuring, monitoring and controlling risks within their areas of accountability. They are required to establish effective controls in line with policy, to maintain appropriate risk management skills, practices and tools, and to act within Board-approved risk appetite parameters. All Executives undertake a monthly control effectiveness review and a quarterly risk and control attestation;
- the Risk function (second line) provides proactive advice and constructive challenge on the effectiveness of risk decisions taken by line management. It is responsible for the design and development of the risk management framework and risk appetite. It provides a view of the Company's risk profile while reporting against risk appetite to the Board. It also oversees the Company's internal stress testing framework and maintains the Company's relationship with regulators; and
- Internal Audit (third line) provides independent, objective assurance to improve operations. It helps the Company achieve its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.

Risk management framework

The Company's Risk Management Framework covers all types of risk which affect the Company and could impact on the achievement of strategic objectives. It is designed to ensure a consistent approach is taken regarding the treatment of all risks applicable to business management and decision making. The Risk Management Framework is designed to support the identification, assessment, management and control of the material risks that can threaten achievement of the Company's business objectives and is therefore vital to the Company's Senior Management, Board and external stakeholders. The Risk Management Framework is underpinned by the risk policies, standards and procedures of the front-line business areas, which provide the detail of how risks are managed and activities conducted.

Risk identification and control assessment

The process to identify, measure and control risk is integrated into the overall risk governance framework. Risk identification processes are forward-looking to ensure emerging risks are identified. Risks are captured in risk logs and measured using consistent methodologies. Risk measurement includes the application of stress testing and scenario analysis, and considers whether relevant controls are in place.

Risk decision-making and reporting

A current and forecast view of the Company's overall risk profile, key exposures and management actions is reporting to the Risk Management Committee, the Board Risk Committee and the Board. The Chief Risk Officer is a member of the Executive and has direct access to the chair of the Board Risk Committee.

Stress testing

Stress testing is an essential risk management tool which examines the sensitivities of the strategic plan and business model and supports the development of management actions and contingency plans. It is overseen by the Board Risk Committee.

Risk Report (continued)

Stress testing (continued)

Sensitivity analysis and scenario stress testing are used to:

- monitor compliance with the Company's risk appetite and ensure that the Company can meet any unexpected demands on financial resources without threatening the viability of the business;
- inform decision-making, ranging from underwriting decisions to ensuring the sufficiency of capital and liquidity over the planning horizon. This involves the use of a variety of macro-economic, operational, liquidity and financial market disruption scenarios;
- support the Internal Capital Adequacy Assessment Process (ICAAP), the Internal Liquidity Adequacy Assessment Process (ILAAP) and inform the setting of regulatory guidance; and
- develop the Recovery Plan for the business including the identification of material recovery options.

Reverse stress testing is used to explore the vulnerabilities of the Company's strategies and plans in extreme adverse situations with the aim of improving contingency planning.

The Senior Managers and Certification Regime outlines stress testing as a prescribed responsibility, with clear accountabilities and responsibilities assigned to Senior Management and the Risk and Finance functions. The Chief Risk Officer is the Executive accountable for stress testing.

Emerging risks

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

Emerging risks	Key mitigating actions
Geopolitical and macro-economic environment	Although the economy remains resilient, the UK faces a period of political and economic uncertainty in relation to the UK's departure from the European Union (EU), with the risk of a potentially negative impact on the UK macro economy. As an entirely UK-focused retail bank, the Company is not impacted by the EU market access issues facing some other UK banks. The Company has looked closely at the potential impact of Brexit across all areas of its operations and is confident it will be able to provide services to customers on a business as usual basis, regardless of the outcome of the current Brexit discussions. In addition, the Company maintains and monitors a suite of macroeconomic and credit indicators to provide early warning of any potential deterioration in the macroeconomic environment.
Regulatory change	The Board is focused on responding effectively and efficiently to changes in the regulatory environment and overseeing the delivery of these regulatory changes. The business planning process incorporates the Company's view of emerging capital requirements. Stress and scenario testing forms an integral part of the Company's strategic and capital planning. The Company actively participates in regulatory developments, engaging with HM Treasury, the PRA, the FCA and the Bank of England on the evolving UK regulatory framework. The risk of regulatory intervention at an industry level remains high due to ongoing market reviews into the retail banking sector, credit cards and the asset management market. Following the combination with CYBG, both banks are required to maintain separate banking licences until the FSMA Part VII transfer is complete, and therefore separate compliance. This brings additional complexities regarding the co-ordination of regulatory change across both businesses. This is being monitored closely. As the UK negotiates its exit from the EU, there will be a significant legal and regulatory redrafting process. Relevant resources will be aligned to identify and assess the implications for the Company as these changes arise.
Competition	The Company operates in an increasingly competitive and mature UK personal financial services market. The mortgage market saw heightened competition throughout 2018. Increased margin pressures have continued in both the mortgage and savings market. The Company continues to apply strict affordability requirements, robust credit decisioning and prudent underwriting standards, to protect asset quality performance. Credit card market conditions are changing. Overall growth is slowing, driven primarily by changes in customer behaviour. The Company has responded to this with a strategy of long-term diversification, acquiring high-quality customers with attractive risk-adjusted returns through fee and non-fee credit cards in partnership with Virgin Atlantic. The behaviour of maturing long and medium-duration balance transfer cards is monitored closely to ensure behaviour remains in line with expectations.

Risk Report (continued)

Emerging risks (continued)

Emerging risks	Key mitigating actions
Cyber-crime and financial crime risk	The external threat of cyber-crime continues with reports of data and security breaches increasing in frequency and severity across all industries. Ongoing evidence of ransomware attacks emphasises the need for firms to remain alert to the emerging threat environment with detective and preventative processes and systems. The FCA regards financial crime risk as a significant threat to realising their objective to promote and enhance the integrity of the UK financial system and emphasises the need for firms to ensure they have adequate and effective systems and controls to manage this. The Company has a Cyber Security Strategy to enhance its control environment, IT resilience and information security capability, taking account of both the external threat environment and the changing risk profile of the business. The Company remains responsive to newly identified external vulnerabilities, increasing monitoring where required to mitigate risk to the Company. The Company has in place a strategic financial crime programme designed to enhance the Company's systems and controls.
Supplier partnerships	The Company works with mortgage intermediaries and manages outsourced relationships with third parties who support the credit card business. The Company has strategic suppliers for key components of its infrastructure. Reliance on key corporate partners and strategic suppliers gives rise to risks in relation to operational continuity. The Company develops its supplier partnership and oversight capability to minimise the risk of service disruption caused by the failure of a third party. The Company engages specialist third parties to undertake targeted reviews of supplier performance as required. There is enhanced oversight activity in relation to all third party suppliers and relationships are closely monitored.
Integration risk	Integration activity as a result of the combination with CYBG increases the Company's people risk profile by introducing uncertainty and creating capacity risk as the business operates under its own banking licence at the same time as supporting integration activity. There is also the risk of business interruption as a result of a poorly implemented migration. The impact of resource and knowledge stretch on critical projects, processes and systems operating during the period of integration will be monitored.

Principal risk categories

The Board have carried out a robust assessment of the principal risks facing the Company, including those that would threaten its business model, future performance, solvency or liquidity. The Company's principal risks are shown on page 8 of the Strategic Report.

All disclosures in the Risk Report are unaudited, unless otherwise stated.

Risk Report (continued)

CREDIT RISK

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

Risk appetite
The Company has appetite for high-quality credit exposures including retail lending and liquid wholesale investments.

Exposures
The principal credit risks arise from loans and advances to customers, debt securities and derivatives. The credit risk exposures of the Company are set out on page 14. Credit risk exposures are categorised as retail (secured and unsecured) and wholesale. In terms of loans and advances, credit risk arises both from amounts lent and commitments to extend credit to a customer. This applies to the secured and unsecured portfolios.

Retail mortgages expose the Company to customer re-mortgage risk. Re-mortgage risk is the possibility that an outstanding exposure cannot be repaid at its contractual maturity date. The debt management strategies employed by the Company are detailed on page 15.

The Company's buy-to-let lending policy is predominantly targeted towards retail customers rather than professional landlords, with specific restrictions in place on total exposures by loan amount and number of properties. Following enhancements to systems and underwriting strategies, the Company introduced lending to buy-to-let portfolio landlords in June 2018.

The Company's unsecured portfolio has grown in line with expectations and within strict underwriting criteria. The Company assesses customer affordability rigorously and takes into account the total unsecured debt held by a customer, and their ability to repay existing debt as well as the additional credit requested.

Credit risk in the wholesale portfolio arises from debt securities and derivatives.

Measurement
The Company uses statistical models, supported by both internal and external data, to measure retail credit risk exposures.

The models reflect three components: (i) the 'probability of default' (PD) by the borrowers on their contractual obligations, (ii) current exposures to the borrowers and their likely future development ('exposure at default'), and (iii) the likely loss ratio on the defaulted obligations (the 'loss given default'). These parameters are used in order to derive an expected loss and assess capital allocation.

Portfolios are assessed by using segmentation for measurement and reporting purposes. Details of the classifications used for asset quality can be found on page 17.

The Company uses Advanced Internal Ratings Based (AIRB) models in measuring the credit risk of secured loans and advances to customers. All retail unsecured and wholesale exposures are measured under the Standardised Approach for regulatory capital.

The Company's credit portfolios are subject to regular stress testing. Further information on the stress testing process, methodology and governance can be found on pages 10 and 11.

Page 17 provides details of the Company's approach to the impairment of financial assets, and further information can be found in note 1.6 to the financial statements. From 1 January 2018, the Company transitioned to the new accounting requirements of IFRS 9. Further information can be found in note 5.4.

Risk Report (continued)

CREDIT RISK (continued)

Maximum exposure to credit risk (audited)

The table below shows the maximum exposure to credit risk including derivatives. In relation to derivative financial assets, the maximum exposure is shown gross, before the effect of mitigation through use of master netting and collateral agreements. The table also shows the maximum amount of commitments from the Company's banking operations. Comparative balances are shown as at 1 January 2018, due to the implementation of IFRS 9 on this date. Information regarding the 31 December 2017 position on an IAS 39 basis can be found in the 2017 Annual Report and Accounts.

	31 Dec 2018 £m	1 Jan 2018 £m
Cash and balances with central banks (note 3.1)	**3,472.8**	2,579.0
Due from other banks	**118.0**	122.7
Debt securities classified as fair value through other comprehensive income	**2,087.8**	899.3
Gross positive fair value of derivative financial assets (note 3.4)	**15.8**	22.0
Loans and advances to customers (note 3.5)	**38,963.2**	37,115.6
	44,657.6	40,738.6
Other credit commitments (note 5.1)	**7,483.5**	6,193.5
Maximum credit risk exposure	**52,141.1**	46,932.1

Mitigation

The Company uses a range of approaches to mitigate credit risk.

Credit policy

The Risk function uses risk appetite to set the credit policy for each type of credit risk. These policies are supported by lending manuals which define the responsibilities of underwriters and provide a rule set for credit decisions. The risk appetite, target market and risk acceptance criteria are reviewed at least annually. Risk oversight teams monitor early warning indicators, credit performance trends, and key risk indicators, and review and challenge exceptions to planned outcomes. Counterparty exposures are regularly reviewed and action taken where necessary. Risk Assurance perform independent risk-based reviews to provide an assessment of the effectiveness of internal controls and risk management practices. Oversight and review is also undertaken by Internal Audit.

Controls over AIRB rating systems

The Company has an established Independent Model Validation team that sets common minimum standards for predictive modelling development and operations. The standards are designed to ensure risk models and associated AIRB rating systems are developed consistently, and are of sufficient quality to support business decisions and meet regulatory requirements.

Credit underwriting

The Company uses a variety of lending criteria when assessing applications for secured and unsecured lending. The general approval process uses credit acceptance scorecards and involves a review of an applicant's previous credit history using information held by credit reference agencies.

The Company assesses the affordability of the borrower under stressed scenarios including increased interest rates. In addition, the Company has in place limits on permitted indebtedness which take into account the debt customers hold with other lenders.

The Company rejects any application for a product where a customer is registered as bankrupt or insolvent, or has a County Court Judgement that is unsatisfied registered at a credit reference agency used by the Group. From March 2019 the Group will allow applications for mortgages where the customer has a satisfied County Court Judgement with a value less than £500. In addition, the Company's approach to underwriting applications, for both secured and unsecured products, takes into account the total unsecured debt held by a customer and their ability to afford that debt.

Risk Report (continued)

CREDIT RISK (continued)

Mitigation (continued)

Credit underwriting (continued)
For residential mortgages, the Company's policy is to accept only standard applications with a loan-to-value (LTV) of less than 95%. The Company has maximum % LTV limits which depend upon the loan size. Residential mortgage limits are:

Loan size from	To	Maximum LTV
£1	£500,000	95% (purchase) 95% (re-mortgage)
£500,001	£1,250,000	80%
£1,250,001	£2,000,000	75%

Buy-to-let is limited to a maximum of 80% LTV and residential interest only is limited to a maximum of 75% LTV, regardless of loan size. Residential mortgage applications in excess of £2m are approved by exception.

The PRA introduced more rigorous stress testing for landlords with four or more mortgaged buy-to-let properties, effective from September 2017. The Company has taken a conservative approach to applying these minimum standards and will continue to review buy-to-let lending policy. The number of buy-to-let mortgages held by a customer is capped at five and the maximum customer exposure is capped at £3m.

The Company uses statistically based decisioning techniques (primarily credit scoring models) for its retail portfolios.

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 responsibilities to support customers and act in their best long-term interests. This allows customer credit facilities to be brought back into a sustainable position. The Company offers a range of tools and assistance to support customers who are encountering financial difficulties. Cases are managed on an individual basis, with the circumstances of each customer considered separately and the action taken designed to be affordable and sustainable for the customer.

Customers are assisted by the Debt Management function where tailored repayment programmes can be agreed. Customers are actively supported and referred to free money advice agencies in instances where they have multiple credit facilities, including those at other lenders, which require restructuring.

Specific tools are available to assist customers which vary by product and the customer's status. Further details can be found on page 26.

Income and expenditure assessments are undertaken for all customers entering into a long-term repayment plan. This ensures that customers are provided with a sustainable and affordable solution that allows them a realistic opportunity to repay their debt in the short to medium term. In addition, the Company will advise customers to contact debt management companies such as Citizens Advice Bureau, StepChange and PayPlan. These companies do not charge any fees and will offer advice to customers as well as work with creditors to agree affordable repayment plans. Understanding what has changed and establishing the customers' current and future financial situation is imperative to ensuring that the right level of support is offered and that customers receive the appropriate solution to help them manage their debt when in financial difficulty.

Collateral for secured retail and wholesale exposures
The sole collateral type for secured loans is residential real estate. Property offered as collateral must be of acceptable construction and located in England, Wales, Scotland or Northern Ireland. Title to the property must be good, marketable and free from onerous restrictions and conditions. The Company requires first legal charge over the property offered as collateral and does not accept charges over part of the collateral. Unless the product is a custom build mortgage, the Company does not lend where the collateral is land only.

Collateral held as security for financial assets other than loans and advances is determined by the nature of the instrument. Debt securities, treasury and other bills are generally unsecured, with the exception of asset-backed securities and similar instruments such as covered bonds, which are secured by portfolios of financial assets. Collateral is generally not held against loans and advances to financial institutions, except where a collateral agreement has been entered into under a master netting agreement.

All new eligible derivative transactions with wholesale counterparties are centrally cleared with cash posted as collateral to further mitigate credit risk. Residual and non-eligible trades are collateralised under a Credit Support Annex in conjunction with the ISDA Master Agreement. The Company will receive additional collateral from certain counterparties in the event their external credit rating falls below contractually set triggers as agreed in the Credit Support Annex. It is the Company's policy that, at the time of borrowing, collateral should always be realistically valued by an appropriately qualified source, independent of both the credit decision process and the customer. Collateral valuation is reviewed on a regular basis.

Risk Report (continued)

CREDIT RISK (continued)

Monitoring

The Company produces regular portfolio monitoring reports for review by Senior Management. The Risk function produces a review of credit risk throughout the Company, including reports on significant credit exposures, which are presented to the Risk Management Committee and the Board Risk Committee.

The performance of all rating models is monitored on a regular basis to ensure that:

- appropriate risk differentiation capability is provided;
- generated ratings remain as accurate and robust as practical; and
- appropriate risk estimates are assigned to grades and pools of accounts.

In the event that the monitoring identifies material exceptions or deviations from expected outcomes, these are escalated for resolution.

Concentrations

Loans and advances to customers (audited)

	31 Dec 2018 £m	1 Jan 2018 £m
Residential mortgages	**35,344.5**	33,684.5
Credit cards	**3,378.6**	3,071.3
Overdrafts	**0.1**	0.1
Amounts due from group companies	**240.0**	359.7
Gross loans and advances to customers	**38,963.2**	37,115.6
Impairment provisions on credit exposures (note 3.6)	**(128.3)**	(104.2)
Total loans and advances to customers excluding portfolio hedging adjustment	**38,834.9**	37,011.4

Geographical concentration of assets (audited)

The following table shows the geographical concentration of the mortgage portfolio as at 31 December 2018:

	2018 £m	**2018 %**	2017 £m	2017 %
East Anglia	**930.6**	**2.6**	862.4	2.6
East Midlands	**1,918.0**	**5.4**	1,784.3	5.3
North	**1,147.4**	**3.2**	1,118.2	3.3
Yorkshire and Humberside	**2,008.2**	**5.7**	1,881.5	5.6
North West	**2,673.0**	**7.6**	2,512.2	7.5
West Midlands	**1,898.8**	**5.4**	1,785.5	5.3
South West	**2,804.2**	**7.9**	2,676.6	7.9
South East	**8,801.7**	**24.9**	8,447.1	25.1
Greater London	**9,583.2**	**27.1**	9,297.2	27.6
Wales	**807.0**	**2.3**	753.7	2.2
Scotland	**2,209.8**	**6.3**	2,030.3	6.0
Northern Ireland	**560.2**	**1.6**	534.0	1.6
Other	**2.4**	**-**	1.5	-
Total secured loans and advances to customers	**35,344.5**	**100.0**	33,684.5	100.0

The geographical split of the mortgage portfolio remains broadly unchanged.

Risk Report (continued)

CREDIT RISK (continued)

Credit quality of loans and advances

Information regarding the Company's retail credit risk exposures at 31 December 2018 and 1 January 2018, including corresponding impairment allowances and coverage ratios, can be found in the following pages. Information regarding the 31 December 2017 position on an IAS 39 basis can be found in the 2017 Annual Report and Accounts.

The Company defines three classifications of credit quality for all credit exposures; strong, good and satisfactory. Retail credit exposures are segmented according to IFRS 9 12-month PD. The 12-month PD is an internal parameter used within the Company's IFRS 9 provision models which aims to estimate the probability of default over the next 12 months based on account characteristics and customer behavioural data. For secured exposures, default occurs where the borrower has missed six months of mortgage repayments or the borrower is deemed to be unlikely to repay their loan. For unsecured exposures, default occurs where the borrower is more than 90 days past due on their contractual payments or they are deemed unlikely to repay their loan.

Secured exposures are categorised as:

Description	12-month PD
Strong	<=0.5%
Good	>0.5% - 2.0%
Satisfactory	>2.0%

Unsecured exposures are categorised as:

Description	12-month PD
Strong	<=4.9%
Good	>4.9% - 7.5%
Satisfactory	>7.5%

A three stage categorisation is used for assessing impairment under IFRS 9, as outlined in the table below.

Credit risk categorisation	Expected credit loss (ECL) calculation period	Description
Stage 1	12 months	A loan that is not credit-impaired on initial recognition and has not experienced a significant increase in credit risk.
Stage 2	Lifetime	If a significant increase in credit risk has occurred since initial recognition, the loan is moved to stage 2, but is not yet deemed to be credit-impaired.
Stage 3	Lifetime	If the loan is credit-impaired it is moved to stage 3. All expired term loans, material fraud loans and operational risk loans are classified as credit-impaired.

A reconciliation of the IAS 39 retail impairment allowance at 31 December 2017 to the IFRS 9 ECL at 1 January 2018 can be found on page 22.

Risk Report (continued)

CREDIT RISK (continued)

Maximum credit risk exposure, by credit risk rating, by IFRS 9 stage allocation

Secured

	Stage 1		Stage 2		Stage 3		Total	
31 December 2018 (audited)	**£m**	**%**	**£m**	**%**	**£m**	**%**	**£m**	**%**
Strong	**32,284.4**	**91.3**	**736.5**	**2.1**	**-**	**-**	**33,020.9**	**93.4**
Good	**1,097.6**	**3.1**	**762.6**	**2.2**	**-**	**-**	**1,860.2**	**5.3**
Satisfactory	**17.7**	**0.1**	**313.3**	**0.8**	**-**	**-**	**331.0**	**0.9**
Default	**-**	**-**	**-**	**-**	**132.4**	**0.4**	**132.4**	**0.4**
Gross carrying amount	**33,399.7**	**94.5**	**1,812.4**	**5.1**	**132.4**	**0.4**	**35,344.5**	**100.0**

	Stage 1		Stage 2		Stage 3		Total	
1 January 2018 (audited)	**£m**	**%**	**£m**	**%**	**£m**	**%**	**£m**	**%**
Strong	30,220.4	89.7	629.7	1.9	-	-	30,850.1	91.6
Good	1,798.2	5.3	535.0	1.6	-	-	2,333.2	6.9
Satisfactory	18.8	0.1	318.8	0.9	-	-	337.6	1.0
Default	-	-	-	-	163.6	0.5	163.6	0.5
Gross carrying amount	**32,037.4**	**95.1**	**1,483.5**	**4.4**	**163.6**	**0.5**	**33,684.5**	**100.0**

Unsecured

	Stage 1		Stage 2		Stage 3		Total	
31 December 2018 (audited)	**£m**	**%**	**£m**	**%**	**£m**	**%**	**£m**	**%**
Strong	**2,911.1**	**86.2**	**203.4**	**6.0**	**-**	**-**	**3,114.5**	**92.2**
Good	**38.2**	**1.1**	**112.4**	**3.4**	**-**	**-**	**150.6**	**4.5**
Satisfactory	**1.1**	**-**	**70.7**	**2.1**	**-**	**-**	**71.8**	**2.1**
Default	**-**	**-**	**-**	**-**	**41.8**	**1.2**	**41.8**	**1.2**
Gross carrying amount	**2,950.4**	**87.3**	**386.5**	**11.5**	**41.8**	**1.2**	**3,378.7**	**100.0**

	Stage 1		Stage 2		Stage 3		Total	
1 January 2018 (audited)	**£m**	**%**	**£m**	**%**	**£m**	**%**	**£m**	**%**
Strong	2,709.0	88.2	142.6	4.6	-		2,851.6	92.8
Good	32.2	1.1	99.3	3.2	-		131.5	4.3
Satisfactory	0.4	0.0	58.5	1.9	-		58.9	1.9
Default	-	-	-	-	29.4	1.0	29.4	1.0
Gross carrying amount	**2,741.6**	**89.3**	**300.4**	**9.7**	**29.4**	**1.0**	**3,071.4**	**100.0**

Amounts due from group companies, representing non-retail credit risk exposures within loans and advances to customers, are not included in the tables above. All amounts due from group companies were categorised as Strong within Stage 1 at 31 December 2018 and 1 January 2018.

Further analysis of the movements during the year in stage 2 and stage 3 assets can be found on pages 21 and 20 respectively.

The maximum credit risk exposures by credit risk rating for secured and unsecured loans and advances at 31 December 2017 are consistent with the 1 January 2018 totals presented above. At 31 December 2017 £33,362.7m of secured loans and advances and £3,028.8m of unsecured loans and advances were neither past due nor impaired.

Risk Report (continued)

CREDIT RISK (continued)

Gross retail credit risk exposures by IFRS 9 stage allocation

At 31 December 2018 (audited)	Stage 1	Stage 2	Stage 3	Total
Gross exposure (£m)				
Residential mortgage loans	26,344.4	1,633.9	118.3	28,096.6
Residential buy-to let mortgage loans	7,055.3	178.5	14.1	7,247.9
Total secured	33,399.7	1,812.4	132.4	35,344.5
Credit cards	2,950.4	386.4	41.8	3,378.6
Overdrafts	-	0.1	-	0.1
Total unsecured	2,950.4	386.5	41.8	3,378.7
Total	36,350.1	2,198.9	174.2	38,723.2
Impairment allowance (£m)				
Residential mortgage loans	2.0	4.6	5.2	11.8
Residential buy-to let mortgage loans	0.1	0.3	1.6	2.0
Total secured	2.1	4.9	6.8	13.8
Credit cards	26.8	63.2	24.4	114.4
Overdrafts	-	0.1	-	0.1
Total unsecured	26.8	63.3	24.4	114.5
Total	28.9	68.2	31.2	128.3
Coverage ratio (%)				
Residential mortgage loans	<0.1	0.3	4.4	<0.1
Residential buy-to let mortgage loans	<0.1	0.2	11.3	<0.1
Total secured	<0.1	0.3	5.1	<0.1
Credit cards	0.9	16.4	58.4	3.4
Overdrafts	-	100.0	-	100.0
Total unsecured	0.9	16.4	58.4	3.4
Total	<0.1	3.1	17.9	0.3

Risk Report (continued)

CREDIT RISK (continued)

Gross retail credit risk exposures by IFRS 9 stage allocation (continued)

As at 1 January 2018 (audited)

Gross exposure (£m)	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
Residential mortgage loans	25,869.6	1,300.1	147.5	27,317.2
Residential buy-to let mortgage loans	6,167.8	183.4	16.1	6,367.3
Total secured	**32,037.4**	**1,483.5**	**163.6**	**33,684.5**
Credit cards	2,741.6	300.3	29.4	3,071.3
Overdrafts	-	0.1	-	0.1
Total unsecured	**2,741.6**	**300.4**	**29.4**	**3,071.4**
Total	**34,779.0**	**1,783.9**	**193.0**	**36,755.9**
Impairment allowance (£m)				
Residential mortgage loans	3.2	4.5	3.2	10.9
Residential buy-to let mortgage loans	0.1	0.3	0.8	1.2
Total secured	**3.3**	**4.8**	**4.0**	**12.1**
Credit cards	23.3	51.5	17.2	92.0
Overdrafts	-	0.1	-	0.1
Total unsecured	**23.3**	**51.6**	**17.2**	**92.1**
Total	**26.6**	**56.4**	**21.2**	**104.2**
Coverage ratio (%)				
Residential mortgage loans	<0.1	0.3	2.2	<0.1
Residential buy-to let mortgage loans	<0.1	0.2	5.0	<0.1
Total secured	**<0.1**	**0.3**	**2.4**	**<0.1**
Credit cards	0.8	17.1	58.5	3.0
Overdrafts	-	100.0	-	100.0
Total unsecured	**0.8**	**17.2**	**58.5**	**3.0**
Total	**<0.1**	**3.2**	**11.0**	**0.3**

Credit-impaired assets and impairment allowances

Total credit-impaired assets reduced by £18.8m during 2018, and the proportion of credit-impaired assets as a percentage of total loans and advances to customers remained low at 0.4% as at 31 December 2018 (1 January 2018: 0.5%).

Secured credit-impaired loans as a proportion of total secured loans has decreased to 0.4% (1 January 2018: 0.5%), with balances reducing by £31.2m to £132.4m as at 31 December 2018. This is due to a reduction in interest only expired terms in addition to a reduction in fraud balances, following a change in fraud methodology. Previously, cases where there was a suspicion of fraud were automatically classified as credit-impaired, irrespective of performance or LTV. During the second half of 2018, a new methodology was implemented, whereby the business assess each individual case and apply a rating based on the expected risk. As a result, some balances previously classified as credit-impaired are classified as stage 2. Provisioning for fraud reflects the expected credit loss associated with each individual account.

Secured impairment allowances increased from £12.1m to £13.8m during 2018. House Price Index (HPI) reductions in some regions of the UK and book growth were partially offset by favourable arrears performance.

Unsecured credit-impaired loans as a proportion of retail unsecured loans increased marginally to 1.2% (1 January 2018: 1.0%), with balances increasing by £12.4m to £41.8m as at 31 December 2018. This is primarily due to expected seasoning of the portfolio.

In line with the growth in new lending and the seasoning of the portfolio, unsecured impairment allowances increased by £22.4m during the year.

Risk Report (continued)

CREDIT RISK (continued)

Assets classified as stage 2

The tables below present stage 2 loans and advances to customers by number of days past due at 31 December 2018 and 1 January 2018.

As at 31 December 2018 (audited)	Not past due	1-30 days past due	Over 30 days past due	Total
	£m	£m	£m	£m
Residential mortgage loans	**1,456.2**	**114.7**	**63.0**	**1,633.9**
Residential buy-to let mortgage loans	**155.0**	**15.0**	**8.5**	**178.5**
Total secured	**1,611.2**	**129.7**	**71.5**	**1,812.4**
Credit cards	**364.9**	**11.4**	**10.1**	**386.4**
Overdrafts	**0.1**	**-**	**-**	**0.1**
Total unsecured	**365.0**	**11.4**	**10.1**	**386.5**
Total	**1,976.2**	**141.1**	**81.6**	**2,198.9**

As at 1 January 2018 (audited)	Not past due	1-30 days past due	Over 30 days past due	Total
	£m	£m	£m	£m
Residential mortgage loans	1,119.0	121.5	59.6	1,300.1
Residential buy-to let mortgage loans	167.7	9.1	6.6	183.4
Total secured	**1,286.7**	**130.6**	**66.2**	**1,483.5**
Credit cards	292.9	4.5	2.9	300.3
Overdrafts	0.1	-	-	0.1
Total unsecured	**293.0**	**4.5**	**2.9**	**300.4**
Total	**1,579.7**	**135.1**	**69.1**	**1,783.9**

Stage 2 loans as a proportion of total loans and advances to customers have increased to 5.7% (1 January 2018: 4.9%), with balances increasing by £415.0m to £2,198.9m as at 31 December 2018. This is primarily driven by an increase in stage 2 assets not past due. In assessing whether an account is classified as stage 2, the Company considers a series of quantitative, qualitative and backstop criteria. As a consequence, certain fully performing loans will be captured through the Company's internal provisioning processes. These accounts are closely monitored.

In relation to mortgages, the movement is primarily due to an increase in accounts that, while fully performing, have experienced PD deterioration since origination. This is partly driven by interest only accounts approaching maturity, and partly driven by increased indebtedness levels which increase the likelihood of default. The average LTV of these accounts is 43.9% and the resultant expected credit loss is low. The average lifetime PD for secured accounts classified as stage 2 is 7.1% (1 January 2018: 8.2%).

In relation to credit cards, the movement is primarily due to an increase in accounts subject to internal account management activity, which is reflective of expected seasoning of the portfolio.

Risk Report (continued)

CREDIT RISK (continued)

Impairment allowance

The reconciliation of the IAS 39 retail impairment allowance at 31 December 2017 to the IFRS 9 retail ECL at 1 January 2018 is shown in the table below:

	£m
At 31 December 2017 – IAS 39 incurred loss provision	59.4
Removal of latent risk and other calibration differences	(14.0)
12 month ECL	3.9
Lifetime ECL	42.1
Undrawn balances	11.6
Multiple economic scenarios	1.2
At 1 January 2018 – IFRS 9 expected credit loss	**104.2**

The reconciling items in the table above represent:

Latent risk and other calibration differences: Under IFRS 9, an ECL is recognised for every financial asset, on either a 12 month or lifetime basis. This reconciling item removes the provision held under IAS 39 for losses which had been incurred but not specifically identified at the reporting date, and adjustments arising from other calibration differences under IFRS 9.

12 month ECL: IFRS 9 recognises a 12 month ECL on all performing loans classified as stage 1. Under IAS 39, an impairment provision would only have been recognised against these accounts to the extent that there were observable indicators of impairment.

Lifetime ECL: IFRS 9 recognises a lifetime ECL on all loans that have experienced a significant increase in credit risk. Under IAS 39, an impairment provision would only have been recognised against these accounts to the extent that there were observable indicators of impairment.

Undrawn balances: IFRS 9 requires an impairment allowance to be recognised on undrawn balances, where IAS 39 did not. For credit cards, the impact of undrawn exposure on ECL is captured as part of the EAD estimate and recognised within the ECL calculation.

Multiple economic scenarios: IFRS 9 requires that multiple forward-looking economic scenarios are incorporated into the ECL calculation. Details of the macro-economic scenarios used at 1 January 2018 and 31 December 2018 can be found in note 5.4 to the consolidated financial statements.

Risk Report (continued)

CREDIT RISK (continued)

The following tables explain the changes in the loss allowance and gross carrying value of the mortgage and credit card portfolios between 1 January 2018 and 31 December 2018. Values are calculated using the individual customer account balances, and the stage allocation is taken as at the end of each month. Secured and unsecured balances can therefore vary between months as a result of repayments and other account activity. The monthly position of each account is aggregated to report a net closing position for the period, thereby incorporating all movements an account has made during the year.

Reconciliation of retail expected credit loss (audited)
Secured

	Non-credit-impaired				Credit-impaired			
	Subject to 12-month ECL		Subject to lifetime ECL		Subject to lifetime ECL		Total	
	Stage 1		Stage 2		Stage 3			
	Balance £m	ECL £m	Balance £m	ECL £m	Balance £m	ECL £m	Balance £m	ECL £m
As at 1 January 2018	32,037.4	3.3	1,483.5	4.8	163.6	4.0	33,684.5	12.1
New assets originated or purchased	6,547.0	0.4	-	-	-	-	6,547.0	0.4
Stage transfers:								
To lifetime ECL (non-credit-impaired)	(2,393.2)	(0.9)	2,388.2	10.0	-	-	(5.0)	9.1
To credit-impaired	(51.9)	(0.5)	(73.3)	(1.7)	123.3	3.5	(1.9)	1.3
To 12-month ECL	1,844.2	0.5	(1,856.0)	(4.0)	-	-	(11.8)	(3.5)
From credit-impaired	4.3	0.5	61.7	0.8	(68.1)	(1.9)	(2.1)	(0.6)
Repayments (excluding derecognitions) and other movements	(1,375.5)	(0.9)	(67.6)	(4.5)	(11.1)	1.5	(1,454.2)	(3.9)
Changes to model methodologies	-	-	34.5	-	(34.5)	0.7	-	0.7
Financial assets derecognised or repaid (exc. write-offs)	(3,212.6)	(0.3)	(158.6)	(0.5)	(40.0)	(0.8)	(3,411.2)	(1.6)
Decrease due to write-offs	-	-	-	-	(0.8)	(0.2)	(0.8)	(0.2)
As at 31 December 2018	**33,399.7**	**2.1**	**1,812.4**	**4.9**	**132.4**	**6.8**	**35,344.5**	**13.8**

Unsecured

	Non-credit-impaired				Credit impaired			
	Subject to 12 month ECL		Subject to lifetime ECL		Subject to lifetime ECL		Total	
	Stage 1		Stage 2		Stage 3			
	Balance £m	ECL £m	Balance £m	ECL £m	Balance £m	ECL £m	Balance £m	ECL £m
As at 1 January 2018	2,741.6	23.3	300.4	51.6	29.4	17.2	3,071.4	92.1
New assets originated or purchased	575.4	13.9	-	-	-	-	575.4	13.9
Stage transfers:								
To lifetime ECL (non-credit-impaired)	(625.0)	(13.0)	640.6	106.8	-	-	15.6	93.8
To credit-impaired	(9.6)	(0.3)	(59.3)	(29.3)	69.9	55.6	1.0	26.0
To 12-month ECL	423.5	9.4	(442.7)	(68.4)	-	-	(19.2)	(59.0)
From credit-impaired	-	-	-	-	(0.6)	(0.4)	(0.6)	(0.4)
Repayments (excluding derecognitions) and other movements	(128.4)	(6.0)	(48.8)	3.7	(0.4)	(0.8)	(177.6)	(3.1)
Financial assets derecognised or repaid (exc. write-offs)	(27.1)	(0.5)	(3.7)	(1.1)	(0.4)	(0.2)	(31.2)	(1.8)
Decrease due to write-offs	-	-	-	-	(56.1)	(47.0)	(56.1)	(47.0)
As at 31 December 2018	**2,950.4**	**26.8**	**386.5**	**63.3**	**41.8**	**24.4**	**3,378.7**	**114.5**

Risk Report (continued)

CREDIT RISK (continued)

Collateral

Collateral held as security and other credit enhancements

A general description of collateral held as security in respect of financial instruments is provided on page 15. The Company holds collateral against loans and receivables in the mortgage portfolio. Quantitative and, where appropriate, qualitative information is provided below in respect of this collateral.

The Company holds collateral in respect of loans and advances to customers as set out on page 15. The Company does not hold collateral against debt securities, comprising asset-backed securities and corporate and other debt securities, which are classified as fair value through other comprehensive income.

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

LTV ratio (audited)[1]	**2018**	**2018**	2017	2017
	£m	**%**	£m	%
Less than 50%	**12,962.4**	**36.7**	12,542.3	37.2
50% to 75%	**16,533.8**	**46.8**	15,852.4	47.1
76% to 80%	**2,134.8**	**6.0**	2,111.7	6.3
81% to 85%	**1,647.0**	**4.7**	1,702.5	5.0
86% to 90%	**1,415.2**	**4.0**	1,027.6	3.1
91% to 95%	**579.8**	**1.6**	402.9	1.2
96% to 100%	**70.7**	**0.2**	41.5	0.1
Greater than 100%	**0.8**	**-**	3.6	-
	35,344.5	**100.0**	33,684.5	100.0

[1] LTV of the mortgage portfolio is defined as mortgage portfolio weighted by balance and indexed using the Information Handling Services (his) Markit house price index at a given date.

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

Total collateral value of mortgage loans (audited)	**31 Dec 2018**		1 Jan 2018	
	£m	**%**	£m	%
Stage 1	**33,399.7**	**100.0**	32,037.2	100.0
Stage 2	**1,812.2**	**100.0**	1,483.4	100.0
Stage 3	**132.4**	**100.0**	163.6	100.0
Total	**35,344.3**	**100.0**	33,684.2	100.0

Retail secured credit concentrations by loan size (audited)

The table below shows retail secured credit concentrations by loan size.

	2018	**2018**	2017	2017
	£m	**%**	£m	%
0-£100k	**5,342.7**	**15.1**	5,324.4	15.9
£100k-£250k	**17,348.2**	**49.1**	16,023.6	47.6
£250k-£500k	**10,045.5**	**28.4**	9,569.0	28.4
£500k-£1m	**2,390.5**	**6.8**	2,542.0	7.5
£1m-£2.5m	**207.8**	**0.6**	215.5	0.6
>£2.5m	**9.8**	**-**	10.0	-
Total secured loans and advances to customers	**35,344.5**	**100.0**	33,684.5	100.0

Risk Report (continued)

CREDIT RISK (continued)

Retail secured credit average LTV by loan size (audited)

The table below shows retail secured credit average LTV by loan size.

	2018	2017
	%	%
0-£100k	**47.3**	47.5
£100k-£250k	**58.3**	58.1
£250k-£500k	**58.8**	58.2
£500k-£1m	**50.3**	50.2
£1m-£2.5m	**43.1**	42.3
>£2.5m	**33.4**	34.0
Total secured loans and advances to customers	**56.2**	55.8

The Company's policy restricts LTV for higher value loans. The average LTV for each loan band demonstrates that, excluding loans under £100,000, higher value loans generally have lower LTVs, primarily due to seasoning of the portfolio and tightened underwriting practices. The average indexed LTV across the loan size bands has increased reflecting negative house price index movements in some regions and an increase in high LTV new lending throughout 2018.

Loan type

The residential mortgage loan portfolio comprises three principal loan repayment types:

- capital repayment loans amortise monthly through customer repayments which comprise an interest payment and contribution to the principal loan balance;
- part-and-part loans provide customers with the flexibility to choose to pay a proportion of the loan on a capital repayment basis and a proportion on interest only, with the interest only element repaid from an acceptable repayment vehicle; and
- interest only loans allow borrowers to pay only the interest on the loan each month, with the capital to be repaid in full at the end of the loan period from an acceptable repayment vehicle.

For residential mortgage customers, the Company continues to apply strict affordability criteria and restricts applicant LTV. For buy-to-let customers, interest only mortgages continue to be the predominant repayment method, with the majority of customers looking to the sale of the mortgaged property as the ultimate loan repayment vehicle. These loans are also subject to stringent lending standards.

Retail secured credit concentrations by loan type (audited)

The table below shows retail secured credit concentrations by loan type.

	2018	**2018**	2017	2017
	£m	**%**	£m	%
Capital repayment	**25,422.2**	**71.9**	24,003.2	71.3
Part-and-part	**906.7**	**2.6**	1,053.9	3.1
Interest only	**9,015.6**	**25.5**	8,627.4	25.6
Total secured loans and advances to customers	**35,344.5**	**100.0**	33,684.5	100

Risk Report (continued)

CREDIT RISK (continued)

Forbearance

The Company operates a number of treatments to assist borrowers who are experiencing financial distress. In defining these 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 or short-term arrangements to pay more to clear arrears;
- *transfers to interest only*: an account change to assist customers through periods of financial difficulty where arrears do not accrue at the original contractual payment. Any arrears of capital repayment existing at the commencement of the arrangement remain outstanding;
- *term extensions*: a permanent account change for customers in financial distress where the overall term of the mortgage is extended, resulting in a lower contractual monthly payment; and
- *discretionary payment holidays*: a temporary account change to assist customers through periods of financial difficulty where arrears do not accrue at the original contractual payment.

Loans which are subject to forbearance are grouped with other assets with similar risk characteristics and assessed collectively for impairment. Loans are not considered as impaired loans unless they meet the Company's definition of an impaired asset.

The value of forbearance stock totalled £133.0m at 31 December 2018 (1 January 2018: £176.4m). £114.5m (1 January 2018: £161.2m) of retail secured loans and advances were subject to forbearance, representing 0.32% (1 January 2018: 0.48%) of total secured loans and advances. A review of forbearance activity was undertaken in 2017, which resulted in operational process and system changes to enhance forbearance data capture. Although the changes were implemented in Q4 2018, reporting could only be amended on a forward-looking basis. The comparative figures are therefore unchanged. The 31 December 2018 figures as reported fully reflect the changes.

The tables below summarise the level of forbearance in respect of the Company's mortgage and credit card portfolio:

	Total		**Of which in stage 3**	
As at 31 December 2018 (audited)	**£m**	**%**	**£m**	**%**
Secured				
Payment arrangement	**35.4**	**30.9**	**17.0**	**85.0**
Transfer to interest only	**11.8**	**10.3**	**1.4**	**7.0**
Term extension	**3.5**	**3.1**	**0.3**	**1.5**
Payment holiday	**63.8**	**55.7**	**1.3**	**6.5**
Total secured forbearance	**114.5**	**100.0**	**20.0**	**100.0**
Unsecured				
Accounts where the customer has been on an approved payment plan	**18.5**	**100.0**	**13.9**	**100.0**
Total forbearance	**133.0**	**100.0**	**33.9**	**100.0**

	Total		Of which in stage 3	
As at 1 January 2018 (audited)	£m	%	£m	%
Secured				
Payment arrangement	2.0	1.2	1.0	7.6
Transfer to interest only	30.9	19.2	1.1	8.3
Term extension	64.3	39.9	10.3	78.0
Payment holiday	64.0	39.7	0.8	6.1
Total secured forbearance	161.2	100.0	13.2	100.0
Unsecured				
Accounts where the customer has been on an approved payment plan	15.2	100.0	11.4	100.0
Total forbearance	176.4	100.0	24.6	100.0

Risk Report (continued)

CREDIT RISK (continued)

Interest only mortgages

The Company provides interest only mortgages to customers, whereby payments made by the customer comprise interest for the term of the mortgage, with the customer responsible for repaying the principal outstanding at the end of the loan term.

The tables below provide details of balances which are on an interest only basis, analysed by maturity. This includes the interest only balances for loans that provide the customer with the flexibility to choose to pay a proportion of the loans on a capital repayment basis and a proportion on interest only (part-and-part).

The Company's interest only exposure for customers on both interest only and part-and-part for year to 31 December 2018 reduced to 27.1% of total secured balances, from 27.6% at 31 December 2017.

	2018	2017
	£m	£m
Term expired (still open)	**35.8**	49.5
Due within 2 years	**172.5**	172.5
Due after 2 years and before 5 years	**588.0**	544.4
Due after 5 years and before 10 years	**1,761.6**	1,724.9
Due after more than 10 years	**7,026.7**	6,796.3
Total	**9,584.6**	9,287.6
% of total secured loans and advances to customers	**27.1**	27.6

The Company contacts customers who have an interest only mortgage scheduled to mature within the next ten years, to confirm that their strategy to repay the mortgage loan in full at the end of the agreed term remains on track. If not, the Company will discuss a range of options, including a mortgage review, to ensure the customers' individual needs continue to be met. In 2018, the Company went into partnership with a third party who offer a range of Lifetime mortgage products to offer customers further options depending on their circumstances.

Interest only balances due to mature in the next two years represent 1.8% of total interest only balances, totalling £172.5m at 31 December 2018. The decrease in interest only expired term loans of £13.7m is the result of introduction of additional strategies to support customers who may not be able to repay the full amount of principal balance at maturity.

All expired term balances are categorised as impaired loans, regardless of estimated credit loss. Less than 0.11% of the secured portfolio relates to expired term loan balances. The average balance of expired term loans which are more than six months past their maturity date is £99,724 with an average LTV of 27.9%.

Buy-to-let lending of £6,045.9m (2017: £5,309.0m) is on an interest only basis, accounting for 63.1% (2017: 57.2%) of total interest only lending. The proportion of buy-to-let lending on an interest only basis remained stable at 83.4% (2017: 83.4%).

The Company offers interest only loans to applicants who have credible means to repay the mortgage loan at maturity other than sale of main residence. The flow of new interest only residential balances has remained low during 2018, representing 2.9% of residential completions. As a result, the proportion of residential interest only mortgages (excluding part-and-part) in the portfolio continues to reduce, moving from 12.3% to 10.6% during 2018. The Company regularly reviews the effectiveness of its interest only policy and contact strategies.

Repossessions

The Company works with customers who have difficulty paying their mortgages, and will repossess a property only when all other possibilities have been exhausted. Where properties have been repossessed, the Company will obtain the best price, 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 held 15 repossessed properties as at 31 December 2018 compared to 10 as at 31 December 2017.

Risk Report (continued)

CREDIT RISK (continued)

Offsetting of financial assets and liabilities

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 3.4 to the financial statements. The amounts set off on the balance sheet, as shown below, represent derivatives and variation margin collateral with central clearing houses which meet the criteria for offsetting under IAS 32.

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 derivatives 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 below tables.

31 December 2018 (audited)				**Net amounts not offset in the balance sheet**		
	Gross amounts £m	**Gross amounts offset on the balance sheet £m**	**Net amounts presented on balance sheet £m**	**Subject to master netting agreements £m**	**Collateral received / pledged £m**	**Net amount £m**
Financial assets						
Derivative financial instruments	**89.3**	**(73.5)**	**15.8**	**(5.9)**	**(5.6)**	**4.3**
Due from other banks	**417.5**	**(299.5)**	**118.0**	**-**	**(21.8)**	**96.2**
Other assets	**58.2**	**1.8**	**60.0**	**-**	**-**	**60.0**
Financial liabilities						
Due to other banks	**7,475.4**	**(299.5)**	**7,175.9**	**-**	**(5.6)**	**7,170.3**
Derivative financial instruments	**74.7**	**(44.2)**	**30.5**	**(5.9)**	**22.8**	**47.4**
Other liabilities	**279.3**	**(27.5)**	**251.8**	**-**	**-**	**251.8**

1 January 2018 (audited)				Net amounts not offset in the balance sheet		
	Gross amounts £m	Gross amounts offset on the balance sheet £m	Net amounts presented on balance sheet £m	Subject to master netting agreements £m	Collateral received / pledged £m	Net amount £m
Financial assets						
Derivative financial instruments	73.0	(51.0)	22.0	(11.5)	(7.1)	3.4
Due from other banks	122.7	-	122.7	-	(71.3)	51.4
Financial liabilities						
Due to other banks	5,377.7	-	5,377.7	-	(7.1)	5,370.6
Derivative financial instruments	107.3	(14.2)	93.1	(11.5)	(63.2)	18.4
Other liabilities	247.3	(36.8)	210.5	-	-	210.5

Risk Report (continued)

CREDIT RISK (continued)

Wholesale credit risk (audited)

The table below shows the wholesale credit risk exposures of the Company.

	31 Dec 2018 £m	1 Jan 2018 £m
Due from other banks	**118.0**	122.7
Cash and balances with central banks	**3,472.8**	2,579.0
Debt securities classified as fair value through other comprehensive income	**2,087.8**	899.3
Derivative financial assets	**15.8**	22.0
Loans and advances to customers – amounts due from group companies	**240.0**	359.7
Other assets	**-**	0.3
Total wholesale credit risk exposures	**5,934.4**	3,983.0

The Company has increased its holdings of high-quality wholesale assets during the period including supranational, covered bond and RMBS investments. Wholesale credit risk exposures are assessed by reference to credit rating. All wholesale credit exposures are classified as stage 1, with none classified as credit-impaired at 31 December 2018 or 1 January 2018 and no exposures past due.

An impairment allowance of £0.2m as at 31 December 2018 (1 January 2018: £0.2m, 31 December 2017: £Nil) is recognised in relation to amounts due from other banks. Full disclosure of the Company's portfolio of liquid assets can be found on page 37.

At 31 December 2018, the single largest exposure to any single counterparty, which is not a sovereign or a supranational, was £159.5m (1 January 2018: £94.6m). The table below shows the credit ratings of amounts due from other banks excluding the Bank of England, which has a credit rating of AA (2017: AA).

Credit rating of amounts due from other banks (audited)	31 Dec 2018 £m	1 Jan 2018 £m
AA-	**37.7**	38.1
A+	**56.8**	7.2
A	**1.1**	46.5
A-	**18.5**	14.8
BBB+	**3.9**	16.1
Total	**118.0**	122.7

The table below shows the credit rating of debt securities classified as fair value through other comprehensive income.

Credit rating of debt securities classified as fair value through other comprehensive income (audited)	31 Dec 2018 £m	1 Jan 2018 £m
AAA	**1,353.1**	692.0
AA+	**68.2**	-
AA	**666.5**	207.3
Total	**2,087.8**	899.3

The table below provides credit quality analysis of the gross derivative exposures, excluding those that are centrally cleared, by credit rating of the counterparties.

Credit rating of gross derivative exposures (audited)	31 Dec 2018 £m	1 Jan 2018 £m
AA-	**1.2**	1.6
A+	**5.0**	6.5
A	**5.1**	10.3
A-	**0.1**	0.3
BBB+	**0.2**	0.2
NR	**4.2**	3.1
Total	**15.8**	22.0

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS

Balance Sheet risks in the financial services industry are highly regulated with ongoing changes in the regulatory environment expected to influence the risks and their management. Key risks include Capital Risk, Funding and Liquidity Risk and Market Risk which in the case of the Company is primarily interest rate risk in the banking book (IRRBB).

17.5%[(1)]	173.8%
Common Equity Tier 1	Liquidity Coverage Ratio

Risk appetite
The Company maintains a high-quality capital base, targeting capital ratios which support business development and the risks inherent in the strategic plan. The Company's capital planning approach is focused on maintaining capital in excess of regulatory requirements at all times.

Capital
Capital risk is defined as the risk that the Company has a sub-optimal amount or quality of capital or that capital is inefficiently deployed across the Company.

Mitigation measures
The Company has capital management procedures that are designed to ensure compliance with risk appetite and regulatory requirements and are positioned to meet anticipated future changes to capital requirements.

The Company is able to accumulate additional capital through profit retention, by raising equity through, for example, a rights issue or debt exchange and by raising Tier 1 and Tier 2 capital. The cost and availability of additional capital is dependent upon market conditions and perceptions at the time. The Company is also able to manage the demand for capital through management actions including adjusting lending strategy, risk hedging strategies and through business disposals. If necessary, this could include limiting business growth.

Measurement
The Company calculates capital resources and requirements using the CRD IV CRR regulatory framework as implemented by the PRA. Pillar 1 capital requirements are calculated in respect of credit risk, operational risk, market risk and credit valuation adjustments. The capital requirement for residential mortgages is measured using an Advanced Internal Ratings Based (AIRB) approach approved by the PRA, and all other requirements are calculated using the Standardised Approach.

The PRA supplements the Company's Pillar 1 capital requirements, by setting additional Pillar 2 requirements issued following the Supervisory Review and Evaluation Process (SREP). The PRA provided the Company's revised Total Capital Requirement (TCR) in June 2018.

As part of the capital planning process, capital positions are subjected to stress testing and sensitivity analysis to determine the adequacy of capital resources against minimum requirements, including TCR, over the forecast period. This stress testing generates an additional capital requirement issued by the PRA, known as the PRA buffer, which is a matter between the PRA and the Company. The PRA buffer also takes account of the capital conservation buffer.

Capital Buffers
CRD IV introduced new capital limits and buffers for banks, and includes a combined buffer requirement which is the sum of the capital conservation buffer and the countercyclical buffer. The capital conservation buffer has been set at 2.5% with a transitional period between 1 January 2016 and 31 December 2018. During 2018, the transitional buffer was set at 1.875%, increasing to 2.5% on 1 January 2019.
The Bank of England increased the countercyclical buffer from 0.0% to 0.5% in June 2018, and then to 1.0% in November 2018. The Company reviews the capital structure on an on-going basis to ensure it is well placed to react to prevailing economic and regulatory conditions.

The framework for a systemic risk buffer (SRB) for ring-fenced banks will be applied to individual institutions by the Bank of England and will be introduced from 2019. Current guidance states that firms with balance sheet assets less than £175bn will have an SRB of 0%.

(1) The Company's CET1 ratio of 17.5%, as at 31 December 2018, is stated after the application of IFRS 9 transitional arrangements.

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

Monitoring

Capital is actively managed with regulatory ratios being a key factor in the Company's planning processes and stress analysis. A longer term forecast of the Company's capital position, based upon the strategic plan, is produced at least annually to inform the capital strategy. Shorter term forecasts are more frequently undertaken to understand and respond to variations of the Company's actual performance against the plan.

Regular reporting of actual and projected ratios is undertaken, including submissions to the Asset and Liability Committee, the Risk Management Committee and the Board.

Recent Developments

During 2018, the Company made a submission to the PRA seeking approval for improvements to its mortgage risk-weight models. These improvements have been approved and, as a result, mortgage risk weight density was 13.0% at 31 December 2018, compared to 17.2% at 31 December 2017.

The Company also received notification from the PRA of its revised Pillar 2A capital requirement, which includes both fixed and variable elements, and took effect from 5 July 2018. The Company has significant headroom against minimum regulatory capital requirements.

Ring-fencing was implemented on 1 January 2019, whereby the Bank of England requires all banks with core deposits over £25bn to ring-fence their core activities. During 2018, the Group received formal approval from the PRA of the formation of its ring-fenced sub-group (including the Company and other VM entities) and for the rule modifications which permit the membership of the Board and some Board Committee roles to mirror those of CYBG. This is subject to the Group appropriately managing potential conflicts of interest which may arise between legal entities, as per the updated Conflicts of Interest Policy.

IFRS 9 came into force from 1 January 2018 and, in parallel, CRD IV has introduced transitional capital arrangements. These arrangements allow both the initial impact of the increase in the impairment allowance under IFRS 9, and the impact of subsequent increases, to be phased in over five years. The five year transitional period allows a percentage of the IFRS 9 adjustment to be added back each year. In 2018, 95% of the impact of IFRS 9 is added back as a transitional adjustment.

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

Capital position

The Company's capital position as at 31 December 2018 is summarised below.

Regulatory capital	**2018 £m**	2017 £m
CET1 capital		
Share capital and share premium account	**1,400.0**	1,400.0
Other equity instruments	**230.0**	230.0
Other reserves	**(0.2)**	4.5
Retained earnings	**168.5**	244.7
Total equity per balance sheet	**1,798.3**	1,879.2
Regulatory adjustments and deductions		
Net assets of controlled structured entities	**12.9**	19.1
Foreseeable distribution on Additional Tier 1 securities	**(2.1)**	(2.1)
Other equity instruments	**(230.0)**	(230.0)
Additional valuation adjustment	**(2.3)**	(1.2)
Intangible assets	**(107.9)**	(128.4)
Deferred tax on tax losses carried forward	**-**	(0.6)
Excess of expected loss over impairment allowance	**(40.1)**	(46.9)
IFRS 9 transitional adjustments	**42.4**	-
	1,471.2	1,489.1
Tier 1 capital		
Additional Tier 1 (AT1) securities	**230.0**	230.0
Total Tier 1 capital	**1,701.2**	1,719.1
Tier 2 capital		
Credit risk adjustments	**-**	14.3
Total Tier 2 capital	**-**	14.3
Total capital	**1,701.2**	1,733.4

Regulatory capital flow of funds	**CRD IV 2018 £m**	CRD IV 2017 £m
CET1 capital		
CET1 capital at 31 December 2017	**1,489.1**	1,356.8
Changes on adoption of IFRS 9	**(33.6)**	-
Movement in retained earnings	**77.4**	187.6
Additional valuation adjustment	**(1.1)**	-
Movement in revaluation reserve	**(4.7)**	0.4
Distributions on ordinary shares paid during the year	**(120.0)**	-
AT1 coupons accrued at previous year end	**2.1**	2.8
AT1 coupons accrued at this year end	**(2.1)**	(2.1)
Movement in net assets of controlled structured entities	**(6.2)**	(9.5)
Movement in intangible assets	**20.5**	(47.8)
Movement in excess of expected loss over impairment	**6.8**	(5.8)
Movement in deferred tax on tax losses carried forward	**0.6**	6.7
IFRS 9 transitional arrangements	**42.4**	-
CET1 capital at 31 December 2018	**1,471.2**	1,489.1

The decrease in capital resources is driven primarily by the ordinary distributions made in the year, offset by the increase in retained earnings and the net reduction in intangible asset deduction. The day one impact of IFRS 9 on reserves has been more than offset by the transitional arrangements which provide relief against day one and subsequent IFRS 9 movements.

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

RWA movements

RWA flow statement

	AIRB Mortgage £m	Standardised lending £m	Other standardised assets £m	Credit valuation adjustment £m	Operational risks £m	Total £m
RWA at 1 January	**5,790.5**	**2,282.9**	**322.6**	**9.9**	**687.5**	**9,093.4**
Book size growth / (reduction)	**768.3**	**216.4**	**-**	**-**	**-**	**984.7**
Other	**(1,964.7)**	**(12.8)**	**160.5**	**8.1**	**124.9**	**(1,684.0)**
RWAs at 31 December	**4,594.1**	**2,486.5**	**483.7**	**18.0**	**812.4**	**8,394.1**

Were the IFRS 9 transitional arrangements not applied, total risk-weighted assets would be £8,360.1m as at 31 December 2018.

During 2018, the Company carried out a re-segmentation of the mortgage AIRB models, resulting in a £1.7bn reduction in mortgage risk-weighted assets. This model change was approved by the PRA in June 2018.

For credit cards, growth in risk-weighted assets was largely in line with growth in customer balances as unsecured risk-weighted assets are calculated using the standardised approach.

Other movements includes an increase in the Company's deferred tax asset as a consequence of the implementation of IFRS 9. In addition, there was an increase in exposure to higher risk-weighted instruments and counterparties in the Company's liquid asset portfolio.

There was an additional increase in operational risk-weighted assets of £124.9m. This increase was in line with the standardised approach for the calculation of operational risk, where the growth in average income over the past three years is recognised in higher levels of operational risk-weighted assets.

Total risk-weighted assets by business line

	2018 £m	2017 £m
Retail mortgages	**4,594.1**	5,790.5
Retail unsecured lending	**2,486.5**	2,282.9
Treasury	**221.8**	126.0
Other assets	**261.3**	196.6
Credit valuation adjustments	**18.0**	9.9
Operational risk	**812.4**	687.5
	8,394.1	9,093.4

Capital ratios	**2018**	2017
CET1 ratio	**17.5%**	16.4%
Tier 1 ratio	**20.3%**	18.9%
Total capital ratio	**20.3%**	19.1%

In June, the PRA approved model changes to reduce the Company's average risk weight for mortgages. As a result, the Company's CET1 ratio as at 31 December 2018, including the agreed reduction, was 17.5% and the total capital ratio was 20.3%.

Were the IFRS 9 transitional capital arrangements not applied, the table below shows the fully loaded position as at 31 December 2018.

Capital ratios	**2018**
CET1 ratio	17.1%
Tier 1 ratio	19.8%
Total capital ratio	19.8%

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

The leverage ratio for the Company (based on the Basel III definition of January 2014, and the revised CRD IV definition of October 2014) is 3.7%, as illustrated below. At present the Group has no minimum UK leverage requirement as it is currently exempt from the UK Leverage Framework Regime, which only applies to institutions with retail deposit levels of £50bn or more.

Under the EBA leverage rules, the leverage ratio is calculated by dividing Tier 1 capital resources by a defined measure of on balance sheet assets and off-balance sheet items. While there is currently no minimum leverage requirement under the CRR, in August 2016 the EBA recommended that a 3.0% minimum leverage ratio requirement should be introduced from 1 January 2018. The leverage ratio of 3.7% as at 31 December 2018 exceeds this recommended minimum requirement.

Leverage ratio	**2018** **£m**	2017 £m
Total Tier 1 capital for the leverage ratio		
Total CET1 capital	**1,471.2**	1,489.1
AT1 capital	**230.0**	230.0
Total Tier 1	**1,701.2**	1,719.1
Exposures for the leverage ratio		
Total statutory assets	**44,790.9**	41,018.9
Controlled structured entity adjustments	**294.3**	156.2
Adjustment for off-balance sheet items	**885.5**	776.8
Adjustment for derivative financial instruments	**53.0**	16.7
Adjustment for securities financing transactions (SFTs)	**270.4**	364.3
Regulatory deductions and other adjustments	**(150.4)**	(177.1)
Adjustment for intragroup exposures excluded from leverage ratio exposure	**(0.2)**	(88.0)
IFRS 9 adjustments	**42.4**	-
Leverage ratio exposure	**46,185.9**	42,067.8
Leverage ratio	**3.7%**	4.1%

Were the IFRS 9 transitional capital arrangements not applied, the fully loaded leverage ratio as at 31 December 2018 would be 3.6%.

Exposure values associated with derivatives and securities financing transactions have been reported in compliance with CRD IV rules. For the purposes of the leverage ratio, the derivative measure has been adjusted for regulatory netting rules, potential future exposures and cash collateral.

Off-balance sheet items are made up of undrawn credit facilities. Credit conversion factors have been applied to these items to convert them to an on-balance sheet equivalent in compliance with the CRD IV rules.

Other adjustments consist of regulatory adjustments that have been applied to Tier 1 capital which are also applied to the leverage ratio exposure measure. This ensures consistency between Tier 1 capital and the total exposures component of the ratio.

Funding and liquidity risk

Funding risk is defined as the inability to raise and maintain sufficient cost-effective funding in quality and quantity to support the delivery of the business plan. Sound funding risk management reduces the likelihood of liquidity risks occurring through minimising refinancing concentration.

Liquidity risk is defined as the inability to accommodate liability maturities and withdrawals, fund asset growth and otherwise meet contractual obligations to make payments as they fall due.

Risk appetite

The Company funds before it lends, and has a clear framework for balance sheet structure in order to control funding, refinancing and liquidity risk. The Company operates an investment strategy for wholesale investments which prioritises liquidity and ensures that the Company holds a liquid asset buffer in excess of both regulatory and internally assessed requirements.

Exposures

Liquidity exposure represents the amount of potential stressed outflows in any future period less expected inflows. The Company's primary liquidity risk exposure arises through the redemption of retail deposits where customers are permitted to withdraw funds with limited or no notice. Additional exposures exist in relation to pipeline mortgage business, undrawn card balances and wholesale funding.

The Company is exposed to refinancing risk at the point of contractual maturity. The risk arises from both wholesale and retail funding sources.

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

Funding and liquidity risk (continued)

Risk assessment and measurement

A series of measures are used across the Company to monitor both short and long-term liquidity requirements including ratios, cash outflow triggers, wholesale and retail funding maturity profile, early warning indicators and stress test survival periods. Liquidity risk appetite covers a range of metrics considered key to maintaining a strong liquidity and funding position. Strict criteria and limits are in place to ensure highly liquid marketable securities are available as part of the portfolio of liquid assets.

The measurement framework has two other important components:

- the volume and quality of the Company's liquid asset portfolio is defined through a series of stress tests across a range of time horizons and stress conditions. The Company ensures a liquidity surplus is held during normal market conditions above liquidity stress outflow requirements. Stress cash outflow assumptions have been established for individual liquidity risk drivers across idiosyncratic and market wide stresses.

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

  As the Company is predominantly retail funded, the largest potential source of liquidity stress is the unexpected outflow of retail customer deposits.

  The key risk driver assumptions applied to the scenarios are:

Risk	Rationale for assessment
Retail funding	Severe unexpected withdrawal of retail deposits by customers arising from redemption or refinancing risk. No additional deposit inflows are assumed.
Wholesale funding	Limited opportunity to refinance wholesale contractual maturities. Full outflow of secured and unsecured funding during the refinancing period, with no reinvestment of funding.
Off-balance sheet	Cash outflows during the period of stress as a result of off-balance sheet commitments such as mortgage pipeline, undrawn credit card facilities and collateral commitments.
Franchise viability	Lending outflows, over and above contractual obligations, are honoured as the Company preserves ongoing franchise viability.
Liquid assets	The liquidity portfolio value is reduced, reflecting stressed market conditions.

  The scenarios and the assumptions are reviewed to ensure that they continue to be relevant to the nature of the business. The Company's liquidity risk appetite is calibrated against a number of stressed metrics. The funding plan is also stressed against a range of macro-economic scenarios; and

- the Company maintains a Liquidity Contingency Plan which is designed to provide an early warning indicator for liquidity concerns and a list of potential actions to address a liquidity shortfall. As a result, mitigating actions can be taken to avoid a more serious situation developing.

Mitigation

The most material component of the Company's funding and liquidity position is the customer deposit base, which is supplemented by wholesale funding providing a source of stable funding for balance sheet growth. Where funding concentrations exist, for example refinancing at maturity, these are managed within the appropriate internal risk appetite, to control the size of the exposure. Refinancing is planned in advance of maturity with liquidity held to mitigate the potential exposure. Longer term funding is used to manage the Company's strategic liquidity profile in line with limits.

The Company operates a Funds Transfer Pricing (FTP) mechanism which supports customer pricing and the overall Company balance sheet strategy.

FTP makes use of behavioural maturity profiles, taking account of expected customer loan prepayments and the stability of customer deposits. Such behavioural maturity assumptions are subject to formal governance and reviewed periodically.

The ability to deploy assets quickly, either through the repo market or through outright sale, is also an important source of liquidity for the Company. In addition to central bank reserves, the Company holds sizeable balances of high-quality marketable debt securities. Such securities can be sold to provide, or used to secure, additional cash inflows from market counterparties or central bank facilities (Bank of England), should the need arise.

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

Funding and liquidity risk (continued)

Monitoring

Liquidity is actively monitored by the Company. Reporting is conducted through the Asset and Liability Committee and the Board Risk Committee. In a stress situation the level of monitoring and reporting is increased commensurate with the nature of the stress event.

Daily monitoring and control processes are in place to address internal and regulatory liquidity requirements. The Company monitors a range of market and internal early warning indicators on a daily basis for early signs of liquidity risk in the market or specific to the Company. These are a mixture of quantitative and qualitative measures including daily variation of customer balances, cash outflows, changes in primary liquidity portfolio, credit default swap spreads and changing funding costs.

Funding and liquidity management in 2018

During 2018, the Company maintained a strong funding and liquidity position in excess of risk appetite and the short-term liquidity stress metric, the Liquidity Coverage Ratio (LCR). The Company's LCR as at 31 December 2018 was 173.8%, representing a material surplus above the UK regulatory minimum requirement of 100%. The LCR decreased from 200.6% at 31 December 2017 driven by higher levels of SME deposits, upcoming repo maturities and wholesale debt payments. Following discussion with the PRA, the Company has an additional liquidity requirement relating to risks during the period of integration with the CYBG group.

Wholesale funding is used to support balance sheet growth, lengthen the contractual tenor of funding and diversify sources of funding. During 2018, the Company raised £350.0m through a subordinated note issuance and raised additional amounts due to controlled structured entities as a result of an issuance by the Group's Gosforth funding franchise in September.

Sources of funding

The table below provides an overview of the Company's funding sources as at 31 December 2018:

	31 Dec 2018 £m	1 Jan 2018 £m
Total assets	**44,790.9**	40,985.3
Less: other liabilities	**(310.1)**	(362.1)
Funding requirement	**44,480.8**	40,623.2
Funded by:		
Customer deposits	**32,429.9**	30,808.4
Due to other banks	**7,167.0**	5,366.0
of which:		
Securities sold under agreements to repurchase	**780.0**	1,130.0
Amounts drawn under the Term Funding Scheme	**6,387.0**	4,236.0
Amounts due to controlled structured entities	**2,432.9**	2,300.4
Debt securities in issue	**652.7**	302.8
Equity	**1,798.3**	1,845.6
Total funding	**44,480.8**	40,623.2

External credit ratings

The Company's short and long-term credit ratings as at 31 December 2018 are shown below:

	Long-term	**Short-term**	**Outlook**	**Date of last rating action**	**Rating action type**
Fitch	BBB+	F2	Stable	23 August 2018	Affirmed
Moody's	Baa1	P2	Positive	14 December 2018	Upgraded to Baa1 with a positive outlook

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

The Company monitors the amount of additional collateral that it would need to provide in the event of a one and two notch downgrade by external credit ratings agencies. These figures are not considered material compared to the volume of unencumbered liquid assets.

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

Funding and liquidity risk (continued)

Liquid assets

The Company maintains a portfolio of liquid assets, predominantly in high-quality unencumbered securities issued by the UK Government or supranational institutions and deposits with the Bank of England. The portfolio mix is aligned to the liquidity coverage requirement defined in European liquidity regulatory standards. Other liquidity resources represent additional unencumbered liquid assets held over and above high-quality liquid assets. These are intended to cover more extreme stress events and provide flexibility for liquidity management.

Level 1	**31 Dec 2018 £m**	**2018 Average £m**	31 Dec 2017 £m	2017 Average £m
Cash and balances with central banks	**3,378.5**	**4,018.0**	2,525.9	1,923.0
UK Government securities	**708.7**	**259.8**	207.3	221.8
Other HQLA level 1 eligible	**63.1**	**32.4**	-	-
Supranational securities	**593.2**	**438.7**	234.1	178.0
Treasury bills raised through FLS	**-**	**129.3**	1,850.6	2,219.7
Covered bonds (Level 1 eligible)	**587.8**	**500.7**	374.7	378.8
Total level 1	**5,331.3**	**5,378.9**	5,192.6	4,921.3
Level 2a				
Covered bonds (Level 2a eligible)	**29.1**	**27.7**	21.7	22.2
Total level 2a	**29.1**	**27.7**	21.7	22.2
Level 2b				
Eligible RMBS	**148.2**	**137.2**	50.1	52.6
Total level 2b	**148.2**	**137.2**	50.1	52.6
High quality liquid assets (Level 1 + 2a + 2b)	**5,508.6**	**5,543.8**	5,264.4	4,996.1
Other liquidity resources				
Non-eligible RMBS	**-**	**7.3**	11.4	8.6
Certificates of deposit	**-**	**-**	-	37.6
Floating rate notes	**-**	**-**	-	7.7
Money market loans	**-**	**-**	-	-
Total other liquidity resources	**-**	**7.3**	11.4	53.9
Self-issued RMBS	**485.1**	**795.8**	601.7	958.2
Total liquidity	**5,993.7**	**6,346.9**	5,877.5	6,008.2

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

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

Funding and liquidity risk (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.

					Other assets					
	Assets encumbered with non-central bank counterparties					Assets not positioned at the central bank				
31 December 2018 (audited)	Covered bonds	Securitisations	Other	Total	Positioned at the central banks (including encumbered)	Readily available for encumbrance	Other assets capable of being encumbered	Cannot be encumbered	Total	Total
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Cash and balances with central banks	-	-	-	-	295.3	3,177.5	-	-	3,472.8	3,472.8
Due from other banks	-	-	69.7	69.7	-	-	48.3	-	48.3	118.0
Financial instruments at FVOCI	26.1	56.6	169.4	252.1	5.0	1,830.7	-	2.6	1,838.3	2,090.4
Equity investments at FVPL	-	-	-	-	-	-	-	1.0	1.0	1.0
Derivative financial instruments	-	-	-	-	-	-	-	15.8	15.8	15.8
Loans and advances to customers	-	5,985.3	-	5,985.3	11,390.8	14,585.4	5,878.7	955.6	32,810.5	38,795.8
Other assets	-	-	21.0	21.0	-	-	-	276.1	276.1	297.1
Total assets	**26.1**	**6,041.9**	**260.1**	**6,328.1**	**11,691.1**	**19,593.6**	**5,927.0**	**1,251.1**	**38,462.8**	**44,790.9**

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

Funding and liquidity risk (continued)

Encumbered assets (continued)

	Assets encumbered with non-central bank counterparties				Other assets					
					Positioned at the central banks (including encumbered)	Assets not positioned at the central bank				
1 January 2018 (audited)	Covered bonds	Securitisations	Other	Total		Readily available for encumbrance	Other assets capable of being encumbered	Cannot be encumbered	Total	Total
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Cash and balances with central banks	-	-	-	-	253.0	2,326.0	-	-	2,579.0	2,579.0
Due from other banks	-	-	89.7	89.7	-	-	33.0	-	33.0	122.7
Financial instruments at FVOCI	-	23.0	154.8	177.8	-	721.4	-	2.2	723.6	901.4
Equity investments at FVPL	-	-	-	-	-	-	-	1.0	1.0	1.0
Derivative financial instruments	-	-	-	-	-	-	-	22.0	22.0	22.0
Loans and advances to customers	-	4,836.8	-	4,836.8	12,935.4	12,570.2	5,674.7	1,038.0	32,218.3	37,055.1
Other assets	-	-	8.5	8.5	-	0.3	-	295.3	295.6	304.1
Total assets	-	4,859.8	253.0	5,112.8	13,188.4	15,617.9	5,707.7	1,358.5	35,872.5	40,985.3
Off-balance sheet assets	-	23.1	159.8	182.9	-	1,850.6	-	-	1,850.6	2,033.5
Total assets plus off-balance sheet assets	-	4,882.9	412.8	5,295.7	13,188.4	17,468.5	5,707.7	1,358.5	37,723.1	43,018.8

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

Funding and liquidity risk (continued)

Assets and liabilities by maturity

The following tables 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.

In particular, the majority of customer deposits are contractually payable on demand or at short notice. In practice, these deposits are not usually withdrawn on their contractual maturity.

31 December 2018 (audited)	Call £m	Within 3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	No specified maturity £m	Total £m
Assets							
Cash and balances with central banks	3,214.8	-	-	-	-	258.0	3,472.8
Due from other banks	118.0	-	-	-	-	-	118.0
Financial instruments at FVOCI	-	50.0	334.7	775.4	927.7	2.6	2,090.4
Equity investments at FVPL	-	-	-	-	-	1.0	1.0
Derivative financial instruments	-	0.4	1.1	13.1	1.2	-	15.8
Loans and advances to customers	3,264.2	435.2	844.9	4,597.2	29,654.3	-	38,795.8
All other assets	-	53.1	23.5	72.2	126.7	21.6	297.1
Total assets	6,597.0	538.7	1,204.2	5,457.9	30,709.9	283.2	44,790.9
Liabilities							
Due to other banks	8.9	300.0	480.0	6,387.0	-	-	7,175.9
Derivative financial instruments	-	3.2	2.3	21.6	3.4	-	30.5
Customer deposits	28,838.0	941.8	1,886.6	761.3	2.2	-	32,429.9
Amounts due to controlled structured entities	230.4	44.1	160.5	820.6	1,177.3	-	2,432.9
Debt securities in issue	-	-	-	300.8	351.9	-	652.7
All other liabilities	-	186.8	61.8	20.1	1.5	0.5	270.7
Total liabilities	29,077.3	1,475.9	2,591.2	8,311.4	1,536.3	0.5	42,992.6
Off balance sheet items							
Other credit commitments	7,483.5	-	-	-	-	-	7,483.5
Total off balance sheet items	7,483.5	-	-	-	-	-	7,483.5

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

Funding and liquidity risk (continued)

Assets and liabilities by maturity (continued)

1 January 2018 (audited)	Call £m	Within 3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	No specified maturity £m	Total £m
Assets							
Cash and balances with central banks	2,363.0	-	-	-	-	216.0	2,579.0
Due from other banks	122.7	-	-	-	-	-	122.7
Financial instruments at FVOCI	-	10.0	18.9	314.9	555.5	2.1	901.4
Equity investments at FVPL	-	-	-	-	-	1.0	1.0
Derivative financial instruments	-	0.5	1.4	20.0	0.1	-	22.0
Loans and advances to customers	2,979.3	536.6	794.2	4,429.2	28,315.8	-	37,055.1
All other assets	-	62.8	9.1	63.3	160.0	8.9	304.1
Total assets	5,465.0	609.9	823.6	4,827.4	29,031.4	228.0	40,985.3
Liabilities							
Due to other banks	11.7	5.0	850.0	4,511.0	-	-	5,377.7
Derivative financial instruments	-	9.4	4.4	63.9	15.4	-	93.1
Customer deposits	26,472.4	796.2	2,144.2	1,395.0	0.6	-	30,808.4
Amounts due to controlled structured entities	180.2	38.5	142.1	767.6	1,172.0	-	2,300.4
Debt securities in issue	-	-	-	-	302.8	-	302.8
All other liabilities	-	177.4	70.2	5.7	3.4	0.6	257.3
Total liabilities	26,664.3	1,026.5	3,210.9	6,743.2	1,494.2	0.6	39,139.7
Off balance sheet items							
Other credit commitments	6,193.5	-	-	-	-	-	6,193.5
Total off balance sheet items	6,193.5	-	-	-	-	-	6,193.5

Cash flows payable under financial liabilities by contractual maturity

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.

2018 (audited)	**Call £m**	**Within 3 months £m**	**3-6 months £m**	**6-12 months £m**	**1-5 years £m**	**Over 5 years £m**	**Total £m**
Due to other banks	**8.9**	**315.3**	**494.2**	**24.5**	**6,484.6**	**-**	**7,327.5**
Customer deposits	**28,838.0**	**1,018.0**	**673.7**	**1,415.5**	**927.7**	**2.2**	**32,875.1**
Amounts due to controlled structured entities	**230.6**	**348.5**	**329.7**	**778.0**	**885.4**	**-**	**2,572.2**
Debt securities in issue	**-**	**11.8**	**6.8**	**-**	**365.8**	**361.8**	**746.2**
Total	**29,077.5**	**1,693.6**	**1,504.4**	**2,218.0**	**8,663.5**	**364.0**	**43,521.0**

2017 (audited)	Call £m	Within 3 months £m	3-6 months £m	6-12 months £m	1-5 years £m	Over 5 years £m	Total £m
Due to other banks	11.7	10.2	858.9	12.4	4,567.9	-	5,461.1
Customer deposits	26,472.6	865.5	847.3	1,495.7	1,571.6	0.6	31,253.3
Amounts due to controlled structured entities	180.2	422.4	355.8	750.4	763.7	-	2,472.5
Debt securities in issue	-	-	6.8	-	313.5	-	320.3
Total	26,664.5	1,298.1	2,068.8	2,258.5	7,216.7	0.6	39,507.2

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

Funding and liquidity risk (continued)

The following tables display future derivative cash flows in the relevant maturity groupings in which they fall due. Cash flows for the floating legs of derivative transactions are calculated using the forward interest rate curve. These cash flows are not discounted in the same way that derivative valuations are, and totals will therefore not be identical to those reported on derivatives in the notes to the financial statements.

2018 (audited)	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	(1.5)	0.1	(1.0)	(2.0)	-	(4.4)
Derivatives in accounting hedge relationships	(3.4)	(2.4)	(4.2)	(6.8)	-	(16.8)
	(4.9)	(2.3)	(5.2)	(8.8)	-	(21.2)
Settled on a gross basis						
Inflows	4.4	7.1	7.8	66.9	53.8	140.0
Outflows	(4.7)	(7.2)	(7.7)	(68.4)	(60.3)	(148.3)
Total	(5.2)	(2.4)	(5.1)	(10.3)	(6.5)	(29.5)

2017 (audited)	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	(1.5)	(0.1)	(1.5)	(4.4)	-	(7.5)
Derivatives in accounting hedge relationships	(12.9)	(8.1)	(14.1)	(32.3)	(7.6)	(75.0)
	(14.4)	(8.2)	(15.6)	(36.7)	(7.6)	(82.5)
Settled on a gross basis						
Inflows	2.5	2.5	4.7	28.5	-	38.2
Outflows	(2.7)	(2.6)	(4.9)	(31.6)	-	(41.8)
Total	(14.6)	(8.3)	(15.8)	(39.8)	(7.6)	(86.1)

Market risk

Market risk is defined as the risk that the value of, or net income arising from, assets and liabilities changes as a result of interest rate or exchange rate movements. Market risk for the Company arises as a natural consequence of carrying out and supporting core business activities. The Company does not trade or make markets and transacts foreign exchange for limited operational purposes only. As a result, interest rate risk is the only material market risk for the Company.

Risk appetite

The Company has limited risk appetite for exposures to interest rate risk in the banking book (IRRBB), in terms of both potential changes to economic value, and changes to expected net interest income or earnings. Risk appetite limits and metrics are set with reference to stress scenarios using measures described in this section.

Exposures

The Company's banking activities expose it to the risk of adverse movements in interest rates and exchange rates.

Term mismatch risk in the Company's portfolio arises from the different re-pricing characteristics of the Company's assets, liabilities and off-balance sheet exposures. Term mismatch risk arises predominantly from the mismatch between assets and liabilities either maturing or the amount resetting in any given time period, and the investment term of capital and reserves, and the need to stabilise earnings in order to minimise income volatility.

Basis risk arises from possible changes in spreads, between different reference rates, for example, where assets and liabilities reprice at the same time and the scale of rate movement differs. The Company is exposed to Bank Base Rate, LIBOR and SONIA. If the spread between these rates moves adversely, the Company may experience a reduction in income on unhedged exposures.

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

Market risk (continued)

Exposures (continued)

Pipeline risk arises where new business volumes are higher or lower than forecast, requiring the business to unwind or execute additional hedging at rates unfavourable to those that were expected. Variations in business volume outturn to forecast arise from changes in customer behaviour and relative product competitiveness.

Product optionality risk arises when customer balances reduce more quickly or slowly than anticipated due to economic conditions or customers' responses to changes in interest rates or other economic conditions differing from expectations.

Swap spread risk arises through the hedging of the repricing risk of fixed rate securities (e.g. gilt securities) with derivatives. The yields in securities and swap markets for a given tenor may not change by the same amount as each other. Such differences cause spread risk to arise.

Foreign currency risk arises as a result of having assets, liabilities and derivative items denominated in currencies other than Sterling as a result of banking activities. The Company has minimal exposure to foreign currency risk.

Measurement

The Company quantifies the impact to economic value and earnings arising from a shift to interest rates using stress scenarios. These scenarios examine the interest rate re-pricing gaps, asset and liability interest rate bases and product optionality.

The Company maintains IRRBB management practices in line with applicable regulatory expectations.

Interest rate risk exposure is measured as follows:

- Capital at Risk (CaR) is considered for assets and liabilities in all interest rate risk re-pricing periods. This is expressed as the present value of the negative impact of a sensitivity test on the Company's capital position.
- Earnings at Risk (EaR) is considered for assets and liabilities on the forecast balance sheet over a 12 month period, measuring the adverse change to net interest income from a change in interest rates.

IRRBB is measured considering both positive and negative instantaneous shocks to interest rates. The measurement is enhanced with non-parallel stress scenarios (basis risk), swap spread risk and behavioural volume stresses (pipeline and optionality risk). Both EaR and CaR are controlled by a defined risk appetite limit and supporting metrics.

The Company calculates both CaR and EaR sensitivities on a regulated entity basis, being the consolidated interest rate exposures of the Company and its controlled structured entities detailed in note 3.7 to the financial statements. This aligns to the basis of the Company's capital resources.

CaR measurements are based on a 2% parallel stress over the balance sheet horizon, for term mismatch. EaR measurements are based on a 1% parallel stress over a 12 month period. The stress scenarios capture the risk of negative interest rates. The magnitude of stress used within the Company's internal risk appetite differs from the standardised regulatory stress, based on observed rate movements and internally defined exposure holding periods. In the case of basis risk, the Company uses an internal stress test outcome for CaR and EaR.

The Company has an integrated Asset and Liability Management system which allows it to measure and manage interest rate re-pricing profiles (including behavioural assumptions), perform stress testing and produce forecasts.

Mitigation measures

The Company uses derivative financial instruments to bring its residual net exposure within risk appetite. The residual net exposure takes account of natural offsets between assets and liabilities.

As defined within the scope of the Company's IRRBB Policy, the Interest Rate Risk Transfer Pricing framework is used for interest rate risk arising from commercial product lines that can be hedged. Treasury is responsible for managing risk and does this through natural offsets of matching assets and liabilities where possible.

Appropriate hedging activity of residual exposures is undertaken, subject to the authorisation and mandate of the Asset and Liability Committee, within the Board-approved risk appetite. Certain residual interest rate risks may remain due to differences in basis and profile mismatches arising from customer behaviour.

Where possible, the Company mitigates basis risk by creating natural offsets. When required, the Company uses basis derivatives to maintain the residual exposure within risk appetite.

The Company is exposed to fair value interest rate risk on fixed rate customer loans and deposits and to cash flow interest rate risk on variable rate loans and deposits. Accounting methodology for derivative financial instruments and hedge accounting is captured within the notes to the financial statements.

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

Market risk (continued)

Monitoring
Interest rate risk is monitored centrally using the measures described above and other key risk indicators.

The Asset and Liability Committee and the Risk Management Committee regularly review market risk exposure as part of the wider risk management framework. The Asset and Liability Committee reviews and approves strategies to manage IRRBB.

Interest rate risk (audited)

	Capital at Risk			
	2018		2017	
	Positive 2% rate shock £m	**Negative 2% rate shock £m**	Positive 2% rate shock £m	Negative 2% rate shock £m
Interest rate mismatch risk	**0.4**	**(1.8)**	2.9	(6.2)
Basis risk	**(8.2)**	**(8.2)**	(1.5)	(1.5)
Pipeline risk	**(7.5)**	**(6.0)**	(4.7)	(5.5)
Optionality risk	**(20.9)**	**(5.3)**	(39.7)	(18.9)
Total interest rate risk – Capital at Risk	**(36.2)**	**(21.3)**	(43.0)	(32.1)

	Earnings at Risk			
	2018		2017	
	Positive 1% rate shock £m	**Negative 1% rate shock £m**	Positive 1% rate shock £m	Negative 1% rate shock £m
Interest rate mismatch risk	**2.6**	**20.6**	23.1	0.4
Basis risk	**(8.2)**	**(8.2)**	(0.1)	(9.2)
Pipeline risk	**(3.6)**	**(1.8)**	(2.5)	(1.3)
Optionality risk	**(3.1)**	**(0.1)**	(6.3)	(1.6)
Total interest rate risk – Earnings at Risk	**(12.3)**	**10.5**	14.2	(11.7)

Foreign currency assets and liabilities split by type

	31 Dec 2018		1 Jan 2018	
	US$ in £m	**€ in £m**	US$ in £m	€ in £m
Assets				
Due from other banks	**0.6**	**0.8**	0.7	0.9
Financial instruments at FVOCI	**1.5**	**79.6**	1.4	54.0
Intangible assets	**0.1**	**0.1**	0.1	0.1
Other assets	**-**	**0.7**	-	0.6
Total assets	**2.2**	**81.2**	2.2	55.6
Liabilities				
Other liabilities	**0.2**	**0.3**	0.3	0.4
Total liabilities	**0.2**	**0.3**	0.3	0.4
Notional value of derivatives affecting currency exposure	**2.5**	**80.2**	1.6	54.1
Net position	**(0.5)**	**0.7**	0.3	1.1

Risk Report (continued)

REGULATORY, COMPLIANCE & CONDUCT RISK

Conduct risk and compliance 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 effective operational processes, systems and controls and maintain compliance with all applicable regulatory requirements.

Risk appetite
The Company has no appetite for failure to remediate regulatory breaches and no tolerance for failing to deliver fair customer outcomes, whether through product design, sales or after sales processes.

Measurement
Risk assessments are regularly reviewed and include assessments of control and material regulatory rule breaches, complaints and whistleblowing.

Mitigation measures
The Company takes a range of mitigating actions with respect to conduct risk and compliance. They include:

- promoting a culture throughout the business that places the customer at the heart of decision-making, business planning and culture;
- policies, processes and standards which provide a framework for the business to operate in accordance with the relevant laws and regulations;
- using a risk assessment framework that ensures product design and sales processes offer customers value for money, meet the needs of the target market, and deliver fair outcomes to customers, including vulnerable customers;
- focusing on recruitment and training and how the Company manages colleagues' performance in relation to fair customer outcomes;
- regulatory horizon scanning; and
- using oversight and assurance themed reviews to assess compliance with rules, regulations and policies.

Monitoring
A robust assurance and quality monitoring regime is in place to test the performance of customer critical activities. Customer metrics are proactively used when reviewing business performance and feedback mechanisms have been established to learn from any issues identified.

The Risk function reports on conduct risk and compliance exposure. The report forms the basis of challenge to the business at the monthly Operational Risk, Conduct Risk and Compliance Committee.

Risk Report (continued)

OPERATIONAL RISK (including people risk)

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. It also includes legal risk.

Risk Appetite

The Company's operational risk appetite is designed to safeguard the interests of customers, internal and external stakeholders, and shareholders.

Exposures

The principal operational risks to the Company are:

- IT systems, resilience and change risk arising from failure to develop, deliver and maintain effective IT solutions;
- information security risk arising from information leakage, loss or theft;
- external fraud arising from an act of deception or omission;
- cyber-crime arising from malicious attacks on the Company via technology, networks and systems;
- service disruption;
- failure of a third party corporate partner or strategic supplier;
- normal business operational risk including transaction processing, information capture and implementation of change; and
- people risk.

Measurement

A variety of measures are used to monitor operational risk, such as scoring of potential risks, considering impact and likelihood, assessing the effectiveness of controls, monitoring of events and losses by size, functional area and internal risk categories. The Company maintains a formal approach to operational risk event escalation. Material events are identified, captured and escalated. The root cause of events are determined and action plans put in place to ensure an optimum level of control. This ensures the Company keeps customers and the business safe, reduces costs, and improves efficiency.

Approach to Monitoring and Mitigating Exposures

The Company's control environment is regularly reviewed and reporting on material risks is discussed monthly by Senior Management. Risks are managed through a range of strategies such as mitigation, transfer (including insurance), and acceptance. Contingency plans are maintained for a range of potential scenarios with regular disaster recovery exercises.
Mitigating actions for the principal risks include:

- investment in IT infrastructure to ensure continued availability, security and resilience;
- investment in information security capability to protect customers and the Company;
- investment in the protection of customer information, including access to key systems and the security, durability and accessibility of critical records;
- a risk-based approach to mitigate the financial crime risks the Company faces, reflecting the current and emerging financial crime risks within the market. The Company has developed a comprehensive financial crime operating model. The Company's fraud awareness programme is a key component of the financial crime control environment; and
- operational resilience measures and recovery planning to ensure an appropriate and consistent approach to the management of continuity risks, including potential interruptions from a range of internal and external incidents or threats.

Monitoring and reporting of operational risk is undertaken at Board and Executive Committees. A combination of systems, monthly reports, oversight and challenge from the Risk function, Internal Audit and assurance teams ensures that key risks are regularly presented and considered by Executive management.

Key operational risks are appropriately insured, where possible. The insurance programme is monitored and reviewed regularly, with recommendations made to Executive management prior to each renewal.

Stress testing

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

Risk Report (continued)

FINANCIAL CRIME RISK

Financial Crime Risk is the risk that the Company's products and services will be used to facilitate financial crime against the Company, its customers or third parties. It encompasses the risk of failing to understand and comply with relevant laws, regulations and supervisory requirements relating to money laundering, sanctions, terrorist financing, and bribery and corruption. The Company maintains an overarching financial crime policy, aligned to relevant legislation and regulation, which sets out the minimum standards with which the Company must comply. These are:

Sanctions and Terrorist Financing – The Company has no appetite for non-compliance with the legal and regulatory obligations relating to sanctions and terrorist financing. To reflect the Company's risk appetite and to protect the Company from financial and reputational damage, including regulatory censure, fines and enforcement action, the Company must comply with the Financial Crime policy which articulates a set of minimum standards and requirements.

Anti-Money Laundering – The Company adopts a risk proportionate approach to the management of money laundering risk. Our policies and standards set out the types of customer we have no risk appetite to on-board as well as customers with whom the Company is prohibited from entering into or maintaining a customer relationship. All other customers who are not prescribed shall be subject to controls commensurate with their risk.

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

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

Exposures

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

Mitigation measures

Assessment of the financial crime risk associated with the Company's products, services and customers takes place on an annual basis. Over and above these assessments, regular oversight of higher-risk activities takes place as part of the formal oversight plan and embedded activity takes place throughout the year. Key performance metrics relative to critical financial crime controls are kept under review to ensure ongoing effectiveness. Training completion and compliance is subject to annual oversight.

All standards are reflected in the Company policy, standards and the AML handbook, the content of which is provided by Financial Crime Risk and updated as appropriate.

Monitoring

The Financial Crime Risk team is responsible for developing and maintaining financial crime policies, standards, monitoring compliance with risk appetite, training and reporting to the competent authorities and governance committees and Board.

The control framework is owned by Financial Crime Risk but management and execution of customer identity and verification, customer due diligence, enhanced due diligence, identifying high risk customers, and record keeping is the responsibility of first line management.

Risk Report (continued)

STRATEGIC & FINANCIAL PERFORMANCE RISK

Strategic risk is the risk of significant loss or damage arising from business decisions that impact the long-term interest 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.

Risk appetite
The Company has limited appetite for concentrated exposures by country, region, loan size and type.

Exposures
The principal source of concentration risk is from loans and advances to customers in relation to:

- geography (see page 16);
- loan size (see page 24); and
- loan type (see page 25).

In addition, concentration risk arises from cash, debt securities and derivatives in relation to individual counterparties and country of exposure.

The Company has no significant concentrations of risk in the credit card portfolio.

Measurement
Credit concentration risk is measured through the application of limits in relation to each concentration category.

Mitigation measures
Credit risk management includes portfolio controls on product lines and risk segments to reflect risk appetite and individual limit guidelines. Credit policy is aligned to the Company's risk appetite, restricts exposure to higher risk sectors and segments and manages overall portfolio concentrations. Active focus is on asset origination and portfolio management to manage margins and eliminate inappropriate concentration risk.

In relation to strategic risk, Board focus is on ensuring alignment of business development and planning with risk appetite. The Company invests in processes, systems, recruitment and training to support new business developments and uses robust risk and project management disciplines to ensure that implementation is delivered safely.

The Company maintains pricing discipline across all product ranges, ensuring that risk is appropriately rewarded within Board approved risk appetite. The Company continually monitors customer behaviour metrics to identify adverse trends, and regular validation and review of internal models is performed to ensure they align with known customer behaviour trends.

Monitoring
Monthly reporting on concentration risk exposures is made to the Board. All large exposures are reported in accordance with regulatory reporting requirements. Since the end of 2013, London and the South East have experienced higher levels of house price growth than the rest of the UK. Whilst the international market may influence demand for London property, concerns over an asset bubble forming in these two regions are based on the rate of growth relative to other regions, a potential divergence in supply and demand for property, and customer affordability being stretched. The Company's policy restricts LTV for higher value loans, resulting in the lower average new lending LTVs observed in London (60.1%) and the South East (66.6%) compared to other regions (73.0%).

Report of the Directors

Profits and appropriations

Virgin Money PLC (the 'Company') made a profit before tax for the year ended 31 December 2018 of £108.6m (2017: £263.1m).

Dividends

An interim dividend, amounting to £42.0 million, was declared on 27 February 2019 and will be paid on 28 February 2019 to the parent undertaking, further details are set out in note 5.5 to the financial statements.

Future developments and financial risk management objectives and policies

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

Directors and Directors' interests

The current composition of the Board of Directors together with details of appointments up to the date of this report are shown on page 1. Directors are appointed in accordance with the Company's Articles of Association. The Company, as a public limited company, is required to hold an Annual General Meeting at which a director shall retire from office if they have been appointed to the Board since the previous Annual General Meeting or it is the third Annual General Meeting following the annual general meeting at which they were elected or last re-elected.

Directors' indemnities

The Directors and Debbie Crosbie, who served as a Director during the year, have each entered into individual deeds of indemnity with CYBG PLC ('CYBG'), the former Directors (other than Debbie Crosbie) have each entered into individual deeds of indemnity with the Company each of which constitute 'qualifying third party indemnity provisions' for the purpose of the Companies Act 2006 (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 six-year period thereafter. The deeds were in force during the whole of the financial year and remain in force at the date of this report.

Deeds for current Directors, and the former Directors who retired during the year, are available for inspection at the Company's registered office. In addition, the Company had appropriate Directors' and Officers' insurance cover, as well as professional indemnity cover in place throughout 2018.

Employee engagement, communication and the employment of disabled persons

The Company's employees are integral to its success; it is through their engagement and advocacy that the Company is able to deliver strong and sustainable business performance. The Company officially recognises Unite. The elected Unite representatives are regularly informed of the Company's performance and any planned changes to terms and conditions; arrange for their members to vote on the annual remuneration policy for colleagues; and in 2018 supported colleagues during the acquisition of Virgin Money by CYBG. In addition to Unite, the Company has launched a new Colleague Integration Forum to ensure that all colleagues are consulted with on issues arising over the anticipated three year integration period following the acquisition of Virgin Money.

The Company continues to meet its Time to Change pledge to make Virgin Money a better place to work for colleagues who have a mental health disability. We have also successfully maintained the highest (3rd tier) Disability Confident accreditation. The Company's successful strategy and initiatives were recognised through winning the 2018 Personnel Today Award for best private sector Diversity and Inclusion.

Board Diversity

During the course of the year, the Board reviewed the Company's performance against the Board approved Diversity Policy, which can be found on the Virgin Money website and sets out the approach to diversity for each of the main boards within the Virgin Money group ('Group').

The Company supports the Women in Finance Charter and the Parker Review 'Beyond One by 21' recommendation and has committed to having at least one director which makes the Board composition ethnically diverse by 2021 and 2024 respectively. The Board currently meets this minimum recommendation and female representation on the Board was 31% at 31 December 2018.

Related party transactions

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

Report of the Directors (continued)

Share capital

The powers of the Directors, including in relation to the issue or buy back of the Company's shares, are set out in the Act and in the Articles of Association of the Company. The Company did not repurchase any of the issued ordinary shares during 2018 and up to the date of this report.

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

Research and Development Activities

The Company does not undertake formal research and development activities although it does invest in the development of platforms, products and services.

Events after the balance sheet date

Post balance sheet events are disclosed in note 5.5 to the financial statements.

Going concern

The Company's business activities, together with the factors likely to affect its future development, performance and position, are set out in the Strategic Report. In addition, the Risk Report includes the Company's risk management objectives and the Company's objectives, policies and processes for managing its capital.

The Group's ultimate parent has announced its intention to execute a transfer of the Company's business under Part VII of the Financial Services and Markets Act 2000, which could potentially be effected within the next 12 months. Following such a transfer it is anticipated the Company would cease to trade and become dormant. At the date of this report the ultimate parent is finalising plans for the transfer, and has currently not commenced any binding substantive steps. As a result, there is insufficient certainty that such a transfer will be effected in its proposed form or within the next 12 months.

In assessing the Company's going concern position as at 31 December 2018, the Directors have considered the lack of certainty in relation to any Part VII transfer and a number of other factors, including the current financial position, the principal and emerging risks which could impact the performance of the Company and the strategic and financial plan of the Group which includes future projections of profitability, capital adequacy, liquidity and funding. The assessment concluded that, for the foreseeable future, the Company has sufficient capital to support its operations; has a funding and liquidity base which is strong, robust and well managed with future capacity; and has expectations that the Company's trading performance will continue to support execution of the Group's strategy.

As a result of the assessment, the Directors have a reasonable expectation that the Company will have adequate resources to continue in operational existence for the foreseeable future and therefore believe that the Company is well placed to manage its risks successfully in line with its business model and strategic aims. Accordingly, they continue to adopt the going concern basis in preparing the financial statements.

Auditors

PricewaterhouseCoopers LLP (PwC) were the Company's auditors for ten months of the year prior to the acquisition of the Group by CYBG. During 2018 PwC had provided services to CYBG, which, when CYBG became the ultimate parent of the Company, became impermissible for the Company's auditor to provide. As it was not possible to cease these services within the permitted three month period following the acquisition, PwC resigned as auditor of the Company on 17 October 2018. The Boards of both the Group and CYBG recommended Ernst & Young LLP (EY) be appointed as the auditor of all entities within the Group. The recommendation was approved by the Board and EY was appointed as external auditor of the Company on 30 October 2018.

In accordance with section 489 of the Act, a resolution to appoint EY, and to authorise the Audit Committee to agree the auditor's remuneration, will be proposed at the next Annual General Meeting.

Each of the Directors who is in office at the time of approving the Report and whose name is listed on page 1 confirms that:

- so far as the Director is aware, there is no relevant audit information of which the Company's auditors are unaware; and
- they have taken all the steps that they ought to have taken as a Director in order to make themselves aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

By order of the Board

Katie Marshall
Company Secretary
27 February 2019

Statement of Directors' responsibilities

The Directors are responsible for preparing the Annual 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 are required to prepare financial statements in accordance with IFRSs as adopted by the EU and applicable law. Under company law, the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of its profit or loss for that year. In preparing these financial statements the Directors are required to:

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

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the 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 Act. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Under applicable law and regulations, the Directors are also responsible for preparing a Strategic report and a Directors' report that comply with that law and those regulations.

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

Each of the Directors who is in office at the time of approving the Report and whose name is listed on page 1 confirms that, to the best of their 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 of loss of the Company; and
- the Strategic Report and Directors' Report include 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.

Katie Marshall
Company Secretary
27 February 2019

Independent auditor's report to the members of Virgin Money PLC

Opinion

In our opinion:

- the 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 2018 and of the Company's profit after tax for the year then ended;
- the Company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- the Company financial statements been properly prepared in accordance with IFRSs as adopted by the European Union as applied in accordance with the provisions of the Companies Act 2006.
- We have audited the financial statements of Virgin Money PLC which comprise the:

Company
Income Statement for the year ended 31 December 2018
Statement of Comprehensive Income for the year ended 31 December 2018
Balance Sheet as at 31 December 2018
Statement of Changes in Equity for the year ended 31 December 2018
Statement of Cash Flows for the year ended 31 December 2018
Related notes 1.1 to 5.5 to the financial statements including a summary of significant accounting policies
Certain required disclosures in the Credit Risk, and Funding and Liquidity Risk sections of the Risk Report, identified as 'audited' on pages X to X.

The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union and; as regards to the Company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

Basis for opinion

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

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

Conclusions relating to going concern

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

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

Overview of our audit approach

Key audit matters	• Application of the effective interest rate ("EIR") method – (Revenue Recognition) • Impairment provisions on unsecured loans and advances to customers
Audit scope	• We performed an audit of the complete financial information of Virgin Money PLC. • All audit work performed for the purposes of the audit was undertaken by the primary team.
Materiality	• Overall materiality was £12.5m which represents 5% of adjusted profit before tax forecast.

Independent auditor's report to the members of Virgin Money PLC (continued)

Key audit matters

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

Risk	Our response to the risk	Key observations communicated to the Audit Committee
Application of the effective interest rate ("EIR") method – (Revenue recognition) As at 31 December 2018, the Company recorded adjustments to the mortgage and credit card loans and advances to customers, in line with the requirements of IFRS 9. Please refer to pages 63 and 73 for disclosure of the relevant accounting policies and key judgements. For both the secured and unsecured lending, the Company utilises models to recognise interest income and associated fees and charges under the EIR accounting method. The EIR method spreads the income statement recognition of income and expense cash flows that are, in substance, fundamental to the overall yield of the financial instrument, over its modelled life. EIR models are sensitive to judgements about the expected lives and yields of the product portfolios to which they relate. Due to the complexity of calculations, the degree of judgement exercised by the Directors in respect of forecast future cash flows, the different products for which fees are recognised, and the sensitivity of assumptions this is considered a key audit matter.	We gained an understanding of key processes and controls and assessed the assumptions and judgements used within the Directors' EIR models. We assessed model methodology including the inclusion / exclusion of income and expenditure. We compared the Directors' forecast customer behaviours and balance attrition rates with recent experience within the lending portfolio and observed practice in the UK banking sector. We assessed the Directors' forecast portfolio yields with reference to trends in gross income and margins, interest rate forecasts and the Company's expectations of future income. We performed data integrity testing on the key sources of information used within the effective interest calculations. We also assessed the sufficiency of the disclosures made within the financial statements regarding the estimates made within the EIR models, and their sensitivity to alternative assumptions.	We reported to the Audit Committee that the EIR models were sensitive to judgements, particularly in respect of forecast customer balance attrition and forecast yields. We observed that the most significant inputs to the EIR estimates included retention of customer balances and the yield earned over the life of the modelled period. We challenged the Directors on the factors driving these key assumptions. We communicated to the Audit Committee our observations of these key risks. We communicated our observations on the Directors' assumptions including the consideration of estimation uncertainty. We concluded that the assumptions made by the Directors were reasonable in the context of the Company's lending portfolios and current observable customer behaviours. We concluded that the Directors' model methodology including assumed caps to modelled behavioural life were reasonable in all material aspects. We also noted the downside risk to the EIR adjustments, should future customer behaviour result in cash flows that are lower than the levels anticipated by the Directors within the EIR models. We communicated to the Audit Committee that the models, assumptions and calculations informing the EIR calculation as at 31 December 2018 were reasonable and that these resulted in EIR adjustments which were appropriately derived.

Independent auditor's report to the members of Virgin Money PLC (continued)

Key audit matters (continued)

Risk	Our response to the risk	Key observations communicated to the Audit Committee
Impairment provisions on unsecured loans and advances to customers From 1 January 2018, IFRS 9 'Financial Instruments' replaced IAS 39 'Financial Instruments: Recognition and Measurement' and contains new requirements for the classification and measurement of financial assets and liabilities and the recognition of impairment of financial assets. On transition to IFRS 9, the Company made an opening balance adjustment of £44.8m increase in provision. The impairment provision of £128.3m as at 31 December 2018 consists of provisions of £13.8m in relation to secured lending and £114.5m in relation to unsecured lending. Total loans and advances as at 31 December 2018 relating to secured lending was £35.3bn and £3.4bn for unsecured lending. Due to the magnitude of the unsecured lending provision balance, the heightened level of estimation uncertainty and the risk associated with providing for undrawn commitments, our key audit matter relates specifically to the valuation of credit impairment provisions on unsecured lending.	We understood and evaluated the design effectiveness of key controls over the impairment process. This includes controls over processes for data governance and setting forward-looking assumptions, as well as controls in relation to governance over key estimates and judgements for both secured and unsecured portfolios. Our substantive audit procedures over the collective IFRS 9 provision models included assessing, challenging and substantiating key assumptions, such as probability of default ("PD"), loss given default, significant increases in credit risk, exposure at default ("EAD") and the staging applied, forward looking assumptions and the determination of lifetime PD curves. As part of our work, we also assessed the Company's key accounting policies against IFRS 9 standards, related industry guidance, and peer banks. We used credit modelling specialists to perform substantive procedures over the impairment models by performing sample test of the expected credit losses ("ECL") calculation. We performed sensitivity analysis and determined whether any indications of model weakness exist which could reasonably give rise to a material misstatement. We used EY economists to assess the macro-economic factors considered in the forward looking assumptions, including the probability weighting applied to each scenario. We also assessed the completeness of model overlays overlays by comparison with those applied by other banking groups and tested material overlays for reasonableness of estimation. We also assessed the adequacy and appropriateness of disclosures for compliance with the accounting standards including disclosure of transition from IAS 39.	We communicated to the Audit Committee that the impairment models, calculations and assumptions employed by the Company were reasonable as at 31 December 2018 and that these resulted in impairment provisions that were appropriately estimated. We found the key accounting decisions taken in relation to the Company's impairment provisions to be consistent with the requirements of IFRS 9 and judgements made were reasonable. We observed that the Directors' impairment provisions considered alternative economic scenarios that included appropriate macroeconomic factors reflecting forecasts across the current uncertain economic outlook. Based on our sample test of ECL calculation, we did not identify any material differences to the provisions. We also concluded that the disclosures presented were in compliance with IFRSs.

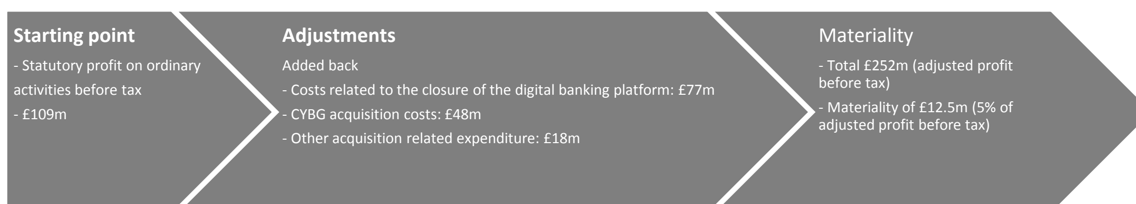
Our application of materiality

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

Materiality

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

We determined materiality for the Company to be £12.5 million which is 5% of the adjusted profit before tax. We believe that adjusted profit before tax is the appropriate basis for materiality as it excludes one-off expenditure incurred during the year which is unrelated to the ongoing performance of the Company. A reconciliation between statutory profit and adjusted profit before tax is shown below:



In the prior year audit, the predecessor auditor adopted a materiality of £13.0 million for the Company financial statements, based on 5% of profit before tax.

Independent auditor’s report to the members of Virgin Money PLC (continued)

Our application of materiality (continued)

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

On the basis of our risk assessments, together with our assessment of the Company’s overall control environment, our judgement was that performance materiality was 50% of our planning materiality, namely £6.2m. We have set performance materiality at this percentage in order to be prudent, since this is a first year audit.

Reporting threshold
An amount below which identified misstatements are considered as being clearly trivial.

We agreed with the Audit Committee that we would report to them all uncorrected audit differences in excess of £0.6m which is set at 5% of planning materiality, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds.

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

Performing a first year audit
In preparation for our first year audit of the 31 December 2018 financial statements, we performed a number of transitional procedures.

Following our selection, we undertook procedures to establish our independence of the Company. This involved considering previous commercial relationships and personal financial arrangements, and confirming that all staff who work on the audit are independent of the Company.

We held discussions with the Company’s predecessor auditor and reviewed their 2017 financial statement audit work papers to obtain evidence regarding the opening balances. We gained an understanding of the Company’s processes, including the risk assessment and key judgements made by the predecessor auditors. At the outset of our audit we gained an understanding of the business issues and met with executive and key management of the Company.

We used the understanding the audit team had formed to establish our audit base and assist in the formalisation of our audit strategy for the 2018 audit.

Other information

The other information comprises the information included in the annual report set out on pages 1 to 51, and the additional information set out on pages 112 to 118 other than the financial statements and our auditor’s report thereon. The Directors are responsible for the other information.

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

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

We have nothing to report in this regard.

Opinions on other matters prescribed by the Companies Act 2006

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

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

Matters on which we are required to report by exception

In the light of the knowledge and understanding of the Company and its environment obtained in the course of the audit, we have not identified material misstatements in the Strategic Report or the Report of the Directors.

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

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

Responsibilities of Directors

As explained more fully in the Statement of Directors’ responsibilities set out on page 51, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the Directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Independent auditor's report to the members of Virgin Money PLC (continued)

Responsibilities of Directors (continued)

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

Auditor's responsibilities for the audit of the financial statements

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

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

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

Our approach was as follows:

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

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

Other matters we are required to address

- We were appointed as the Company's External Auditor on 30 October 2018 to audit the financial statements for the year ending 31 December 2018 and subsequent financial periods.
- The non-audit services prohibited by the FRC's Ethical Standard were not provided to the Company and we remain independent of the Company in conducting the audit.
- The audit opinion is consistent with our audit committee report.

Use of our report

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

Steven Robb (Senior Statutory Auditor)
for and on behalf of Ernst & Young LLP,
Statutory Auditor
Leeds
27 February 2019

Income statement
for the year ended 31 December

	Note	2018 £m	2017 £m
Interest income		**1,074.2**	967.5
Other similar interest		**(2.3)**	(2.8)
Interest expense and similar charges		**(470.7)**	(370.0)
Net interest income	2.1	**601.2**	594.7
Gains less losses on financial instruments at fair value		**14.3**	9.8
Other operating income		**36.8**	34.9
Non-interest income	2.2	**51.1**	44.7
Total operating income		**652.3**	639.4
Total operating and administrative expenses	2.3	**(472.4)**	(332.1)
Operating profit before impairment losses		**179.9**	307.3
Impairment losses on credit exposures	3.6	**(71.3)**	(44.2)
Profit on ordinary activities before tax		**108.6**	263.1
Tax expense	2.4	**(37.6)**	(70.8)
Profit for the year attributable to equity holder		**71.0**	192.3

The notes on pages 62 to 111 form an integral part of these financial statements.

Statement of comprehensive income for the year ended 31 December

	2018 £m	2017 £m
Profit for the year	**71.0**	192.3
Items that may be reclassified to the income statement		
Change in available-for-sale reserve		
Gains during the year	**-**	14.0
Transfers to the income statement	**-**	(13.5)
Taxation	**-**	(0.1)
	-	0.4
Change in revaluation reserve for debt instruments at fair value through other comprehensive income		
Losses during the year	**(4.0)**	-
Transfers to the income statement	**(3.1)**	-
Taxation	**2.2**	-
	(4.9)	-
Total items that may be reclassified to the income statement	**(4.9)**	0.4
Items that will not be reclassified to the income statement		
Change in revaluation reserve for equity investments designated at fair value through other comprehensive income		
Gains during the year	**0.3**	-
Taxation	**(0.1)**	-
Total items that will not be reclassified to the income statement	**0.2**	-
Other comprehensive (losses)/income net of tax	**(4.7)**	0.4
Total comprehensive income for the year, net of tax	**66.3**	192.7
Total comprehensive income attributable to equity holder	**66.3**	192.7

The notes on pages 62 to 111 form an integral part of these financial statements.

Balance sheet
as at 31 December

	Note	2018 £m	2017 £m
Assets			
Cash and balances with central banks	3.1	**3,472.8**	2,579.0
Due from other banks		**118.0**	122.9
Financial instruments at fair value through other comprehensive income	3.2	**2,090.4**	-
Equity investments at fair value through profit and loss		**1.0**	-
Financial assets available-for-sale	3.3	**-**	902.4
Derivative financial instruments	3.4	**15.8**	22.0
Loans and advances to customers	3.5	**38,795.8**	37,099.9
Current tax asset		**3.6**	-
Property, plant and equipment	3.8	**71.7**	73.5
Intangible assets	3.9	**107.9**	128.4
Deferred tax assets	3.10	**21.1**	10.4
Other assets		**92.8**	80.4
Total assets		**44,790.9**	41,018.9
Liabilities			
Due to other banks	3.11	**7,175.9**	5,377.7
Derivative financial instruments	3.4	**30.5**	93.1
Customer deposits	3.12	**32,429.9**	30,808.4
Current taxes		**-**	23.7
Provisions for liabilities and charges	3.13	**4.3**	7.4
Amounts due to controlled structured entities	3.5	**2,432.9**	2,300.4
Debt securities in issue	3.14	**652.7**	302.8
Other liabilities	3.15	**266.4**	226.2
Total liabilities		**42,992.6**	39,139.7
Equity			
Share capital	4.1	**1,400.0**	1,400.0
Other equity instruments	4.1	**230.0**	230.0
Other reserves	4.1	**(0.2)**	4.5
Retained earnings		**168.5**	244.7
Total equity		**1,798.3**	1,879.2
Total liabilities and equity		**44,790.9**	41,018.9

The notes on pages 62 to 111 form an integral part of these financial statements.
These financial statements were approved by the Board of Directors on 27 February 2019 and were signed on its behalf by:

David Duffy
Chief Executive Officer

Ian Smith
Chief Financial Officer

Company name: Virgin Money PLC
Company number: 06952311

Statement of changes in equity

	Notes	Share capital £m	Other equity instruments £m	Other reserves: Revaluation reserve financial instruments at fair value through other comprehensive income £m	Other reserves: Available-for-sale reserve £m	Retained earnings £m	Total equity £m
As at 1 January 2017		1,400.0	230.0	-	4.1	57.1	1,691.2
Profit for the year		-	-	-	-	192.3	192.3
Other comprehensive income		-	-	-	0.4	-	0.4
Total comprehensive income, net of tax		-	-	-	0.4	192.3	192.7
AT1 distributions paid (net of tax)		-	-	-	-	(14.6)	(14.6)
Dividends paid		-	-	-	-	-	-
Share based compensation expensed		-	-	-	-	9.9	9.9
As at 31 December 2017	4.1	1,400.0	230.0	-	4.5	244.7	1,879.2
Changes on adoption of IFRS 9	5.4	-	-	4.5	(4.5)	(33.6)	(33.6)
As at 1 January 2018		**1,400.0**	**230.0**	**4.5**	**-**	**211.1**	**1,845.6**
Profit for the year		-	-	-	-	71.0	71.0
Other comprehensive losses		-	-	(4.7)	-	-	(4.7)
Total comprehensive (losses)/income, net of tax		-	-	(4.7)	-	71.0	66.3
AT1 distributions paid (net of tax)		-	-	-	-	(14.7)	(14.7)
Dividends paid		-	-	-	-	(120.0)	(120.0)
Settlement of share awards on vesting		-	-	-	-	(0.9)	(0.9)
Share based compensation expensed		-	-	-	-	22.0	22.0
As at 31 December 2018	4.1	**1,400.0**	**230.0**	**(0.2)**	**-**	**168.5**	**1,798.3**

The notes on pages 62 to 111 form an integral part of these financial statements.

Statement of cash flows
for the year ended 31 December

	Notes	2018 £m	2017 £m
Operating activities			
Profit on ordinary activities before tax		**108.6**	263.1
Adjustments for:			
Non cash or non operating items included in profit before tax	5.2	**(472.3)**	(519.1)
Changes in operating assets	5.2	**(1,741.2)**	(4,276.2)
Changes in operating liabilities	5.2	**1,358.7**	2,968.2
Interest received		**953.9**	846.5
Interest paid		**(436.0)**	(370.6)
Net settlement of share awards		**(0.9)**	-
Tax paid		**(54.4)**	(45.1)
Net cash used in operating activities		**(283.6)**	(1,133.2)
Cash flows from investing activities			
Interest received		**9.0**	4.9
Proceeds from maturity of securities		**312.5**	56.5
Proceeds from sale of securities		**426.1**	440.6
Purchase of property, plant and equipment		**(5.9)**	(5.7)
Purchase and development of intangible assets		**(71.0)**	(74.3)
Purchase of securities		**(1,932.9)**	(541.5)
Net cash used in investing activities		**(1,262.2)**	(119.5)
Cash flows from financing activities			
Interest paid		**(16.1)**	(14.9)
Proceeds from other equity instruments issued		**-**	2.3
Proceeds from issuance of debt securities	5.2	**348.6**	-
Amounts drawn down under the Term Funding Scheme	5.2	**2,803.0**	4,468.0
Amounts repaid under the Term Funding Scheme	5.2	**(652.0)**	(1,500.0)
Ordinary dividends paid		**(70.0)**	-
AT1 distributions paid		**(20.1)**	(20.1)
Net cash provided by financing activities		**2,393.4**	2,935.3
Net increase in cash and cash equivalents		**847.6**	1,682.6
Cash and cash equivalents at the beginning of the year		**2,648.9**	966.3
Cash and cash equivalents at the end of the year	5.2	**3,496.5**	2,648.9

The notes on pages 62 to 111 form an integral part of these financial statements.

Notes to the financial statements
Section 1: Basis of preparation and accounting policies

1.1 General information

Virgin Money PLC (the 'Company') is incorporated in the United Kingdom and registered in England and Wales. The registered office in Jubilee House, Gosforth, Newcastle upon Tyne, NE3 4PL.

On 15 October 2018, an all-share offer for the Company's immediate parent, Virgin Money Holdings (UK) PLC, was effected by means of a court sanctioned scheme of arrangement under Part 26 of the Companies Act 2006. Following the scheme of arrangement, the Company's ultimate parent is CYBG PLC, a company registered in England and Wales.

Virgin Money Holdings (UK) PLC heads the largest and smallest group in which the results of the Company are consolidated. The consolidated financial statements of Virgin Money Holdings (UK) PLC may be obtained from its registered office at Jubilee House, Gosforth, Newcastle upon Tyne, NE3 4PL. All references in the financial statements to 'the Group' refer to Virgin Money Holdings (UK) PLC and its subsidiaries, including the Company.

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

1.2 Basis of accounting

The Company's financial statements have been prepared 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 financial information has been prepared under the historical cost convention, as modified by the revaluation of derivative financial instruments; financial instruments at fair value through other comprehensive income; equity investments at fair value through profit and loss; and financial assets available-for-sale. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

1.3 Presentation of risk offsetting and maturity disclosures

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

1.4 Going concern

The Company's business activities, together with the factors likely to affect its future development, performance and position, are set out in the Strategic Report. In addition, the Risk Report includes the Company's risk management objectives and the Company's objectives, policies and processes for managing its capital.

The Group's ultimate parent has announced its intention to execute a transfer of the Company's business under Part VII of the Financial Services and Markets Act 2000, which could potentially be effected within the next 12 months. Following such a transfer it is anticipated the Company would cease to trade and become dormant. At the date of this report the ultimate parent is finalising plans for the transfer, and has currently not commenced any binding substantive steps. As a result, there is insufficient certainty that such a transfer will be effected in its proposed form or within the next 12 months.

In assessing the Company's going concern position as at 31 December 2018, the Directors have considered the lack of certainty in relation to any Part VII transfer and a number of other factors, including the current financial position, the principal and emerging risks which could impact the performance of the Company and the strategic and financial plan of the Group which includes future projections of profitability, capital adequacy, liquidity and funding. The assessment concluded that, for the foreseeable future, the Company has sufficient capital to support its operations; has a funding and liquidity base which is strong, robust and well managed with future capacity; and has expectations that the Company's trading performance will continue to support execution of the Group's strategy.

As a result of the assessment, the Directors have a reasonable expectation that the Company will have adequate resources to continue in operational existence for the foreseeable future and therefore believe that the Company is well placed to manage its risks successfully in line with its business model and strategic aims. Accordingly, they continue to adopt the going concern basis in preparing the financial statements.

Notes to the financial statements (continued)
Section 1: Basis of preparation and accounting policies (continued)

1.5 Foreign currency

Items included in the financial statements are measured using the currency of the primary economic environment in which the Company operates (the 'functional currency'). The financial statements are presented in pounds sterling (GBP), which is also the Company's presentation currency, rounded to the nearest hundred thousand pounds sterling (£0.1m) unless otherwise stated.

The Company records an asset, liability, expense or revenue arising from a transaction using the closing exchange rate between the functional and foreign currency on the transaction date. At each subsequent reporting date, the Company translates foreign currency monetary items at the closing rate. Foreign exchange differences arising on translation or settlement of monetary items are recognised in the income statement during the year in which the gains or losses arise.

Foreign currency non-monetary items measured at historical cost are translated at the date of the transaction, with those measured at fair value translated at the date when the fair value is determined. Foreign exchange differences are recognised directly in equity for non-monetary items where any component of associated gains or losses is recognised directly in equity. Foreign exchange differences arising from non-monetary items, whereby the associated gains or losses are recognised in the income statement, are also recognised in the income statement.

1.6 Accounting policies

(a) 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 Virgin Money Executive Committee). The Company has therefore determined that it has no reportable operating segments and is not required to produce additional segmental disclosure.

(b) Net interest income

'Interest income' and 'interest expense and similar charges' in the income statement reflect income or expenditure derived using the effective interest rate method, which includes (1) interest on all financial instruments measured at amortised cost; and (2) interest income on debt securities measured at fair value through other comprehensive income, and prior to 1 January 2018 recognised as financial assets available-for-sale.

The effective interest rate 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 gross 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, loan commitment fees and all other premiums and discounts.

Once a financial asset or group of similar financial assets has been categorised as credit-impaired (stage 3), interest income is recognised on the net carrying value (after impairment allowances) using the asset's original effective interest rate, being the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

Interest income and interest expense on derivatives designated as hedging instruments are recognised as part of net interest income (not as part of the fair value movement of the derivative), and are recorded as a reduction to the gross interest income or interest expense derived using the effective interest rate method on the related hedged asset or hedged liability.

Interest income and expense on derivatives economically hedging interest bearing financial assets or liabilities (but not designated as hedging instruments) are also recognised within net interest income. From 1 January 2018, IAS 1 'Presentation of financial statements' prohibits the inclusion of interest on derivatives not designated as hedging instruments within 'Interest income', therefore interest income or expense relating to derivatives economically hedging interest bearing assets is now presented within 'Other similar interest'. Previously the Company presented interest on such derivatives consistently with interest on derivatives designated as hedging instruments for interest bearing assets.

Notes to the financial statements (continued)
Section 1: Basis of preparation and accounting policies (continued)

1.6 Accounting policies (continued)

(c) Gains less losses on financial instruments
This represents fair value gains and losses from three distinct activities:

- derivatives classified as fair value through profit or loss - the change in fair value of the derivatives is recognised exclusive of interest income and expense arising on any such instruments economically hedging other interest bearing assets and liabilities (see policy (b)).
- hedged assets, liabilities and derivatives designated in fair value hedge relationships - fair value movements attributable to the hedged risk on the hedged item and fair value movements on the hedging derivative (excluding interest as per policy (b)) in a fair value hedge relationship (the net of which represents hedge ineffectiveness), and
- derivatives designated in cash flow hedge relationships - fair value movements recycled to the income statement in line with hedged items affecting profit or loss and any hedge ineffectiveness recognised immediately in the income statement.

(d) Other operating income
The Company adopted IFRS 15 'Revenue from contracts with customers' on 1 January 2018 and its other operating income streams fall within its scope. IFRS 15 requires the Company to recognise revenues at the point in time or over the period in which its performance obligations to customers for services are satisfied. Under the previous accounting standard (IAS 18) the Company recognised revenues when the risks and rewards of the service were transferred to the customer.

The Company reviewed its material contractual arrangements and related performance obligations against the new standard's requirements, concluding that no change was required to the Company's previously applied accounting to these income streams, including determination of the amount of revenue to be recognised and the timing of recognition of that revenue (see note 1.9).

However, the Company has revised its accounting polices compared to those disclosed in the prior year Annual Report and Accounts to reflect the revised disclosure requirements and differences in terminology between IFRS 15 and IAS 18. The policy below for credit card fee income aligns to the material disaggregated categories of services provided to the Company's customers as disclosed in the 'Non-interest income' note to the financial statements (see note 2.2).

Credit card fee income
This represents credit card fees receivable from customers that are not relating to origination of the lending or integral to the yield of the credit card financial asset and hence are excluded from determination of the asset's effective interest rate. Income comprises fees for certain chargeable transactions made by cardholders subsequent to origination, in addition to the Company's share of interchange fees receivable.

Revenue is recognised at the point in time that the Company has fulfilled its obligation to process the relevant transaction for the customer, which is the date of the transaction. This results in revenue recognition consistent with the previous accounting policy.

(e) Personnel expenses

Salaries, wages and non-cash benefits and social security costs
This includes salaries, short-term non-cash benefits and social security costs recognised over the period in which the employees provide the services to which the payments and benefits 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 that employees are required to provide services.

Defined contribution pension expense
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. Defined contribution pension expense represents contributions recognised in the periods during which related employee services are fulfilled.

Share based compensation
The Group operated a number of equity settled share based payment schemes in respect of services received from certain of its employees. Employees are employed by the Company but received either Virgin Money Holdings (UK) PLC or CYBG PLC shares.

The value of the employee services received in exchange for awards granted under these schemes was recognised as an employee expense with a corresponding increase in equity over the period that the employees became unconditionally entitled to the awards (the vesting period). All awards granted under current schemes were conditional shares which had service conditions. The Long Term Incentive Plan awards also had non-market performance conditions. No awards had market performance conditions and no share options were granted in the current or prior year.

The employee expense was determined by reference to the fair value of the number of shares that were expected to vest. The fair value of the shares granted was based on market prices at the date of award. The determination of fair values excluded the impact of service conditions and any non-market performance conditions, which were included in the assumptions used to estimate the number of shares that were expected to vest. At each balance sheet date, this estimate was reassessed and if necessary revised. Any revision of the original estimate was recognised in the income statement, together with a corresponding adjustment to equity.

Notes to the financial statements (continued)
Section 1: Basis of preparation and accounting policies (continued)

1.6 Accounting policies (continued)

(f) Other operating and administrative expenses
Other operating and administrative expenses, in addition to costs associated with the scheme of arrangement are recognised on an accruals basis as services are provided.

Other operating and administrative expenses include those on operating leases. 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 the income statement in the period in which termination is made.

(g) Impairment losses on credit exposures
On 1 January 2018, the Company adopted IFRS 9 'Financial Instruments' and calculated expected impairment losses in accordance with this accounting standard from that date. Full details of the accounting policies are included in Note 5.4. For the year ended 31 December 2017, the Group applied IAS 39 'Financial Instruments: Recognition and Measurement':

IAS 39 'Financial Instruments: Recognition and Measurement' accounting policies
In the prior year, the Company applied IAS 39 'Financial Instruments: Recognition and Measurement' and calculated impairment losses on an incurred basis. A summary of the prior year accounting policy is set out below.

The Company assessed its financial assets or groups of financial assets for objective evidence of impairment at each balance sheet date. An impairment loss was recognised if a loss event (or events) had 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 could be reliably measured. Losses incurred as a result of events occurring after the balance sheet date were not recognised in these financial statements.

Loans and receivables at amortised cost
The Company assessed whether objective evidence of impairment existed individually for financial assets that were individually significant. Financial assets that were not individually significant were assessed on a collective basis, except for such assets where there were specific circumstances indicating evidence of impairment (for example loans that had entered possession or where fraud had been committed).

If the Company determined that no objective evidence of impairment existed for an individually assessed financial asset, whether significant or not, it included the asset in a group of financial assets with similar credit risk characteristics and collectively assessed them for impairment. In assessing collective impairment for retail assets the Company used 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 was performed to ensure model assumptions remained appropriate.

Assets that were individually assessed and for which an impairment loss was recognised were not included in a collective assessment of impairment.

If there was objective evidence that an impairment loss on loans and receivables had occurred, the amount of the loss was measured as the difference between the asset carrying amount and the present value of the estimated future cash flows (excluding future credit losses that had not occurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset was reduced through the use of an impairment allowance and the amount of the loss was recognised in profit or loss.

When a loan or receivable was uncollectible, it was written off against the related allowance for loan impairment. Such loans were written off after all the necessary procedures had been completed and the amount of the loss had been determined. Subsequent recoveries of amounts previously written off were recognised directly in the income statement. If, in a subsequent period, the amount of the impairment loss decreased and the decrease was 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 was reversed by adjusting the impairment allowance. The amount of the reversal was recognised in profit or loss.

An allowance was also made in the case of accounts which were not in arrears, where losses had been incurred but not yet recognised. An increased allowance was held for accounts where an impairment trigger event had occurred which included accounts benefitting from forbearance and those in arrears. Refer to the Risk Report for details of the forbearance policy.

Available-for-sale financial assets
The Company assessed at each balance sheet date whether there was objective evidence that a financial asset was impaired. The loss was measured as the difference between the asset's acquisition cost less principal repayments and amortisation and its fair value. The impairment loss was recognised in profit or loss. This included cumulative gains and losses previously recognised in other comprehensive income which were 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 increased and the increase was objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss was reversed through profit or loss. Impairment losses recognised in profit or loss on equity instruments were not reversed through profit and loss.

Notes to the financial statements (continued)
Section 1: Basis of preparation and accounting policies (continued)

1.6 Accounting policies (continued)

(h) Taxation

Taxation comprises current tax and deferred tax. Current tax and deferred tax are recognised in the income statement 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.

Deferred tax is recognised in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

Deferred tax assets are recognised for unused tax losses, tax credits and deductible temporary differences, to the extent that it is probable that future taxable profits will be available against which they can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

(i) Financial assets and liabilities

On 1 January 2018, the Company adopted IFRS 9 'Financial Instruments' which replaces IAS 39 'Financial Instruments: Recognition and Measurement'. The key areas of change to the accounting policy are presented in note 5.4 - Transition to IFRS 9. The introduction of IFRS 9 did not significantly change the classification and measurement of financial liabilities, and those IFRS 9 accounting policies are presented here.

Recognition and derecognition

A financial asset or a financial liability is recognised on the balance sheet when the Company becomes party to the contractual provisions of the instrument. Purchases and sales of financial assets classified within fair value through profit or loss are recognised on trade date.

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

Financial liabilities are derecognised when the Company has discharged its obligation to the contract, or the contract is cancelled or expires.

Classification and measurement of 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, amounts due to controlled structured entities and debt securities in issue are recognised initially at fair value, being the issue proceeds net of premiums, discounts and transaction costs incurred. All borrowings are subsequently measured at amortised cost using the effective interest rate method. Amortised cost is adjusted for the amortisation of any premiums, discounts and transaction costs. The amortisation is recognised in 'Interest expense and similar charges' using the effective interest rate method.

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.

Notes to the financial statements (continued)
Section 1: Basis of preparation and accounting policies (continued)

1.6 Accounting policies (continued)

(i) Financial assets and liabilities (continued)

IAS 39 'Financial Instruments: Recognition and Measurement' accounting policies

In the prior year, the Company applied IAS 39 'Financial Instruments: Recognition and Measurement'. A summary of the prior year accounting policy is set out below.

Financial assets

Management determined the classification of its financial instruments at initial recognition, and they were 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 were recognised on the trade date, the date on which the Company committed 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 was no active market, were classified as loans and receivables. Loans and receivables were non-derivative financial assets with fixed or determinable payments that were not quoted in an active market, whose recoverability was based solely on the credit risk of the customer and where the Company had no intention of trading the loan or receivable. Loans and receivables were initially recognised at fair value including direct and incremental transaction costs. Subsequent recognition was at amortised cost using the effective interest rate method, less any provision for impairment.

Available-for-sale financial assets

Available-for-sale financial assets were non-derivative assets that were either designated as available-for-sale or were assets that did not meet the definition of loans and receivables and were not derivatives or assets held at fair value through profit or loss. These were principally, but not exclusively, investment securities intended to be held for an indefinite period of time which could be sold in response to a need for liquidity or changes in interest rates, exchange rates or equity prices. They were initially measured at fair value including direct and incremental transaction costs. With the exception of certain unquoted equity instruments measured at cost less impairment because their fair value could not be measured reliably, subsequent measurement was at fair value, with changes in fair value recognised in other comprehensive income except for impairment losses and translation differences, which were recognised in profit or loss. Upon derecognition of the asset, or where there was objective evidence that the investment security was impaired, the cumulative gains and losses recognised in other comprehensive income were removed from other comprehensive income and recycled to profit or loss.

Held to maturity financial assets

Held to maturity financial assets were non-derivative financial assets with fixed or determinable payments that the Group had the ability and intention to hold to maturity. No financial assets were classified as held to maturity during the prior year.

Financial assets at fair value through profit or loss

This category consisted of derivative financial assets. Assets in this category were carried at fair value. The fair values of derivative instruments were calculated by discounted cash flow models using yield curves that were based on observable market data or were based on valuations obtained from counterparties. Gains and losses arising from the changes in the fair values were recognised in the income statement or other comprehensive income.

(j) Cash and balances with central banks or due from other banks

These are classified as financial assets at amortised cost (see policy (i)).

(k) Financial assets available-for-sale

Prior to 1 January 2018, the Company's debt securities and equity instruments were classified as financial assets available-for-sale. Equity instruments were classified as available-for-sale because they did not meet the definition of loans and receivables under IAS 39, as they have no defined maturity dates and were not derivatives or assets held at fair value through profit or loss.

1.6 Accounting policies (continued)

(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, foreign exchange rates and equity exposures inherent in the Company's assets, liabilities and positions. All derivative transactions are for economic hedging purposes, to bring risk exposure in line with the Company's risk appetite as set out in the Risk Report, and it is decided at the outset which position the derivative will be hedging. Derivatives are reviewed regularly for their effectiveness as hedges and corrective action taken, if appropriate. Derivatives are measured initially and subsequently at fair value. Fair values are calculated by discounted cash flow models using yield curves that are based on observable market data or are based on valuations obtained from counterparties. Where derivatives are not designated as part of an accounting hedge relationship, changes in fair value are recorded in the income statement. Where derivatives are designated within accounting hedge relationships, the treatment of the changes in fair value depends on the nature of the hedging relationship as explained below.

Hedge accounting is used for derivatives designated in this way provided certain criteria are met. The 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 inception and on an ongoing basis of whether the derivatives used in hedging transactions are highly effective in offsetting changes in the fair values of hedged items. The Company designates certain derivatives as fair value hedges.

Fair value hedges
It is the Company's strategy to apply fair value hedge accounting to keep interest rate sensitivities within risk appetite. Applying fair value hedge accounting enables the Company to reduce fair value fluctuations of fixed rate financial assets, such as fixed rate loans, as if they were floating rate instruments linked to the attributable benchmark rate. 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 (see policy (c)). If the hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of the hedged item is amortised to the income statement over the period to maturity.

The most frequently used fair value hedges are:

- hedging the interest rate risk of a portfolio of prepayable fixed rate assets with interest rate derivatives. This solution is used to establish a macro fair value hedge for derivatives hedging fixed rate mortgages;
- hedging the interest rate risk of a portfolio of non-prepayable fixed rate liabilities with interest rate derivatives. This solution is used to establish a macro fair value hedge for derivatives hedging fixed rate savings;
- hedging the interest rate risk of non-prepayable fixed rate assets with interest rate derivatives. This solution is used to establish micro fair value hedges for fixed rate investments; and
- hedging the interest rate risk of non-prepayable, foreign currency denominated fixed rate assets or liabilities on a one-for-one basis with fixed/floating or floating/fixed cross currency interest rate swaps. This solution is used to establish micro fair value hedges for foreign currency denominated fixed rate investments.

Hedge ineffectiveness can arise from:

- Differences in timing of cash flows of hedged items and hedging instruments
- Different interest rate curves applied to discount the hedged items and hedging instruments
- Derivatives used as hedging instruments having a non-nil fair value at the time of designation

Additionally, for portfolio fair value hedges of the Company's fixed rate mortgage portfolio, ineffectiveness also arises from the disparity between expected and actual prepayments (prepayment risk).

For its mortgage portfolio, the Company follows a dynamic hedging strategy. Whilst the Company's overall hedging strategy remains to reduce fair value fluctuations of fixed rate financial mortgages as if they were floating rates instruments linked to the attributable benchmark rates. From an operational point of view, the Company de-designates the previous hedge relationships and replaces them with new ones on a predominantly monthly basis.

(m) Loans and advances to customers
The Company's loans and advances to customers are classified as financial assets at amortised cost (see policy (i)).

Notes to the financial statements (continued)
Section 1: Basis of preparation and accounting policies (continued)

1.6 Accounting policies (continued)

(n) Property, plant and equipment and depreciation
Property, plant and equipment 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 recognised within 'Depreciation and amortisation expense' and provided using the straight line method to allocate costs less residual values over estimated useful lives, as follows:

Freehold buildings	50-100 years
Long leasehold land and buildings	Unexpired period of the leases
Building improvements	5-30 years
Computer equipment	3-5 years
Office fixtures and 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 property, plant and equipment
Property, plant and equipment 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 the 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.

(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 to 10 years.

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 is recognised within 'Depreciation and amortisation expense' and commences on the date that the asset is brought into use.

Internally generated intangible assets relate to capitalised software costs.

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. This includes banking platforms which primarily represent the construction of operating platforms, and are internally generated The capitalised 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.

1.6 Accounting policies (continued)

(o) Intangible assets and amortisation (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) 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.

(q) Other assets
Other assets include prepayments and amounts the Company is due to receive from third parties, including unconditional rights to consideration for services provided in the normal course of business to customers.

(r) Due to other banks
Amounts due to other 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.

Sale and repurchase agreements
Securities sold subject to repurchase agreements (repos) are not derecognised in financial statements, but represent assets pledged when the transferee has the right by contract or custom to sell or repledge the collateral. The counterparty liability is included in 'Due to other banks' or 'Customer deposits, as appropriate. Securities purchased under agreements to resell (reverse repos) are recorded as 'Due from other banks' or 'Loans and advances to 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.

(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 for liabilities and charges
Provisions are recognised for present obligations arising from past events where it is more likely than not that an outflow of resources will be required to settle the obligations and they can be estimated reliably. Provisions for levies are recognised when the conditions that trigger the payment of the levy are met.

(u) Debt securities in issue and securitisation
Issued securities are classified as financial liabilities where the contractual arrangements result in the Company having an obligation to deliver either cash or another financial asset to the security holder, or to exchange financial instruments under conditions that are potentially unfavourable to the Company. Issued securities are classified as equity where they meet the definition of equity and confer a residual interest in the Company's assets on the holder of the securities.

Financial liabilities are carried at amortised cost using the effective interest rate method. Equity instruments are initially recognised at net proceeds, after deducting transaction costs and any related income tax. Appropriations to holders of equity securities are deducted from equity, net of any related income tax, as they become irrevocably due to the holders of the securities.

Securitisation is a means used by the Company to fund an element of its mortgage portfolio. These securitised advances are subject to non-recourse finance arrangements. These advances have been legally transferred at their principal value to structured entities with a deemed loan liability for 'Amounts due to controlled structured entities' recognised for the proceeds of the funding transaction. The securitised loans and advances to customers remain on the Company balance sheet.

Notes to the financial statements (continued)
Section 1: Basis of preparation and accounting policies (continued)

1.6 Accounting policies (continued)

(u) Debt securities in issue and securitisation (continued)
The Company has also invested in certain debt securities issued by its controlled structured entities which may be used as collateral for repurchase or similar transactions. Such investments and the equivalent deemed loan, together with the related income, expense and cash flows, are not recognised in the financial statements. Where the Company uses its financial assets to raise finance through securitisations and the sale of securities subject to repurchase agreements, this leads to the assets becoming encumbered. Once encumbered, the assets are not available for transfer around the Company.

(v) Funding for Lending Scheme
The Company participated in the Bank of England's Funding for Lending Scheme (FLS). The scheme allowed 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 did 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 (i) were not satisfied. Therefore the collateral assets continued to be recognised in the financial statements and the Treasury bills were not separately recognised.

In the event that Treasury bills were utilised for repo transactions, the related collateral assets were categorised as pledged assets and the associated liability to the counterparty was recognised in the financial statements.

(w) Other liabilities
Other liabilities represent amounts the Company is due to pay to third parties in the normal course of business. Accruals represent amounts for expenses that the Company is due to pay to third parties in the normal course of business which have been incurred, but not yet billed.

Deferred income represents amounts advanced from a corporate partner that will be recognised in future periods. The Company does not have any material deferred income contract liabilities relating to revenues from contracts with customers.

(x) Share capital and share premium

The financial instruments issued by the Company are treated as equity (i.e. forming part of shareholders' funds) only to the extent that they meet the following two conditions:

- they include no contractual obligations upon the Company to deliver cash or other financial assets or to exchange financial assets or financial liabilities with another party under conditions that are potentially unfavourable to the Group; and
- where the instrument will or may be settled in the Company's own equity instruments, it is either a non-derivative that includes no obligation to deliver a variable number of the Company's own equity instruments or is a derivative that will be settled by the Company exchanging a fixed amount of cash or other financial assets for a fixed number of its own equity instruments.

To the extent that this definition is not met, the proceeds of issue are classified as a financial liability.

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 are recognised in equity in the period in which they are approved by the Company's shareholders or paid.

(y) Other equity instruments
Issued financial instruments are recognised as other equity instruments where there is no contractual obligation to deliver either cash or another financial asset and the legal form of the instruments are not shares of the Company. The proceeds are included in equity, net of transaction costs. Distributions and other returns to holders of these instruments are treated as a deduction from equity.

Notes to the financial statements (continued)
Section 1: Basis of preparation and accounting policies (continued)

1.6 Accounting policies (continued)

(z) Other reserves

Revaluation reserve financial instruments at fair value through other comprehensive income
The reserve records the unrealised gains and losses arising from changes in the fair value of financial instruments at fair value through other comprehensive income. The opening balance of this reserve included unrealised gains and losses previously recognised in the 'Available-for sale reserve' for financial assets available for sale reclassified on 1 January 2018 to financial instruments at fair value through other comprehensive income on adoption of IFRS 9.

On derecognition of these financial assets, the cumulative gains or losses previously recognised in this reserve are recycled to the income statement and recognised in 'Other operating income', except for equity investments where the cumulative gains or losses are transferred within equity to 'Retained earnings'

Available-for-sale reserve
The available for sale reserve recorded the unrealised gains and losses arising from changes in the fair value of financial assets available-for-sale prior to 1 January 2018. On adoption of IFRS 9 on 1 January 2018 the balance on this reserve was transferred to the 'Revaluation reserve for financial instruments at fair value through other comprehensive income'.

On any derecognition of financial assets available for sale prior to 1 January 2018, the cumulative gains or losses previously recognised in this reserve were recycled to the income statement and recognised in 'Other operating income'.

(aa) Contingent liabilities
Contingent liabilities are possible obligations whose existence depends upon the outcome of uncertain future events or are present obligations where the outflows of resources are uncertain or cannot be reliably measured. Contingent liabilities are not recognised in the financial statements but are disclosed unless they are remote.

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

1.7 Critical accounting estimates and judgements

The preparation of financial statements in conformity with IFRS requires Management to make estimates and judgements in the application of accounting policies that affect the reported amounts of assets, liabilities, income and expense. Estimates and judgements are based on historical experience and Management's best knowledge of the amount. Due to the inherent uncertainty in making estimates and judgements, actual results in future periods may be based on amounts which differ from those estimates.

(a) Critical assumptions and sources of estimation uncertainty
The following areas are the critical assumptions concerning the future and the key sources of estimation uncertainty in the reporting period. These areas may have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year:

Effective interest rates
For financial instruments recorded at amortised cost, IFRS 9 requires interest to be measured under the effective interest rate (EIR) method. For the Company this includes interest income earned on mortgages and credit cards, as well as interest expense paid on wholesale liabilities. The EIR rate is determined at inception based upon Management's best estimate of the future cash flows of the financial instrument.

In the event that these estimates are revised at a later date, a present value adjustment may be recognised in profit and loss. This adjustment includes an element that adjusts income previously recognised, as well as an element that adjusts for future interest not yet recognised. Such adjustments can introduce significant volatility. As such the EIR method introduces a source of estimation uncertainty. Management consider the most material risk of adjustment to be in relation to the application of EIR to the Company's credit card portfolio.

The Company offers a range of credit card products. Interest income is recorded under the EIR method, which provides a level yield over the life of the card. Management model expected future cash flows over the estimated customer life, supported by observed experience, with a restriction on the maximum modelling period applied.

Management uses estimates and assumptions of future customer behaviour. These include the estimation of utilisation of available credit, transaction and repayment activity and the retention of the customer balance after the end of a promotional period. Should Management's current estimation of future cash flows be inaccurate to the extent that the original effective interest rates on unsecured cohorts were all reduced by 0.1%, the present value adjustment to interest income, in relation to the revised future cash flows, would be approximately £13.0m as at 31 December 2018.

Expected credit losses (impairment) on loans and advances to customers
Critical assumptions and the key sources of estimation uncertainty in relation to the calculation of expected credit losses on loans and advances to customers are outlined in note 5.4.

Fair value of financial assets and liabilities
Management must use estimation when calculating the fair value of financial instruments categorised as level 2 and level 3 (as defined by IFRS 13). In these instances the necessary valuation inputs are not observable and/or specific factors may need to be considered. Details of the Group's level 2 and level 3 financial instruments are included in note 3.16.

The most significant area of estimation uncertainty relates to the Company's level 2 derivative financial instruments, where valuations are not derived from quoted prices. The accuracy of fair value calculations would be affected by unexpected market movements and any inaccuracies within the discounted cash flow models used, particularly use of incorrect interest yield curves. For example, to the extent the interest yield curve differed by +/- 10 bps, the net impact on fair values of derivative financial instruments would be an estimated increase of £42.9m (2017: £41.7m) or decrease of £43.1m (2017: £41.9m) respectively.

(b) Critical judgements in applying accounting policies
The following are the critical judgements that have been made in the process of applying the Company's accounting policies that have the most significant effect on the amount recognised in the financial statements:

Assessment for impairment indicators relating to intangible assets
Management judgement is required in assessing whether intangible assets exhibit any indicators of impairment at the reporting date. If there are indicators of impairment, an estimate of the recoverable amount is made which may indicate the need for an impairment charge to be recognised.

Management have assessed and reviewed intangible assets for the existence of impairment indicators. This exercise identified the decision to discontinue development of the Company's digital bank programme as an indicator of impairment for the related intangible asset, resulting in an impairment charge of £67.5m being recognised in the financial statements.

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

1.8 Presentation changes in respect of the financial statements

The Company has made a number of changes to names of line items and subheaders shown on the income statement and the balance sheet to reflect alignment of terminology with that used by the Group's immediate parent, Clydesdale Bank PLC. Further details are provided in the table below:

Description within 2017 Annual Report	Revised description
Fair value losses on financial instruments	Gains less losses on financial instruments at fair value
Other income	Non-interest income
Total income	Total operating income
Operating expenses	Total operating and administrative expenses
Profit before tax from operating activities	Operating profit before impairment losses
Impairment	Impairment losses on credit exposures
Taxation	Tax expense
Cash and balances at central banks	Cash and balances with central banks
Loans and advances to banks	Due from other banks
Available-for-sale financial assets	Financial assets available-for-sale
Tangible fixed assets	Property, plant and equipment
Deposits from banks	Due to other banks
Current tax liabilities	Current taxes

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

1.9 New accounting standards and interpretations

(a) New accounting standards and interpretations adopted
The Company has adopted the following International Accounting Standards Board (IASB) pronouncements from 1 January 2018.

IFRS 9
IFRS 9 *'Financial Instruments'*, which replaced IAS 39 *'Financial Instruments: Recognition and Measurement'*. The IFRS 9 accounting policies and transitional disclosures are set out in note 5.4, and as allowed by the standard, comparatives have not been restated.

IFRS 15
IFRS 15 *'Revenue from contracts with customers'*, which replaced IAS 18 *'Revenue'* and IAS 11 *'Construction contracts'*. Financial instruments and other contractual rights or obligations within the scope of IFRS 9 are excluded from the scope of this standard, and as a substantial proportion of the Company's income is generated from financial instruments, adoption of IFRS 15 has not had a significant impact on the Company's revenue recognition.

The disclosure requirements of IFRS 15 are more extensive than those required by the standards it replaced. The disclosure requirements include qualitative information for all material revenue streams within the scope of the standard, including the Company's accounting policies; significant judgements applied in determining those policies; and material performance obligations in contracts with customers.

These qualitative disclosures can be found in the 'Other operating income' policy within note 1.6. In addition to the qualitative disclosures, the standard requires disaggregated quantitative disclosure of material revenue streams, which are provided in note 2.2.

Amendment to IAS 1 for presentation of interest income
Paragraph 82(a) of IAS 1 *'Presentation of Financial Statements'* requires interest revenue calculated using the effective interest rate (EIR) method to be presented separately on the face of the income statement. This implies that interest income calculated using the EIR method is to be differentiated and presented separately from interest calculated using other methods.

The Company considers its net interest income as an important performance indicator. These include both interest calculated using the effective interest method and interest recognised on a contractual basis on its derivative financial instruments measured at fair value through profit and loss. The Company has therefore concluded that including an additional line item entitled, 'Other similar interest' in order to show all interest, is consistent with its internal reporting of the net interest income and provides relevant and reliable information to its stakeholders.

Other amendments adopted
The Company also adopted a number of minor interpretations and amendments to other accounting standards, which were endorsed for adoption by the EU, and mandatory for annual reporting periods beginning on or after 1 January 2018. These included amendments to IFRS 2 'Share based payments', amendments published through the Annual Improvements to IFRS 2014-2016 cycle and other 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.

(b) New accounting standards and interpretations not yet adopted

IFRS 16
IFRS 16 *'Leases'* was issued in January 2016 and it replaces IAS 17 *'Leases'*, IFRIC 4 *'Determining whether an Arrangement contains a Lease'*, SIC-15 *'Operating Leases-Incentives'* and SIC-27 *'Evaluating the Substance of Transactions Involving the Legal Form of a Lease'*. IFRS 16 is effective for annual periods beginning on or after 1 January 2019 and was EU endorsed on 31 October 2017.

IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of 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 right-of-use asset is initially measured at cost, which comprises the initial amount of the lease liability adjusted for any lease payments made at or before the commencement date, plus any initial direct costs incurred and an estimate of costs to restore the underlying asset, less any lease incentives received.

The right-of-use asset is subsequently depreciated using the straight-line method from the commencement date to the earlier of the end of the useful life of the right-of-use asset or the end of the lease term. In addition, the right-of-use asset is periodically reduced by impairment losses, if any, and adjusted for certain remeasurements of the lease liability.

The lease liability is initially measured at the present value of the lease payments that are not paid at the commencement date, discounted using the interest rate implicit in the lease or, if that rate cannot be readily determined, the incremental borrowing rate is used for the discount rate.

The lease liability is measured at amortised cost using the effective interest method. It is remeasured when there is a change in future lease payments arising from a change in an index or rate, if there is a change in amount expected to be payable under a residual value guarantee, or if there is a change in the assessment of whether a purchase, extension or termination option will be exercised.

When a lease liability is remeasured in this way, a corresponding adjustment is made to the carrying amount of the right-to-use asset, or is recorded in the Income Statement if the carrying amount of the right-of-use asset has been reduced to zero.

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

1.9 New accounting standards and interpretations (continued)

(b) New accounting standards and interpretations not yet adopted (continued)

IFRS 16 (continued)
The Company has less than 100 operating leases in which it is a lessee, the majority of which are property leases relating to the Store and Lounge network.

Transition approach and use of practical expedients
The Company will elect to apply the practical expedient to grandfather the assessment of which transactions are leases. It will apply IFRS 16 only to contracts that were previously identified as leases. Contracts that were not identified as leases under IAS 17 and IFRIC 4 will not be reassessed. Therefore, the definition of a lease under IFRS 16 will only be applied to contracts entered into or changed on or after 1 January 2019.

The Company will also elect to apply the recognition exemptions for short-term and low value item leases. Lease payments associated with these leases will be recognised as an expense on a straight-line basis over the term of the lease.

The Company will apply IFRS 16 using the modified retrospective approach, under which the cumulative effect of initial application is recognised in retained earnings at 1 January 2019 and comparatives are not restated.

Under the modified approach, at transition, lease liabilities will be measured at the present value of the remaining lease payments, discounted at the Company's incremental borrowing rate as at 1 January 2019.

For the purposes of applying the modified retrospective approach, the Company will elect to:

- measure the right-of-use asset as if it had applied IFRS 16 at the commencement date using its incremental borrowing rate at the date of initial application for the majority of its leases except where the required information is not available;
- for leases where the required information is not available, measure the right-of-use asset at an amount equal to the lease liability at the date of initial application adjusted by the amount of any prepaid or accrued lease payments;
- use hindsight when determining lease term if the contract contains options to extend or terminate the lease;
- apply the practical expedient to exclude initial direct costs from measuring the right-of-use asset at the date of initial application;
- apply the exemption not to recognise right-of-use assets and liabilities for leases with less than 12 months of lease term; and
- apply the practical expedient to rely on its assessment whether the lease was onerous under IAS 37 and therefore adjust the right-of-use asset at the date of initial application by the onerous lease provision rather than conduct an impairment test.

Key accounting judgements
The Company undertook a technical assessment of IFRS 16. The two key accounting judgements in relation to IFRS 16 are determining the discount rates and lease term.

When measuring the lease liability, lease payments are discounted using the interest rate implicit in the lease or, if that rate cannot be readily determined, the incremental borrowing rate is used for the discount rate. Under the modified retrospective approach, the Company will use its incremental borrowing rate at the date of initial application as the discount rate. Judgement will be required to determine an appropriate incremental borrowing rate.

When determining lease term, an assessment is required of whether an extension or termination option will be exercised. This is reassessed if there is a significant event or significant change in circumstances within the Company's control. Judgement is required when making this assessment however currently, the Company has very few leases which include extension or termination options.

Impact of transition to IFRS 16
The Company has developed an IFRS 16 model to calculate the lease liabilities and right-of-use assets.

On transition to IFRS 16, the Company estimates it will recognise right-of-use assets of approximately £28m and lease liabilities of approximately £32m. The Company will not restate comparative periods.

The Company continues to refine, monitor and validate certain elements of the IFRS 16 model and related controls ahead of full reporting of IFRS 16 impacts later in 2019.

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

1.9 New accounting standards and interpretations (continued)

(b) New accounting standards and interpretations not yet adopted (continued)

Amendment to IAS 12 for income tax consequences of distributions from equity
The amendment applies for accounting periods beginning on or after 1 January 2019 and clarifies that the income tax consequences of distributions on financial instruments classified as equity should be recognised according to where the past transactions or events that generated the distributable profits were recognised.

The Company has assessed that, on adoption of this amendment, the taxation impacts of distributions relating to Additional Tier 1 (AT1) securities would be recognised within 'Tax expense' in the Income Statement. Currently these taxation impacts are recognised directly in 'Retained earnings' within Equity. As the amendment impacts only the presentation of taxation impacts but not their calculation, adoption will not result in any change to the Company's net assets, but will result in an increase in 'Profit for the year attributable to equity holder' compared to existing practice.

If the Company had applied the amendment in these financial statements, the Profit for the year attributable to equity holder would have been £5.4m (2017: £5.5m) higher than that disclosed in the income statement, with an equivalent reduction to 'Tax expense'.

Other standards and amendments not yet adopted
No other new standards, amendments to standards or interpretations which have been published, but are not yet effective, are expected to have a material impact on the Company.

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

2.1 Net interest income

	2018 **£m**	2017 £m
Interest income		
Cash and balances with central banks	**24.2**	6.3
Due from other banks	**0.6**	0.4
Financial instruments at fair value through other comprehensive income	**13.6**	-
Financial assets available-for-sale	**-**	5.6
Loans and advances to customers	**1,035.1**	953.8
Other interest income	**0.7**	1.4
Total interest income	**1,074.2**	967.5
Other similar interest		
Derivatives economically hedging interest bearing assets	**(2.3)**	(2.8)
Total other similar interest	**(2.3)**	(2.8)
Interest expense and similar charges		
Due to other banks	**(47.5)**	(16.5)
Customer deposits	**(369.9)**	(310.8)
Debt securities in issue	**(12.0)**	(4.3)
Amounts due to controlled structured entities	**(37.4)**	(29.3)
Other	**(3.9)**	(9.1)
Total interest expense and similar charges	**(470.7)**	(370.0)
Net interest income	**601.2**	594.7

2.2 Non-interest income

	2018 **£m**	2017 £m
Gains less losses on financial instruments at fair value		
Derivatives used for economic hedging but not in hedge accounting relationships	**(4.8)**	4.4
Ineffectiveness arising from fair value hedges (note 3.4)	**16.1**	5.4
Gains less losses arising from other financial instruments	**3.0**	-
	14.3	9.8
Other operating income		
Fees and commissions		
Credit cards	**27.3**	18.2
Other	**3.6**	3.4
Gains on disposal of financial instruments at fair value through other comprehensive income	**1.3**	-
Gains on disposal of financial assets available-for-sale	**-**	8.4
Other income	**4.6**	4.9
	36.8	34.9
Non-interest income	**51.1**	44.7

Other operating income presented above has been disaggregated to provide income amounts for material categories of products and services provided by the Company, in accordance with the disclosure requirements of IFRS 15 *'Revenues from contracts with customers'*.

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

2.3 Operating and administrative expenses

	2018 £m	2017 £m
Personnel expenses	**241.1**	198.2
Depreciation and amortisation expense (notes 3.8, 3.9)	**31.7**	29.7
Impairment of intangible assets (note 3.9)	**67.5**	4.8
Other operating and administrative expenses	**132.1**	99.4
	472.4	332.1

Personnel expenses comprises the following items:

	2018 £m	2017 £m
Salaries, wages and non-cash benefits and social security costs	**207.7**	177.4
Defined contribution pension expense	**11.4**	10.9
Share based compensation (note 4.2)	**22.0**	9.9
Personnel expenses	**241.1**	198.2

The average monthly number of employees was 3,338 (2017: 3,224)

All staff are contracted employees of the Company. The average figures above do not include contractors.

Other operating and administrative expenses comprises the following items:

	2018 £m	2017 £m
Costs associated with scheme of arrangement	**32.3**	-
Operating lease charges	**10.1**	12.3
Property costs (excluding lease charges)	**18.2**	17.3
Marketing costs	**18.8**	20.8
Telecommunications and IT	**19.2**	18.5
Professional fees (excluding auditor's remuneration)	**26.5**	21.0
Auditor's remuneration	**1.1**	1.1
Other	**5.9**	8.4
Other operating and administrative expenses	**132.1**	99.4

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

	2018 £m	2017 £m
Fees payable to the Company's auditor for the audit of the Company's financial statements	**1.0**	0.9
Total audit fees	**1.0**	0.9
Audit related assurance services	**-**	0.1
Other assurance services	**-**	0.1
Other services	**0.1**	-
Total non-audit fees	**0.1**	0.2
Total fees payable to the Company's auditor[1]	**1.1**	1.1

[1] Amounts shown in 2018 relate only to Ernst & Young LLP and associates. Amounts shown in 2017 relate only to PricewaterhouseCoopers LLP and associates.

As outlined in the Report of the Directors, both Ernst & Young LLP and PricewaterhouseCoopers LLP acted as the Company's auditor during 2018.

In addition to the amounts shown in the table above, total fees of £0.2m were payable to PricewaterhouseCoopers LLP in 2018, comprising audit fees of £0.1m and non-audit fees of £0.1m. Non-audit services provided by PricewaterhouseCoopers LLP in 2018 included audit related assurance on the Company's interim accounts and comfort letters on debt issuance programmes.

Ernst & Young LLP also provided non-audit services to the Group and the Company in 2017. These services all preceded their appointment as the Company's auditors, with total fees amounting to £0.4m.

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

2.4 Taxation

	2018 £m	2017 £m
Current tax		
UK corporation tax		
Current year	**37.1**	58.9
Adjustment in respect of prior years	**(2.5)**	0.6
	34.6	59.5
Deferred tax (note 3.10)		
Current year	**1.7**	12.2
Adjustment in respect of prior years	**1.3**	(0.9)
	3.0	11.3
Tax expense for the year	**37.6**	70.8

The tax assessed for the year differs from that arising from applying the standard rate of corporation tax in the UK of 19.0% (2017: 19.25%). A reconciliation from the charge implied by the standard rate to the actual tax expense is as follows:

	2018 £m	2017 £m
Profit on ordinary activities before tax	**108.6**	263.1
Tax charge based on the standard rate of corporation tax in the UK of 19.0% (2017: 19.25%)	**20.6**	50.6
Effects of:		
Disallowable expenses	**7.2**	0.9
Bank corporation tax surcharge	**10.0**	19.2
Deferred tax in respect of employee share based compensation	**0.9**	-
Impact of rate changes	**0.1**	0.4
Adjustments in respect of prior years	**(1.2)**	(0.3)
Tax expense for the year	**37.6**	70.8

The total amount of tax, current and deferred, recognised directly in equity during the year was a credit of £17.0m (2017: £5.5m).

The charge in respect of the corporation tax surcharge for banks is £10.0m (2017: £19.2m). The surcharge imposes an 8.0% charge on banking profits of the Company (less a £25.0m allowance against those profits).

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

3.1 Cash and balances with central banks

	2018 £m	2017 £m
Cash assets	**4.7**	4.6
Balances with central banks (including EU payment systems)	**3,468.1**	2,574.4
	3,472.8	2,579.0
Less mandatory deposits with central banks	**(94.3)**	(53.0)
Included in cash and cash equivalents (note 5.2)	**3,378.5**	2,526.0

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

3.2 Financial instruments at fair value through other comprehensive income

	2018 £m
UK sovereign exposures	**666.4**
Supranational	**593.2**
Residential mortgage-backed securities	**148.2**
Covered bonds	**616.9**
Debt securities issued by banks	**63.1**
Equity investments	**2.6**
Total financial assets at fair value through other comprehensive income	**2,090.4**

The fair value through other comprehensive income (FVOCI) category was a new financial asset classification category introduced by IFRS 9 *'Financial Instruments'*. The Company has not restated its comparative financial statements on adoption of IFRS 9, as a result no comparator is presented as at 31 December 2017.

Refer to note 3.16 for further information on the valuation methodology applied to financial instruments at fair value through other comprehensive income at 31 December 2018 and their classification within the fair value hierarchy. Details of the credit quality of financial assets is provided in the Risk Report.

3.3 Financial assets available-for-sale

	2017 £m
UK sovereign exposures	207.3
Supranational	234.1
Residential mortgage-backed securities	61.4
Covered bonds	396.5
Equity investments	3.1
Total financial assets available-for-sale	902.4

The available-for-sale classification category for financial assets ceased to apply from 1 January 2018 on transition from IAS 39 to IFRS 9. As a result, no financial assets are classified as available-for-sale as at 31 December 2018.

Refer to note 3.16 for further information on the valuation methodology applied to financial assets available-for-sale at 31 December 2017 and their classification within the fair value hierarchy. Details of the credit quality of financial assets is provided in the Risk Report.

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

3.4 Derivative financial instruments

The Company enters into derivatives for risk management purposes, as explained in the Risk Report and note 1.6(l). Derivatives held for risk management purposes include hedges that meet the hedge accounting requirements or hedges that are economic hedges, but do not meet hedge accounting requirements.

The table below shows the fair value of derivative financial instruments recorded as assets or liabilities together with their notional amounts.

31 December 2018	Carrying value assets £m	Carrying value liabilities £m	Notional amount £m	Balance sheet line item
Derivatives designated as fair value hedges				
Interest rate derivatives (gross)	**80.3**	**(56.2)**	**26,680.1**	
Less: contracts centrally cleared	**(72.8)**	**34.4**	**(23,812.9)**	Other assets
Interest rate derivatives (net)	**7.5**	**(21.8)**	**2,867.2**	Derivative financial instruments
Total derivative assets / (liabilities) in accounting hedge relationships	**7.5**	**(21.8)**	**2,867.2**	Derivative financial instruments
Derivatives in economic hedge relationships				
Interest rate derivatives (gross)	**4.8**	**(14.1)**	**6,730.2**	
Less: contracts centrally cleared	**(0.7)**	**9.8**	**(4,397.1)**	Other assets
Interest rate derivatives (net)	**4.1**	**(4.3)**	**2,333.1**	Derivative financial instruments
Currency derivatives	**4.2**	**(4.4)**	**99.7**	Derivative financial instruments
Total derivative assets / (liabilities) in economic hedge relationships	**8.3**	**(8.7)**	**2,432.8**	Derivative financial instruments
Total recognised derivative assets / (liabilities)	**15.8**	**(30.5)**	**5,300.0**	Derivative financial instruments

31 December 2017	Carrying value assets £m	Carrying value liabilities £m	Notional amount £m	Balance sheet line item
Derivatives designated as fair value hedges				
Interest rate derivatives (gross)	61.7	(91.1)	23,314.7	
Less: contracts centrally cleared	(50.2)	8.5	(17,360.6)	Other liabilities
Interest rate derivatives (net)	11.5	(82.6)	5,954.1	Derivative financial instruments
Total derivative assets / (liabilities) in accounting hedge relationships	11.5	(82.6)	5,954.1	Derivative financial instruments
Interest rate derivatives (gross)	8.1	(13.1)	8,244.5	
Less: contracts centrally cleared	(0.8)	5.7	(4,029.7)	Other liabilities
Interest rate derivatives (net)	7.3	(7.4)	4,214.8	Derivative financial instruments
Currency derivatives	3.2	(3.1)	76.0	Derivative financial instruments
Equity and other options	-	-	3.0	Derivative financial instruments
Total derivative assets / (liabilities) in economic hedge relationships	10.5	(10.5)	4,293.8	Derivative financial instruments
Total recognised derivative assets / (liabilities)	22.0	(93.1)	10,247.9	Derivative financial instruments

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

3.4 Derivative financial instruments (continued)

Fair value hedges

To protect itself against changes in the fair value of financial assets and financial liabilities due to movements in interest rates, the Company enters into fair value hedge relationships. The Company primarily designates the benchmark rate as the hedged risk and, accordingly, enters into interest rate swaps whereby the fixed legs represent the economic risks of the hedged items.

In the below table, the Company sets out the accumulated fair value adjustments arising from the corresponding continuing hedge relationships, irrespective of whether or not there has been a change in hedge designation during the year.

31 December 2018	Carrying amount of hedged items		Accumulated amount of fair value adjustments on the hedged items		Balance sheet line item
	£m	£m	£m	£m	
Fair value hedges					
Interest rate risk					
Fixed rate mortgages	17,642.7	-	-	(39.1)	Loans and advances to customers
Term deposits	-	(7,156.1)	2.7	-	Customer deposits
Fixed rate medium term notes	-	(648.5)	-	(4.2)	Debt securities in issue
Debt securities[(1)]	1,102.2	-	-	-	Financial instruments at fair value through other comprehensive income
Interest rate and Foreign currency risk					
Debt securities[(1)]	79.9	-	-	-	Financial instruments at fair value through other comprehensive income

[(1)] There are no fair value adjustments on the hedged item for fixed rate treasury assets because they are classified at fair value through other comprehensive income (FVOCI). An adjustment relating to the fair value movement of the hedged risk is reclassified from the Revaluation reserve financial instruments at FVOCI to the income statement to offset the fair value movement on the hedging instrument. The accumulated amount reclassified from the Revaluation reserve financial instruments at FVOCI to the Income Statement at 31 December 2018 is a credit of £9.8m for hedges of interest rate risk and a credit of £0.2m for hedges of interest rate and foreign currency risk.

In addition to cumulative fair value adjustments the changes in the fair value of hedged items in loans and advances to customers includes accumulated unamortised fair value hedge adjustments of £(4.8)m related to hedges that have been discontinued and are now amortised. The changes in the fair value of hedged items in customer deposits includes accumulated unamortised fair value hedge adjustments of £0.5m related to hedges that have been discontinued and are now amortised.

The below table sets out the outcome of the Company's hedging strategy, in particular, to changes in the fair value of the hedged items and hedging instruments in the current year and the comparative year, used as the basis for recognising ineffectiveness:

		2018 Gains/(losses) attributable to the hedged risk			2017 Gains/(losses) attributable to the hedged risk		
Hedged item	Hedging instrument	Hedged item £m	Hedging instruments £m	Hedge ineffectiveness £m	Hedged item £m	Hedging instruments £m	Hedge ineffectiveness £m
Fair value hedges							
Fixed rate mortgages	Interest rate swaps	(57.3)	69.9	12.6	(89.2)	106.6	17.4
Term deposits	Interest rate swaps	(1.6)	(2.3)	(3.9)	(3.1)	(7.1)	(10.2)
Fixed rate medium term notes	Interest rate swaps	(1.0)	1.9	0.9	3.2	(3.1)	0.1
Debt securities	Interest rate swaps	(2.6)	2.6	-	(10.9)	10.9	-
Debt securities	Cross currency swaps	1.6	(1.7)	(0.1)	0.6	(0.5)	0.1
Bid Offer adjustments		-	6.6	6.6	-	(2.0)	(2.0)
Total		(60.9)	77.0	16.1	(99.4)	104.8	5.4

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

3.4 Derivative financial instruments (continued)

The maturity profile of the Company's hedging instruments used in fair value hedge relationships is as follows:

31 December 2018 **Notional principal**	Less than 1 month £m	1 to 3 months £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	Total £m
Loans and advances to customers						
Interest rate swaps	285.9	457.1	2,200.7	14,615.7	208.0	17,767.4
Customer deposits						
Interest rate swaps	114.6	2,137.7	4,643.1	268.0	-	7,163.4
Debt securities in issue						
Interest rate swaps	-	-	-	300.0	350.0	650.0
Financial instruments at FVOCI						
Interest rate swaps	-	-	25.0	352.6	643.9	1,021.5
Cross currency swaps	-	-	-	25.0	52.8	77.8

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

3.5 Loans and advances to customers

	2018 **£m**	2017 £m
Residential mortgages	**35,344.5**	33,684.5
Credit cards	**3,378.6**	3,071.3
Overdrafts	**0.1**	0.1
Amounts due from Group companies	**240.0**	359.7
Gross loans and advances to customers	**38,963.2**	37,115.6
Impairment provisions on credit exposures (note 3.6)	**(128.3)**	(59.4)
Fair value of portfolio hedging (note 3.4)	**(39.1)**	43.7
	38,795.8	37,099.9

Securitisation programmes

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

The mortgage loans assigned to structured entities are not treated as sales by the Company and do not qualify for derecognition because the Company remains exposed to the majority of the risks and rewards of the mortgage loan portfolio, principally the associated credit risk. As a result, no gain or loss has been recognised on pledging mortgages to the programme. The securitised mortgage loans are retained on the Company's balance sheet with a deemed loan liability recognised for the proceeds of the funding transaction. There are a number of notes held internally by the Company, not recognised on the balance sheet, which can be used as collateral for repurchases and similar transactions or for credit enhancement purposes.

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

	2018 **£m**	2017 £m
Fair value of transferred assets	**6,508.2**	5,512.6
Fair value of associated liabilities	**2,432.9**	2,300.4

There were no transfer events during the year (2017: none) that resulted in the Company's financial assets being derecognised.

The Company has contractual and non-contractual arrangements which may require it to provide financial support to securitisation structured entities as follows:

The Company provides credit support to the structured entities by holding junior notes and via reserve funds, which are partly funded through subordinated debt arrangements. Exposures totalled £114.1m in subordinated debt (2017: £127.8m) and £3,072.1m in junior notes held (2017: £2,698.6m). The Company has a beneficial interest in the securitised mortgage portfolio held by the structured entities of £1,072.7m (2017: £529.0m).

Furthermore, the Company has an obligation to repurchase mortgage exposures if such mortgage loans no longer meet programme criteria or representations or warranties. Looking forward through future reporting periods there are a number of date based options on the notes issued by the structured entities which could be actioned by them as issuer. These could require the Company, as sponsor, to provide additional liquidity support via the repurchase of remaining mortgage loans at the relevant call date.

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

3.6 Impairment provisions on credit exposures

	2018	2017
	£m	£m
Opening balance	**59.4**	50.1
Changes on adoption of IFRS 9 at 1 January 2018 (note 5.4)	**44.8**	-
Restated opening balance 1 January	**104.2**	50.1
Charge for the year	**71.3**	44.2
Amounts written off	**(47.2)**	(34.9)
Closing balance (note 3.5)	**128.3**	59.4
Specific	**6.4**	1.9
Collective	**121.9**	57.5
	128.3	59.4

At 1 January and 31 December 2018 there is an expected credit loss allowance of £0.2m in relation to amounts ‘Due from other banks’.

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

3.7 Investments in subsidiaries

The following were subsidiaries of the Company during the year:

Direct holdings	Nature of business	Class of share held	Proportion held	Country of incorporation
Eagle Place Covered Bonds LLP	Dormant	N/A[1]	N/A[1]	England
Northern Rock Limited	Dormant	Ordinary	100%	England

[1] The entity does not have share capital

Eagle Place Covered Bonds LLP has a financial year end of 31 December. Northern Rock Limited has a financial year end of 30 June. The registered address for both entities is Jubilee House, Gosforth, Newcastle upon Tyne, NE3 4PL.

In addition to the above, the Company also has an interest in a number of structured entities associated with securitisation arrangements:

Other controlled entities as at 31 December 2018	Nature of business	Country of incorporation
Gosforth Funding 2014-1 plc	Issuer of securitised notes	England
Gosforth Funding 2015-1 plc	Issuer of securitised notes	England
Gosforth Funding 2016-1 plc	Issuer of securitised notes	England
Gosforth Funding 2016-2 plc	Issuer of securitised notes	England
Gosforth Funding 2017-1 plc	Issuer of securitised notes	England
Gosforth Funding 2018-1 plc	Issuer of securitised notes	England
Gosforth Mortgages Trustee 2014-1 Limited	Trust	England
Gosforth Mortgages Trustee 2015-1 Limited	Trust	England
Gosforth Mortgages Trustee 2016-1 Limited	Trust	England
Gosforth Mortgages Trustee 2016-2 Limited	Trust	England
Gosforth Mortgages Trustee 2017-1 Limited	Trust	England
Gosforth Mortgages Trustee 2018-1 Limited	Trust	England
Gosforth Holdings 2014-1 Limited	Holding company	England
Gosforth Holdings 2015-1 Limited	Holding company	England
Gosforth Holdings 2016-1 Limited	Holding company	England
Gosforth Holdings 2016-2 Limited	Holding company	England
Gosforth Holdings 2017-1 Limited	Holding company	England
Gosforth Holdings 2018-1 Limited	Holding company	England

All of the above controlled entities have a financial year end of 31 December. The registered address for all of the above controlled entities is Fifth Floor, 100 Wood Street, London, EC2V 7EX.

Details of the Company's loans and advances to customers associated with securitisation arrangements, and related liabilities are set out in note 3.5.

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

3.8 Property, plant and equipment

	Freehold land and buildings £m	Long term leasehold land and buildings £m	Building improvements £m	Fixtures, equipment and motor vehicles £m	Total £m
Cost					
At 1 January 2017	46.1	2.5	21.9	38.6	109.1
Additions	-	-	1.0	4.7	5.7
Disposals	-	-	-	(0.1)	(0.1)
At 31 December 2017	46.1	2.5	22.9	43.2	114.7
Additions	-	-	1.4	4.5	5.9
Disposals	-	-	-	(0.4)	(0.4)
At 31 December 2018	**46.1**	**2.5**	**24.3**	**47.3**	**120.2**
At 1 January 2017	2.4	0.5	10.1	20.3	33.3
Charge for the year	0.5	-	2.0	5.5	8.0
Disposals	-	-	-	(0.1)	(0.1)
At 31 December 2017	2.9	0.5	12.1	25.7	41.2
Charge for the year	0.5	-	1.7	5.5	7.7
Disposals	-	-	-	(0.4)	(0.4)
At 31 December 2018	**3.4**	**0.5**	**13.8**	**30.8**	**48.5**
Net book value					
At 31 December 2018	**42.7**	**2.0**	**10.5**	**16.5**	**71.7**
At 31 December 2017	43.2	2.0	10.8	17.5	73.5

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

3.9 Intangible assets

	Capitalised software costs £m
Cost	
At 1 January 2017	147.0
Additions	74.3
Write-off	(5.7)
At 31 December 2017	215.6
Additions	71.0
Write-off	(36.6)
At 31 December 2018	**250.0**
Accumulated amortisation and impairment	
At 1 January 2017	66.4
Charge for the year (note 2.3)	21.7
Write-off	(5.7)
Impairment (note 2.3)	4.8
At 31 December 2017	87.2
Charge for the year (note 2.3)	24.0
Write-off	(36.6)
Impairment (note 2.3)	67.5
At 31 December 2018	**142.1**
Net book value	
At 31 December 2018	**107.9**
At 31 December 2017	128.4

The impairment charge of £67.5m in the year represents the write-down of the Company's digital bank programme, following the decision made by the Group's parent, Clydesdale Bank PLC, to discontinue development and instead to adopt its existing platform, which will be made available across the Group in due course.

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

3.10 Deferred tax assets

Movement in net deferred tax asset

	2018 £m	2017 £m
Opening balance	**10.4**	21.8
IFRS 9 adjustment recognised in equity (note 5.4)	**11.4**	-
Restated opening balance 1 January	**21.8**	21.8
Recognised in the income statement (note 2.4)	**(3.0)**	(11.3)
Transfer of assets from other group company	**0.2**	-
Recognised in other comprehensive income	**2.1**	(0.1)
At 31 December	**21.1**	10.4

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

	2018 £m	2017 £m
Tax losses carried forward	**-**	0.8
Capital allowances	**8.6**	9.8
Employee share based compensation	**5.7**	4.4
Transition adjustment on adoption of IFRS 9	**10.3**	-
Other temporary differences	**(1.1)**	0.8
Change in accounting basis	**(2.5)**	(3.3)
Revaluation reserve financial instruments at fair value through other comprehensive income	**0.1**	-
Available-for-sale reserve	**-**	(2.1)
Net deferred tax asset	**21.1**	10.4

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

3.11 Due to other banks

	2018 £m	2017 £m
Amounts drawn under the Term Funding Scheme	**6,387.0**	4,236.0
Securities sold under agreements to repurchase	**780.0**	1,130.0
Deposits from other banks	**8.9**	11.7
	7,175.9	5,377.7

The underlying securities sold under agreements to repurchase have a carrying value of £954.8m (2017: £1,548.4m).

3.12 Customer deposits

	2018 £m	2017 £m
Interest bearing demand deposits	**28,923.1**	26,584.0
Term deposits	**3,506.8**	4,224.4
	32,429.9	30,808.4

3.13 Provisions for liabilities and charges

	2018 £m	2017 £m
At 1 January	**7.4**	8.5
Charge to the income statement	**6.7**	5.6
Utilised	**(9.8)**	(6.7)
At 31 December	**4.3**	7.4

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

3.14 Debt securities in issue

2018

	Medium-term notes £m	Subordinated notes £m	Total £m
Amortised cost	**299.9**	**348.6**	**648.5**
Fair value hedge adjustments	**0.9**	**3.3**	**4.2**
Total debt securities in issue	**300.8**	**351.9**	**652.7**

2017

	Medium-term notes £m	Subordinated notes £m	Total £m
Amortised cost	299.6	-	299.6
Fair value hedge adjustments	3.2	-	3.2
Total debt securities in issue	302.8	-	302.8

On 24 April 2018, the Company issued callable subordinated notes to its parent undertaking, Virgin Money Holdings (UK) PLC, with a nominal value of £350.0 million at a coupon of 3.375% per annum. The notes constitute direct, unsecured and subordinated obligations of the Company that rank junior to the claims of senior creditors, but senior to claims of Additional Tier 1 securities holders and ordinary shareholders.

Details of the terms and conditions of the notes issued by the Company as at 31 December were as follows:

	2018 £m	2017 £m
Notes		
5-year, 2.25% senior notes due 2020	**300.8**	302.8
8-year, 3.375% callable subordinated notes due 2026	**351.9**	-
Total debt securities in issue	**652.7**	302.8

3.15 Other liabilities

	2018 £m	2017 £m
Accruals and deferred income	**62.1**	60.5
Accrued interest	**131.6**	108.4
Amount owed to ultimate parent	**3.1**	-
Other	**69.6**	57.3
	266.4	226.2

Deferred income comprises £0.5m (2017: £2.2m) of the accruals and deferred income balance detailed above.

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

3.16 Fair value of financial instruments

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

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

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

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

The table below show a comparison of the carrying amounts of financial assets and liabilities measured at amortised cost, as reported on the balance sheet, and their fair values. The fair values below reflect the Company's alignment to the valuation methodologies applied by CYBG PLC in its IFRS 3 valuation exercise undertaken on acquisition of the Group. The valuation methodologies for loans and advances to customers, amounts due to other banks and customer deposits have been revised compared to the prior year.

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

	31 December 2018					31 December 2017				
			Fair value measurement using:					Fair value measurement using:		
	Carrying value	**Fair value**	**Level 1**	**Level 2**	**Level 3**	Carrying value	Fair value	Level 1	Level 2	Level 3
Financial assets	**£m**	**£m**	**£m**	**£m**	**£m**	£m	£m	£m	£m	£m
Cash and balances with central banks	**3,472.8**	**3,472.8**	**-**	**3,472.8**	**-**	2,579.0	2,579.0	-	2,579.0	-
Financial assets available-for-sale	**-**	**-**	**-**	**-**	**-**	0.3	0.3	-	-	0.3
Due from other banks	**118.0**	**118.0**	**-**	**118.0**	**-**	122.9	122.9	-	122.9	-
Loans and advances to customers	**38,795.8**	**38,764.8**	**-**	**240.0**	**38,524.8**	37,099.9	37,311.2	-	359.6	36,951.6
Other assets	**60.0**	**60.0**	**-**	**60.0**	**-**	51.4	51.4	0.3	51.1	-
Financial liabilities										
Due to other banks	**7,175.9**	**7,061.7**	**-**	**7,061.7**	**-**	5,377.7	5,377.7	-	5,377.7	-
Customer deposits	**32,429.9**	**32,438.8**	**-**	**32,438.8**	**-**	30,808.4	30,800.5	-	30,800.5	-
Amounts due to controlled structured entities	**2,432.9**	**2,432.9**	**-**	**2,432.9**	**-**	2,300.4	2,300.4	-	2,300.4	-
Debt securities in issue	**652.7**	**629.6**	**300.1**	**329.5**	**-**	302.8	305.1	305.1	-	-
Other liabilities	**251.8**	**251.8**	**-**	**251.8**	**-**	210.5	210.5	-	210.5	-

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

3.16 Fair value of financial instruments (continued)

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

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

(a) *Cash and balances with central banks* – Fair value approximates to carrying value because cash and balances with central banks have minimal credit losses and are either short-term in nature or reprice frequently.

(b) *Due from other 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.

(c) *Loans and advances to customers* – The Company provides loans of varying rates and maturities to customers. The fair values of loans and advances are determined by firstly segregating them into portfolios of similar characteristics. Contractual cash flows are then adjusted for expected credit losses and expectations of customer behaviour based on observed historic data. The cash flows are then discounted using a market rate of interest.

(d) *Other assets and liabilities* – Fair value is deemed to approximate the carrying value.

(e) *Due to other banks or to customers* – Fair values of deposit liabilities repayable on demand are considered to approximate to carrying value. The fair value of all other deposit liabilities was estimated by discounting cash flows, using market rates appropriate to the remaining term, with notice accounts treated as having a maturity date equivalent to the notice period. Amounts drawn under the Term Funding Scheme, which had previously been considered to approximate carrying value while the scheme was open, are also valued on this basis.

(f) *Amounts due to controlled structured entities* – 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.

(g) *Debt securities in issue* – Fair values are based on quoted prices where available or by discounting cash flows using market rates.

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

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

	Fair value measurement at 31 December 2018				Fair value measurement at 31 December 2017			
	Level 1 £m	**Level 2 £m**	**Level 3 £m**	**Total £m**	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets								
Derivative financial assets	**-**	**15.8**	**-**	**15.8**	-	22.0	-	22.0
Financial instruments at fair value through other comprehensive income	**2,087.8**	**-**	**2.6**	**2,090.4**	-	-	-	-
Financial assets available-for-sale	**-**	**-**	**-**	**-**	899.3	-	2.8	902.1
Equity investments at fair value through profit and loss	**-**	**-**	**1.0**	**1.0**	-	-	-	-
Total financial assets measured at fair value	**2,087.8**	**15.8**	**3.6**	**2,107.2**	899.3	22.0	2.8	924.1
Financial liabilities								
Derivative financial liabilities	**-**	**30.5**	**-**	**30.5**	-	93.1	-	93.1
Total financial liabilities measured at fair value	**-**	**30.5**	**-**	**30.5**	-	93.1	-	93.1

There were no transfers between Level 1 and 2 in the year. The Company fair values for material categories of financial instruments that are measured subsequent to initial recognition at fair value are based on the following methodologies and assumptions:

(a) *Derivative financial assets and liabilities* - The fair values of derivatives 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.

(b) *Financial instruments at fair value through other comprehensive income and financial assets available-for-sale*

- Level 1 - The fair values of listed investments are based on quoted closing market prices.
- Level 3 - These represent the Company's best estimates of the value of equity investments in unlisted companies and of unlisted preferred stock. The valuations take into account relevant information on the individual investments, with discounts applied to reflect their illiquid nature and, in respect of the preferred stock, risks of reduction in conversion rights. There were no transfers into or out of Level 3 in the year ended 31 December 2018 (2017: £Nil).

The Company had a limited exposure to Level 3 fair value measurements during the years ended 31 December 2018 and 31 December 2017, hence no movements analysis has been presented. As a result of this limited exposure, changing one or more of the inputs for fair value measurements in Level 3 to reasonable alternative assumptions would not change the fair value significantly with respect to profit or loss, total assets, total liabilities or equity on these Level 3 measurements.

Notes to the financial statements (continued)
Section 4: Capital

4.1 Equity

4.1.1 Share capital

Allotted, called up and fully paid share capital

	2018 Number of shares	2017 Number of shares	**2018 £m**	2017 £m
Ordinary shares of £1 each				
At 1 January and at 31 December	**1,400,000,000**	1,400,000,000	**1,400.0**	1,400.0

As permitted by the Companies Act 2006, the Company's Articles of Association do not contain any references to authorised share capital.

Interim dividends of £120.0 million (2017: £Nil) were declared and paid in respect of the current financial year. These dividends were deducted from retained earnings in the current year.

By agreement with the parent undertaking, £50.0 million of the interim dividends were set-off against loans receivable from the parent undertaking of equivalent value, with £70.0 million settled from cash and cash equivalents. As the value of the dividend set-off against loans receivable was a non-cash transaction, it is not disclosed within financing activities within the Statement of cash flows.

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. There are no restrictions in the transfer of Ordinary shares in the Company at 31 December 2018.

A description of the other equity categories included within the statement of changes in equity, and significant movements during the year, is provided below.

4.1.2 Other equity instruments

	2018 £m	2017 £m
At 1 January and 31 December	**230.0**	230.0

Other equity instruments consist of perpetual fixed rate resettable (fixed 8.750% up to the first reset date) write down Additional Tier 1 (AT1) securities, which were issued on 10 November 2016 with a nominal value of £230.0m to the parent company, Virgin Money Holdings (UK) PLC. The securities have an optional redemption on the first reset date of 10 November 2021.

AT1 distributions of £20.1m were paid during the year, £14.7m net of tax (2017: £20.1m paid, £14.6m net of tax).

4.1.3 Other reserves

4.1.3.1 Revaluation reserve financial instruments at fair value through other comprehensive income

The reserve records the unrealised gains and losses arising from changes in the fair value of financial assets at fair value through other comprehensive income. The movements in this reserve are detailed in the statement of comprehensive income.

4.1.3.2 Available-for-sale reserve

The available-for-sale reserve recorded the unrealised gains and losses arising from changes in the fair value of financial assets available-for-sale prior to 1 January 2018. On adoption of IFRS 9 'Financial Instruments' on 1 January 2018 the balance on this reserve was transferred to the Revaluation reserve financial instruments at fair value through other comprehensive income.

Notes to the financial statements (continued)
Section 4: Capital (continued)

4.2 Share based compensation

During the year, all equity settled schemes conditionally vested as a result of the change in control of the Company (see note 1.1). The PRA Remuneration Code deferral requirements will continue to be applied but all vesting terms of the awards no longer apply. As a result, there has been accelerated recognition of the share based payment expense in 2018 to reflect that the awards have conditionally vested.

All awards related to equity settled schemes and the share based payment charge for the year is £22.0m (2017: £9.9m).

Plan	Eligible employees	Nature of award	Vesting conditions	Grant dates[1]
Long Term Incentive Plan	Selected senior employees	Conditional share award	Continuing employment or leavers in certain circumstances and achievement of performance conditions	2015, 2016, 2017 & 2018
Deferred Bonus Share Plan	Selected senior employees	Deferred bonus - conditional share award	Continuing employment or leavers in certain circumstances	2014, 2015, 2016, 2017 & 2018
Phantom Share Award	Selected senior employees	Deferred bonus - conditional share award	Continuing employment or leavers in certain circumstances	2012 & 2013
Fixed Share Allowance	Selected senior employees	Share award	None	2018

[1] The year in which grants have been made under the relevant plan. All share awards relate to ordinary shares in Virgin Money Holdings (UK) PLC

Further detail on each plan is provided below:

Long Term Incentive Plan (LTIP)
The LTIP introduced in 2014 was 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 were made within limits set by the rules of the plan.

During 2018, selected senior employees of the Company were granted up to a maximum of 1,814,314 Ordinary shares under the LTIP scheme. Awards granted under the LTIP had performance and service conditions, with vesting dates prescribed for each participant.

The weighted-average fair value of awards granted during 2018 was £2.68 (2017: £3.27).

During 2018, as a result of the change in control of the Company, the satisfaction of the performance conditions was determined, and all LTIP awards conditionally vested. The awards are still subject to the applicable PRA Remuneration Code deferral requirements.

Deferred Bonus Share Plan (DBSP)
The DBSP was 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.

During 2018, selected senior employees of the Company were granted up to a maximum of 2,447,248 Ordinary shares under the scheme. Awards granted under the scheme had service conditions, with vesting dates prescribed for each participant.

The weighted-average fair value of awards granted during 2018 was £2.68 (2017: £3.26).

Grants made under the DBSP are usually made the year following the financial year to which they relate. However as a result of the change in control of the Company, share awards for the upfront and deferred element of 2018 bonuses were agreed and communicated to selected senior employees in September 2018.

All DBSP awards conditionally vested as a result of the change in control. Some of the awards are still subject to the applicable PRA Remuneration Code deferral requirements.

Phantom Share Award
This plan related to awards issued in previous years. No awards were granted under this plan in 2018 (2017: none). All awards vested prior to the change in control of the Company.

Fixed Share Allowance
The fixed share allowance was new in 2018 and was granted to selected senior employees. There were no vesting conditions therefore the award was delivered in shares immediately upon grant.

Notes to the financial statements (continued)
Section 4: Capital (continued)

4.2 Share based compensation (continued)

Plan	Number outstanding at 1 January 2018	Number awarded	Number forfeited/ lapsed	Number exercised	Number released	Number outstanding at 31 December 2018
Long Term Incentive Plan [1]	3,833,758	1,814,314	(1,376,496)	-	(4,271,576)	-
Deferred Bonus Share Plan [1]	2,701,981	2,447,248	-	-	(5,149,229)	-
Phantom Share Award	563,540	-	-	-	(563,540)	-
Interest in Share Options [2]	625,328	-	-	(625,328)		-
Fixed Share Allowance	-	16,444	-	-	(16,444)	-

[1] The awards conditionally vested as a result of the change in control of the Group however some of the awards are still subject to the applicable PRA Remuneration Code deferral requirements.

[2] This scheme was set up for Sir David Clementi, who was Chairman for the period from October 2011 to May 2015. All share options granted under the scheme had vested prior to 1 January 2018. The weighted-average exercise price for options outstanding at 1 January 2018 was £2.15. All outstanding share options were exercised on 17 July 2018 at an exercise price of £2.15.

Notes to the financial statements (continued)
Section 5: Other notes

5.1 Contingent liabilities and commitments

The table below sets out the amounts of commitments to extend credit which are not recorded on the balance sheet. The amounts do not represent the amounts at risk at the balance sheet date but the amounts that would be at risk should the facilities be fully drawn upon and the customer default. Since a significant portion of commitments is expected to expire without being drawn upon, the total of the contract amounts is not representative of future liquidity requirements.

	2018	2017
	£m	£m
Credit commitments		
Undrawn formal standby facilities, credit lines and other commitments to lend at call	**7,483.5**	6,193.5

Capital commitments

The Company had future capital expenditure which had been contracted for but not provided for at 31 December 2018 of £0.4m (2017: £1.1m).

Operating lease commitments

	2018	2017
	£m	£m
Leases as lessee		
Future minimum lease payments under non-cancellable operating leases are:		
Within 1 year	**7.2**	11.6
Between 1 year and 5 years	**24.1**	24.9
Over 5 years	**14.9**	18.3
	46.2	54.8

Contingent liabilities

The Board was not aware of any significant contingent liabilities as at 31 December 2018 (31 December 2017: none).

The Company is, from time to time and in the normal course of business, subject to a variety of legal or regulatory claims, actions or proceedings. When such circumstances arise, the Board considers the likelihood of a material outflow of economic resources and provides for its best estimate of costs where an outflow of economic resources is considered probable. While there can be no assurances, the Directors believe, based on information currently available to them, that the likelihood of material outflows from such matters is remote.

The Board does not expect the ultimate resolution of any other threatened or actual legal proceedings to have a significant adverse effect on the financial position of the Company.

Notes to the financial statements (continued)
Section 5: Other notes (continued)

5.2 Notes to the statement of cash flows

	2018 £m	2017 £m
Non-cash or non operating items included in profit before tax		
Interest income and other similar interest	**(1,071.9)**	(964.7)
Interest expense and similar charges	**470.7**	370.0
Depreciation and amortisation (note 2.3)	**31.7**	29.7
Derivative financial instruments fair value movements	**(14.3)**	(9.8)
Impairment losses on credit exposures (note 3.6)	**71.3**	44.2
Impairment of intangible assets (note 2.3)	**67.5**	4.8
Gain on disposal of financial instruments at fair value through other comprehensive income	**(1.3)**	-
Gain on disposal of financial assets available-for-sale	**-**	(8.4)
Other non-cash items	**(26.0)**	15.1
	(472.3)	(519.1)

	2018 £m	2017 £m
Changes in operating assets		
Net (increase)/decrease in:		
Derivative financial instruments	**19.1**	21.8
Loans and advances to customers	**(1,710.8)**	(4,328.1)
Other assets	**(49.5)**	30.1
	(1,741.2)	(4,276.2)

	2018 £m	2017 £m
Changes in operating liabilities		
Net increase/(decrease) in:		
Due to other banks	**(352.8)**	280.6
Derivative financial instruments	**(56.5)**	(124.4)
Customer deposits	**1,621.5**	2,702.1
Other liabilities	**146.5**	109.9
	1,358.7	2,968.2

For the purposes of the statement of cash flows, cash and cash equivalents comprise the following balances with less than three months maturity from the date of acquisition. This includes cash and liquid assets and amounts due from other banks (to the extent less than 90 days).

	2018 £m	2017 £m
Cash and cash equivalents		
Cash and balances with central banks (note 3.1)	**3,378.5**	2,526.0
Due from other banks	**118.0**	122.9
	3,496.5	2,648.9

Notes to the financial statements (continued)
Section 5: Other notes (continued)

5.2 Notes to the statement of cash flows (continued)

Reconciliation of movements to liabilities from cash flows arising from financing activities

	Term Funding Scheme £m	Debt securities in issue £m	Total £m
At 1 January 2017	1,268.0	305.8	1,573.8
Cash flows:			
Draw downs	4,468.0	-	4,468.0
Repayment	(1,500.0)	-	(1,500.0)
Non-cash flows			
Unamortised costs	-	0.2	0.2
Other movement	-	(3.2)	(3.2)
At 31 December 2017	4,236.0	302.8	4,538.8
Cash flows:			
Issuances	-	348.6	348.6
Draw downs	2,803.0	-	2,803.0
Repayment	(652.0)	-	(652.0)
Non-cash flows			
Unamortised costs	-	0.3	0.3
Other movement	-	1.0	1.0
At 31 December 2018	**6,387.0**	**652.7**	**7,039.7**

Notes to the financial statements (continued)
Section 5: Other notes (continued)

5.3 Related party transactions

From 15 October 2018, CYBG PLC and its controlled entities became related entities to the Company (note 1.1). Amounts in the tables below represent assets held, liabilities outstanding and transactions with these entities only on or after that date.

CYBG PLC and its controlled entities were not related entities at 31 December 2017 or in the year then ended, hence no amounts are presented for any assets held, liabilities outstanding or transactions with these entities within the comparative disclosures provided below and overleaf.

Assets with related entities	**2018 £m**	2017 £m
Financial assets at fair value through other comprehensive income		
Securities issued by controlled securitisation entities of Clydesdale Bank PLC	**35.6**	-
Loans and advances to customers		
Virgin Money Holdings (UK) PLC	**-**	87.4
Securitisation entities controlled by the Company	**240.0**	272.3
	240.0	359.7
Other assets		
Interest accrued on securities issued by controlled entities of Clydesdale Bank PLC	**0.1**	-
Asset recognised in relation to Virgin Atlantic Airways Limited agreement	**-**	10.0
Commissions and charges due from Virgin Atlantic Airways Limited	**1.4**	0.1
Virgin Money Holdings (UK) PLC	**0.2**	0.6
Other subsidiaries of Virgin Money Holdings (UK) PLC	**-**	3.4
	1.7	14.1
Total assets with related entities	**277.3**	373.8
Interest income on the above amounts was as follows:		
Controlled securitisation entities of Clydesdale Bank PLC	**0.1**	-
Virgin Money Holdings (UK) PLC	**0.7**	1.5
Securitisation entities controlled by the Company	**5.7**	5.8
	6.5	7.3

Liabilities with related entities	**2018 £m**	2017 £m
Customer deposits		
The Virgin Money Foundation	**(0.8)**	(0.8)
Amounts due to controlled structured entities		
Securitisation entities controlled by the Company	**(2,432.9)**	(2,300.4)
Debt securities in issue		
Virgin Money Holdings (UK) PLC	**(348.8)**	-
Other liabilities		
Interest accrued on debt securities issued to Virgin Money Holdings (UK) PLC	**(8.2)**	-
Commissions and charges due to Virgin Atlantic Airways Limited	**(5.1)**	-
Liability recognised in relation to Virgin Atlantic Airways Limited agreement	**-**	(10.0)
Trademark licence fees to Virgin Enterprises Limited	**-**	(0.6)
Trademark licence fees to CYBG PLC	**(3.1)**	-
Virgin Money Holdings (UK) PLC	**(2.1)**	(0.3)
Other subsidiaries of Virgin Money Holdings (UK) PLC	**(0.8)**	(0.1)
	(19.3)	(11.0)
Total liabilities with related entities	**(2,801.8)**	(2,312.2)
Interest expense on the above amounts was as follows:		
Securitisation entities controlled by the Company	**(37.8)**	(29.3)
Virgin Money Holdings (UK) PLC	**(8.3)**	-
	(46.1)	(29.3)

Notes to the financial statements (continued)
Section 5: Other notes (continued)

5.3 Related party transactions (continued)

Transactions with related entities	2018 £m	2017 £m
Non-interest income		
Net fee and commissions/(charges) to/from Virgin Atlantic Airways Limited[1]	**(8.4)**	0.5
Virgin Money Holding (UK) PLC	**2.4**	3.6
	(6.0)	4.1
Operating and administrative expenses		
Virgin Money Holding (UK) PLC	**-**	0.4
Other subsidiaries of Virgin Money Holdings (UK) PLC	**6.2**	9.0
Trademark licence fees to Virgin Enterprises Limited[2]	**(6.0)**	(7.5)
Trademark licence fees to CYBG PLC[2]	**(3.0)**	-
Virgin Atlantic Airways Limited agreement[1]	**(10.0)**	-
Other costs to Virgin Atlantic Airways Limited[1]	**(0.3)**	-
Donations to The Virgin Money Foundation[3]	**(1.4)**	(1.4)
Other costs to Virgin Group companies	**(0.3)**	(0.3)
	(14.8)	0.2
Equity transactions with Virgin Money Holdings (UK) PLC		
Dividends	**120.0**	-
AT1 distributions (net of tax)	**14.7**	14.6

(1) The Company incurs credit card commissions and air mile charges to Virgin Atlantic Airways Limited (VAA) in respect of agreements between the two parties. In 2017 an agreement was signed which gave rise to an asset and liability in relation to a committed payment of £10.0m. The committed payment was recognised in operating and administrative expenses in 2018.

Certain incurred costs with VAA represent direct incremental transaction costs related to the issue of unsecured loans and advances to customers. Costs amounting to £5.7m (2017: £Nil) were recognised within the amortised cost of the related loans and advances in the year.

(2) Licence fees were payable for the use of the Virgin Money brand trademark in the year. Licence fees were paid direct to Virgin Enterprises Limited up until 14 October 2018. From 15 October 2018, the licence fees were payable via CYBG PLC under a new contract between CYBG PLC and Virgin Enterprises Limited.

(3) The Company has made donations to the Foundation in both the current and prior year to enable the Foundation to pursue its charitable objectives. The Company has also provided a number of support services to the Foundation on a pro bono basis, including use of facilities and employee time. The estimated gift in kind for support services provided during the year was £0.4m (2017: £0.4m) and is included in the total value disclosed above.

Compensation of key management personnel

Key management personnel comprise Directors of the Company and members of the Virgin Money Executive Committee.

	2018 £m	2017 £m
Salaries and other short-term benefits[1]	**7.4**	7.0
Other long-term employee benefits	**0.6**	0.8
Termination benefits	**6.8**	-
Share based compensation	**12.0**	5.6
	26.8	13.4

(1) Figures for 2017 have been updated to ensure presentation on a basis comparable with 2018.

Aggregate contributions in respect of key management personnel to defined contribution pension schemes were £0.6m (2017: £0.8m).

Notes to the financial statements (continued)
Section 5: Other notes (continued)

5.3 Related party transactions (continued)

Directors' emoluments

Total emoluments of all Directors for the year ended 31 December 2018 were £12.3m (2017: £6.8m).

Included within total emoluments, the aggregate compensation payable to Directors for loss of office in the year ended 31 December 2018 was £3.0m (2017: £Nil). Compensation payable comprised cash consideration.

Three Directors were members of the Company's defined contribution pension scheme during 2018 (2017: three).

None of the Directors hold share options and none were exercised during the year (2017: none).

Disclosures in respect of the highest paid Director

	2018	2017
	£m	£m
Aggregate remuneration	**1.3**	1.8
Share based awards	**3.0**	0.9
Compensation for loss of office	**1.8**	-
	6.1	2.7

Transactions with key management personnel

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

	2018	2017
	£m	£m
Loans and advances	**0.3**	0.4
Deposits	**0.2**	0.7

No provisions have been recognised in respect of loans provided to key management personnel (2017: £Nil). There were no debts written off or forgiven during the year to 31 December 2018 (2017: £Nil). Included in the above is one (2017: one) loan made to a Director with a balance under £0.1m (2017: under £0.1m). The Company has not provided any guarantees in respect of key management personnel at 31 December 2018 (2017: £Nil).

Notes to the financial statements (continued)
Section 5: Other notes (continued)

5.4 Transition to IFRS 9 'Financial Instruments'

On 1 January 2018 the Company adopted IFRS 9 'Financial Instruments' which replaces IAS 39 'Financial Instruments: Recognition and Measurement'. This new accounting standard has three core areas of change: Classification and Measurement; Hedge Accounting; and Impairment. The most significant impacts on the Company are from the changes to impairment.

(a) Transitional disclosures and impact

In relation to classification and measurement, the primary impact of IFRS 9 is the reclassification of debt investments in the available-for-sale (AFS) category to the new fair value through other comprehensive income (FVOCI) category. Management also have an option to classify non-trading equity investments as fair value through profit or loss (FVPL) or irrevocably designate them as FVOCI, on an investment by investment basis.

The material retail financial asset portfolios (primarily secured and unsecured loans) retain their classification as amortised cost, so there is no change in the classification and measurement of these financial assets. The classification requirements for financial liabilities are unchanged on adoption of IFRS 9.

The following table sets out the reclassification impacts of transitioning from IAS 39 to IFRS 9 on 1 January 2018:

	IAS 39		IFRS 9	
Financial assets	**Measurement category**	**Carrying amount £m**	**Measurement category**	**Carrying amount £m**
Cash and balances with central banks	Loans and receivables (amortised cost)	2,579.0	Amortised cost	2,579.0
Derivative financial instruments	FVPL (Hedging instrument)	22.0	FVPL (mandatory)	22.0
Due from other banks	Loans and receivables (amortised cost)	122.9	Amortised cost	122.7
Loans and advances to customers	Loans and receivables (amortised cost)	37,099.9	Amortised cost	37,055.1
Financial assets available-for-sale	Available for sale	902.4	FVOCI	899.3
			FVOCI (designated)[1]	2.1
			FVPL	1.0

[1] Management has the option to designate non-trading equity investments as FVOCI on an investment by investment basis.

The following table sets out the one-off balance sheet reclassification and remeasurement impacts of transitioning from IAS 39 to IFRS 9 on 1 January 2018:

	IAS 39 At 1 Jan 2018	Reclassification	Remeasurement	IFRS 9 At 1 Jan 2018
Assets	**£m**	**£m**	**£m**	**£m**
Cash and balances with central banks	2,579.0	-	-	2,579.0
Derivative financial instruments	22.0	-	-	22.0
Due from other banks	122.9	-	(0.2)	122.7
Loans and advances to customers[1]	37,099.9	-	(44.8)	37,055.1
Financial instruments at fair value through other comprehensive income	-	901.4	-	901.4
Financial assets available-for-sale	902.4	(902.4)	-	-
Equity investments at fair value through profit and loss	-	1.0	-	1.0
Deferred tax assets	10.4	-	11.4	21.8
Other assets	282.3	-	-	282.3
Total assets	**41,018.9**	**-**	**(33.6)**	**40,985.3**
Total liabilities	39,139.7	-	-	39,139.7
Total equity	**1,879.2**	**-**	**(33.6)**	**1,845.6**

[1] Includes £43.7m for fair value of portfolio hedging, which is excluded from the staging analysis below.

5.4 Transition to IFRS 9 'Financial Instruments' (continued)

Transitional disclosures and impact (continued)

The allocation of the Company's loans and advances to customers by stage at 31 December 2018 was:

31 December 2018	Stage 1	Stage 2	Stage 3	Total
	£m	£m	£m	£m
Gross Exposure				
Residential mortgage loans	**26,344.4**	**1,633.9**	**118.3**	**28,096.6**
Residential buy-to-let mortgage loans	**7,055.3**	**178.5**	**14.1**	**7,247.9**
Credit cards	**2,950.4**	**386.4**	**41.8**	**3,378.6**
Overdrafts	**-**	**0.1**	**-**	**0.1**
Total	**36,350.1**	**2,198.9**	**174.2**	**38,723.2**
Impairment allowance				
Residential mortgage loans	**2.0**	**4.6**	**5.2**	**11.8**
Residential buy-to-let mortgage loans	**0.1**	**0.3**	**1.6**	**2.0**
Credit cards	**26.8**	**63.2**	**24.4**	**114.4**
Overdrafts	**-**	**0.1**	**-**	**0.1**
Total	**28.9**	**68.2**	**31.2**	**128.3**

The allocation of the Company's retail loans and advances to customers by stage at 1 January 2018 was:

1 January 2018	Stage 1	Stage 2	Stage 3	Total
	£m	£m	£m	£m
Gross Exposure				
Residential mortgage loans	25,869.6	1,300.1	147.5	27,317.2
Residential buy-to-let mortgage loans	6,167.8	183.4	16.1	6,367.3
Credit cards	2,741.6	300.3	29.4	3,071.3
Overdrafts	-	0.1	-	0.1
Total	34,779.0	1,783.9	193.0	36,755.9
Impairment allowance				
Residential mortgage loans	3.2	4.5	3.2	10.9
Residential buy-to-let mortgage loans	0.1	0.3	0.8	1.2
Credit cards	23.3	51.5	17.2	92.0
Overdrafts	-	0.1	-	0.1
Total	26.6	56.4	21.2	104.2

In addition an impairment allowance of £0.2 million was recognised in relation to amounts 'Due from other banks' at both 1 January and 31 December 2018. All due from other bank balances are classified as stage 1.

(b) Accounting policies

Classification and measurement of financial assets
Under IFRS 9 financial assets are classified into one of three measurement categories:

- amortised cost;
- fair value through other comprehensive income (FVOCI); or
- fair value through profit or loss (FVPL).

Classification is based on the objectives of the Company's business model for managing its financial assets and the contractual cash flow characteristics of the instruments. IFRS 9 retains most of the existing classification and measurement requirements for financial liabilities from IAS 39.

5.4 Transition to IFRS 9 'Financial Instruments' (continued)

(b) Accounting policies (continued)

The business model reflects how the Company manages the assets in order to generate cash flows. One of the following business models is identified for each financial instrument depending on how the risks are managed, past experience with the financial asset and how performance is measured and reported:

- hold to collect: it is intended to collect the contractual cash flows from the assets (Amortised cost classification);
- hold to collect and to sell: it is intended to collect both the contractual cash flows and cash flows arising from the sale of the asset (FVOCI classification); or
- hold to sell: it is intended to sell the financial asset in the short to medium term, or the asset is designated FVPL to minimise an accounting mismatch (FVPL classification).

Where the business model is 'held to collect' or 'held to collect and to sell' the Company assesses whether the financial instruments' cash flows represent solely payments of principal and interest (the 'SPPI test'). In making this assessment, the Company considers whether the contractual cash flows are consistent with a basic lending arrangement i.e. interest includes only consideration for the time value of money, credit risk, other basic lending risks and a profit margin that is consistent with a basic lending arrangement. Where the contractual terms introduce exposure to risk or volatility that are inconsistent with a basic lending arrangement, the related financial asset is classified and measured at fair value through profit or loss.

Financial assets with previously separable embedded derivatives are considered in their entirety when determining whether their cash flows are solely payment of principal and interest.

The Company reclassifies debt investments only when its business model for managing those assets changes. Such changes are expected to be very infrequent and none occurred during the period.

The accounting requirements of the three measurement categories are as follows:

Amortised cost
Financial assets at amortised cost are initially recognised at fair value, including direct and incremental transaction costs. Subsequent measurement is at amortised cost using the effective interest rate method. The Company's secured and unsecured loan portfolios are classified as amortised cost.

The carrying amount of these assets is adjusted by any expected credit loss allowance. Interest income is included in 'Interest income' using the effective interest rate method.

Fair value through other comprehensive income (FVOCI)
Financial assets at FVOCI are initially measured at fair value, including direct and incremental transaction costs. Subsequent measurement is at fair value, with changes in fair value being recognised in other comprehensive income, with the exception of impairment gains or losses, interest income and foreign exchange gains and losses on the instruments amortised cost which are recognised in profit or loss. Interest income from these financial assets is included in 'interest income' using the effective interest rate method. The Company's investments in debt securities are classified as FVOCI.

On derecognition of a financial asset, the cumulative gain or loss previously recognised in OCI is reclassified from equity to the income statement and recognised in 'Other operating income', except for equity investments where the cumulative gains or losses are transferred within equity to 'Retained earnings'

Fair value through profit or loss (FVPL)
Assets that do not meet the criteria for amortised cost or FVOCI are measured at FVPL on initial recognition and at each reporting date.

Any gain or loss on an asset that is subsequently measured at FVPL, and is not part of a hedging relationship, is recognised in profit or loss and presented in the income statement within 'Gains less losses of financial instruments at fair value'.

Interest income from these financial assets is recognised within 'Net interest income' in accordance with note 1.6(b).

Equity instruments
Equity instruments are instruments that do not contain a contractual obligation to pay and that evidence a residual interest in the issuer's net assets (e.g. basic ordinary shares).

The Company measures all equity investments at FVPL, except where Management has elected, at initial recognition, to irrevocably designate the non-trading equity investment at FVOCI. When this election is used, fair value gains and losses are recognised in OCI and are not subsequently reclassified to profit or loss, including on disposal. Impairment losses are not reported separately from other changes in fair value. Dividends continue to be recognised in profit or loss as 'Other operating income' when the Group's right to receive payments is established.

Gains or losses on equity investments at FVPL are included in the 'Gains less losses of financial instruments at fair value' line in the income statement.

Notes to the financial statements (continued)
Section 5: Other notes (continued)

5.4 Transition to IFRS 9 'Financial Instruments' (continued)

(b) Accounting policies (continued)

Fair value measurement
The measurement of fair value has not changed as a result of adopting IFRS 9. Fair value measurement is determined by IFRS 13 'Fair Value Measurement' and the accounting policy for determining fair value can be found in note 3.16

Expected Credit Loss (impairment)

The Company assesses all financial assets at amortised cost, financial instruments at FVOCI and off-balance sheet commitments for impairment at each reporting date. For the Company, this is primarily loans and advances to customers and undrawn lending commitments. Under IFRS 9 a 'three-stage' model for calculating Expected Credit Losses (ECL) is used, and is based on changes in credit quality since initial recognition as summarised below:

- Stage 1 - A financial instrument that is not credit-impaired on initial recognition and has not significantly increased in credit risk;
- Stage 2 - If a significant increase in credit risk has occurred since initial recognition, the financial instrument is moved to stage 2 but is not yet deemed to be credit-impaired; and
- Stage 3 - If the financial instrument is credit-impaired, the financial instrument is then moved to stage 3.

ECL is measured on either a 12 month or lifetime basis depending on whether a significant increase in credit risk (SICR) has occurred since initial recognition or whether an asset is considered to be credit-impaired. 12 month ECL is recognised on stage 1 accounts and lifetime ECL is recognised on stage 2 and 3 accounts. Interest income is recognised on the gross carrying value of stage 1 and 2 assets and the net carrying value of stage 3 assets.

ECL is calculated using a Probability of Default (PD), which reflects the likelihood of a borrower defaulting over either the next 12 months or the lifetime of the account, and includes forward-looking economic information in this estimation. The Exposure at Default (EAD) and Loss Given Default (LGD) for each account are also calculated to estimate actual loss at the point of default. These assumptions incorporate expected contractual payments, utilisation of available credit limits, collateral values and forced sale discounts. The LGD component incorporates forward-looking economic variables (e.g. house price inflation).

These variables (PD, LGD and EAD) are projected for each future month and for each individual exposure or collective segment. Segmentation is used in the determination of these variables where accounts have similar characteristics and are expected to behave in uniform ways. This allows for an ECL to be calculated for each account for each future month, which is then discounted back to the reporting date to create a total ECL at account level. The discount rate used in the ECL calculation is the original effective interest rate or an approximation thereof.

Hedge Accounting

The hedge accounting requirements of IFRS 9 are more closely aligned with risk management practices than the current IAS 39 requirements and follow a principles-based approach. However, there is an option in IFRS 9 to maintain existing IAS 39 hedge accounting rules until the IASB completes its project on macro hedging. This option has been provided because the macro hedging project is still in the consultation phase, with a second discussion paper due to be issued by the International Accounting Standards Board (IASB) in 2019.

Management have analysed the benefits of adopting IFRS 9 hedge accounting but currently the preferred approach is to continue applying IAS 39 hedge accounting in its entirety. As a result there is no change from the 2017 Annual Report and Accounts accounting policy. The revised disclosure requirements of IFRS 7 'Financial Instruments: Disclosures' in relation to hedge accounting will be applied.

Notes to the financial statements (continued)
Section 5: Other notes (continued)

5.4 Transition to IFRS 9 'Financial Instruments' (continued)

(c) Critical judgements and estimates

IFRS 9 requires Management to make estimates and judgements in its application that affect the allowance for expected credit loss. Estimates and judgements are based on Management's knowledge and historical experience. The nature of the calculation of ECL and the various estimates included means that Management recognise the potential for possible volatility in the level of ECL in the coming periods.

Management consider the most material estimates and judgements to be significant increase in credit risk and multiple economic scenarios.

Significant increase in credit risk (SICR) assessment (Judgement)
A significant increase in credit risk is not a defined term, and is determined by Management based on their experience and judgement. In assessing whether the credit risk has significantly increased the Company has identified a series of quantitative, qualitative and backstop criteria (30 days past due as set by IFRS 9) which take into account forward-looking macroeconomic factors. These are referred to as the staging criteria.

The staging criteria have been extensively tested to ensure the characteristics of the portfolio are correctly reflected and accounts appropriately flow through the stages prior to default, without either a prolonged duration in stage 2 or introducing significant volatility by moving unnecessarily between the stages. For unsecured exposures, a cure period of two months has been applied to reduce volatility between stages. This means that an account remains in stage 2 for a period of two months after it ceases to meet any stage 2 criteria.

The staging criteria take into account the following:

- Quantitative criteria – if an account's current lifetime PD is greater than a multiple of origination lifetime PD then the credit risk of the account is considered to have increased significantly;
- Qualitative criteria – if an account enters forbearance or demonstrates other indicators of financial difficulty, not yet caught by an increase in PD, then the credit risk of the account is considered to have increased significantly; and
- Backstop – if the account is 30 days past due it will automatically transition to stage 2.

The staging criteria are monitored and revisited in advance of each reporting date.

The selection of staging criteria is subjective, and in particular, qualitative criteria can have a significant impact on ECL, by moving performing loans into stage 2. This results in lifetime ECL being calculated on performing loans in stage 2, significantly increasing the overall ECL. The impact of qualitative staging criteria on the ECL can be demonstrated by comparing the recognised ECL to the ECL which would have been recognised if all performing loans were classified as stage 1:

	ECL – all performing loans in stage 1 £m	Impact of staging £m	Stage 1 and 2 ECL for performing loans £m
Performing loans	46.1	39.3	85.4

Definition of default (Judgement)

The definition of default is used to determine both the PD and the transition to stage 3 (all accounts which have defaulted are recognised in stage 3).

For the retail portfolios, the Company defines a financial instrument as in default, when it meets one or more of the following criteria:

- The customer is more than 90 days past due on their contractual payments;
- The customer meets unlikeliness to pay criteria, which indicates the customer is in significant financial difficulty; or
- The account term has expired, but the account has not been fully paid down or refinanced (secured lending).

A secured loan can transition (cure) back to stage 2 when it has not met any of the default criteria for six consecutive months. For unsecured loans, an account cannot cure from stage 3 as the account is blocked from future use once the customer enters default.

For secured exposures, the definition of default for regulatory expected loss capital purposes is 180 days past due. However for accounting purposes Management have elected not to rebut the 90 days past due presumption under IFRS 9 for both secured and unsecured loan portfolios.

Probability of default (PD) (Estimate)
PD is a key component in the calculation of ECL and the transition from stage 1 to stage 2. It is an estimate of the likelihood of default over either 12 months or the lifetime of the account. Management have used historical data, assumptions and expectations of future conditions to model PD over time for the secured and unsecured portfolios. An origination PD is required for each account. Where origination PDs were not available at the origination date, the origination PD was approximated, based on available account level data.

Notes to the financial statements (continued)
Section 5: Other notes (continued)

5.4 Transition to IFRS 9 'Financial Instruments' (continued)

(c) Critical judgements and estimates (continued)

Exposure at default (EAD) (Estimate)
EAD is the amount that the Group expects the exposure to be at the point of default. For secured loans, this is a highly predictable amount based on the contractual payment profile and historic behaviours. For unsecured loans, the estimated balance utilisation at default is determined based on the characteristics of the account, including arrears status, consumer credit index of the account, and the current utilisation of the account (including whether the card is inactive).

Loss given default (LGD) (Estimate)
LGD is the amount of loss that will be incurred in the event of default. It represents the actual cash flows expected to be recovered for an individual account, and takes in to account collateral values and other cash recovered (e.g. through debt sale arrangements).

Expected life (Judgement)
The calculation of ECL is over the contractual life of the account, or the period over which the account exposes the Group to credit risk. For secured loans, this is the contractual period of the mortgage. For unsecured loans, the lifetime is the behavioural life of the credit card, which is the period over which the Group is exposed to credit risk.

Origination dates (Judgements)
The origination date of an exposure is the contractual origination date. The origination date is when the origination PD is determined, which will be referenced at each reporting period when determining if there has been a significant increase in credit risk.

For newly originated accounts, the origination PD is recorded on the contractual origination date. For acquired portfolios, Management have considered the facts around the purchase of each portfolio to determine the origination date to be applied.

Notes to the financial statements (continued)
Section 5: Other notes (continued)

5.4 Transition to IFRS 9 'Financial Instruments' (continued)

(c) Critical judgements and estimates (continued)

Macro-economic scenarios (Estimate)
Unbiased macro-economic scenarios covering multiple potential outcomes are required by IFRS 9 to be incorporated into the ECL calculation.

Macro-economic variables impacting credit risk and expected credit losses for each portfolio have been investigated by performing statistical regression analysis to understand how changes in these variables have historically impacted default rates and the components of LGD. The macro-economic variables with the most significant impact on PD and LGD, for the Group, are judged to be house price inflation; unemployment rate; household debt-to-income ratio[1]; and bank base rate.

1 Household debt service ratio is used to inform the debt-to-income ratio used in the calculation of ECL.

The Group has determined an approach to the selection and application of multiple scenarios. The Group does not have an in-house economics function and has therefore sourced economic scenarios from a third party to form the basis of the economic scenarios used. The Group has considered a minimum of three scenarios on a probability-weighted approach. These scenarios include a base, an upside and a downside scenario. The combination of the three scenarios provides an unbiased but representative macro view of reasonably possible future outcomes, not biased to extreme, or stressed, scenarios. The Group have weighted the scenarios, based on their probability as prescribed by the third party provider, at 40% applied to the base case and 30% to each of the upside and downside scenarios. The scenarios include the key variables which ECL is sensitive to, resulting in an asymmetric and non-linear impact on ECL.

As with any economic forecasts, the projections and likelihoods of occurrence are subject to a high degree of inherent uncertainty and therefore the actual outcomes may be significantly different to those projected.

Where there are specific events, which due to timing or their nature, have not been incorporated into the macro-economic scenarios Management may overlay additional adjustments to ECL to take account of additional economic assumptions. This is considered when Management believe the impact of a specific event or change in market sentiment has not been appropriately captured in the ECL calculation inputs, for example events occurring very close to the reporting date.

The base scenario used at 31 December 2018 incorporates risks associated with the UK's withdrawal from the European Union (EU), but assumes a close working relationship with continued trade on a tariff free basis with no border controls, while the downside scenario reflects a clean break from the EU, with World Trade Organisation rules coming into effect from 29 March 2019.

The Company considers these macro-economic forecasts to represent its best estimate of the possible outcomes based on reliable available information. The impact of adopting these multiple economic scenarios on the ECL calculation were:

		Scenarios	
As at 31 December 2018	**Base**	**Upside**	**Downside**
House price index (5 year average)	**1.7%**	**3.6%**	**(0.8)%**
Unemployment rate (5 year average)	**4.8%**	**3.7%**	**6.6%**
Household debt service ratio (5 year average)	**12.2%**	**12.4%**	**11.4%**
Bank base rate (5 year average)	**1.6%**	**1.7%**	**0.2%**
Weighting assigned	**40%**	**30%**	**30%**

	Base case ECL	**Probability weighted ECL**	**Difference**
Impairment allowance as at 31 December 2018	**£128.1m**	**£128.5m**	**£0.4m**

Notes to the financial statements (continued)
Section 5: Other notes (continued)

5.4 Transition to IFRS 9 'Financial Instruments' (continued)

(c) Critical judgements and estimates (continued)

	Scenarios		
As at 1 January 2018	Base	Upside	Downside
House price index (5 year average)	2.0%	3.5%	0.5%
Unemployment rate (5 year average)	5.2%	4.2%	6.8%
Household debt service ratio (5 year average)	11.8%	12.0%	11.4%
Bank base rate (5 year average)	1.2%	1.7%	0.2%
Weighting assigned	40%	30%	30%

	Base case ECL	Probability weighted ECL	Difference
Impairment allowance as at 1 January 2018	£103.2m	£104.4m	£1.2m

5.5 Post balance sheet events

There have been no significant events between 31 December 2018 and the date of approval of the annual financial statements which would require a change to or additional disclosure in the financial statements apart from the declaration of an interim dividend. An interim dividend, amounting to £42.0 million, was declared on 27 February 2019 and will be paid on 28 February 2019 to the parent undertaking.

Glossary - Measuring financial performance

The Company calculates a number of metrics that are commonly used and reported throughout the banking industry, as these provide relevant information to external stakeholders.

Descriptions of alternative performance measures, including their basis of calculation, are set out below.

Cost of risk	Impairment charges, net of debt recoveries, divided by simple average gross loans for the period.
Statutory cost:income ratio	Operating and administrative expenses divided by total operating income.
Return on assets	Profit attributable to equity holder divided by closing total assets.

Following the de-listing of the Group and change in control during the year, the Company has rationalised the number of alternative performance measures used to assess its financial position and performance compared to the prior year. The measures listed above continue to be considered relevant to its stakeholders.

The Company also discloses a number of capital and liquidity metrics relevant to its financial position for which calculation is required under prudential rules issued by the PRA and FCA, in line with requirements of UK/EU legislation and Basel III. The bases of calculation of those metrics is defined within the relevant legislation (for example CRD IV) and are disclosed in the Main Glossary.

Main Glossary

Term	Definition
Advanced Internal Ratings Based ***(AIRB)*** Approach	A CRD IV approach for measuring exposure to credit risks. The method of calculating credit risk capital requirements uses internal probability of default (PD), loss given default (LGD) and exposure at default (EAD) models. AIRB approaches may only be used with Prudential Regulation Authority (PRA) permission.
Basel III	Global regulatory standard on Bank Capital Adequacy, Stress Testing and Market and Liquidity proposed by the Basel Committee on Banking Supervision in 2010. See also CRD IV.
Basis points ***(bps)***	One hundredth of a per cent (0.01%). 100 basis points is 1%. Used when quoting movements in interest rates or yields.
Capital at Risk ***(CaR)***	Approach set out for the quantification of interest rate risk expressed as the impact to the present value of the Company's capital under interest rate sensitivity analysis.
CASS	Client Assets Sourcebook, included in the FCA Handbook and sets out the requirements with which firms must comply when holding or controlling client assets.
Certificates of Deposit	A certificate issued by a bank to a person depositing money for a specified length of time at a specified rate of interest.
Charge-off	Charge-off occurs on outstanding credit card balances where in-house collections and recoveries have been exhausted. This involves the removal of the balance and associated provision from the balance sheet with any remaining outstanding balance recognised as a loss. Charged-off accounts may be subject to debt-sale, where by additional recoveries will be taken to profit or loss.
Common Equity Tier 1 capital ***(CET1)***	The highest quality form of capital under CRD IV that comprises common shares issued and related share premium, retained earnings and other reserves excluding the cash flow hedging reserve, less specified regulatory adjustments.
Company	Virgin Money PLC
Covered bonds	A corporate bond with primary recourse to the institution and secondary recourse to a pool of assets that act as security for the bonds on issuer default. Covered bonds remain on the issuer's balance sheet and are a source of term funding for the Group.
CRD IV	In June 2013, the European Commission published legislation for a Capital Requirements Directive (CRD) and Capital Requirements Regulation (CRR) which form the CRD IV package. The package implements the Basel III proposals in addition to the inclusion of new proposals on sanctions for non-compliance with prudential rules, corporate governance and remuneration. The rules are implemented in the UK via the PRA policy statement PS7/13 and came into force from 1 January 2014, with certain sections subject to transitional phase in.
Credit Enhancements	Risk reduction techniques that improve the credit standing of financial obligations; generally those issued by a structured entity in a securitisation
Credit-impaired	A loan is considered credit-impaired when it is in default. A defaulted account is either 90 days past due or meets specific unlikeliness to pay criteria. All credit-impaired loans are categorised as Stage 3.
Credit Valuation Adjustments ***(CVA)***	These are adjustments to the fair values of derivative assets to reflect the creditworthiness of the counterparty.
Cross-Currency Swaps	An arrangement in which two parties exchange specific principal amounts in different currencies at inception and subsequent interest payments on the principal amounts.
Debt Securities	Debt securities are assets held by the Company representing certificates of indebtedness of credit institutions, public bodies or other undertakings, excluding those issued by central banks.
Earnings at Risk ***(EaR)***	Approach set out for the quantification of interest rate risk expressed as the impact to forecast net interest income under interest rate sensitivity analysis.
Expected Loss - regulatory	Regulatory expected loss represents the anticipated loss, in the event of a default, on a credit risk exposure modelled under the Advanced Internal Ratings Based approach. Expected loss is determined by multiplying the associated PD, LGD and EAD.
Expected Credit Loss ***(ECL)*** - IFRS 9	ECLs are a provision held on the balance sheet for all financial instruments. ECLs may be recognised on either a 12 month or lifetime basis. The level will be determined by the performance of individual assets, and take into consideration associated credit risk attributes, including a significant increase in credit risk or any credit impairment. An ECL may either be individual or collective as a result of the raising of a charge against profit for the expected loss inherent in the lending book. An ECL may either be individual or collective.

Main Glossary (continued)

Term	Definition
Exposure at Default ***(EAD)***	An estimate of the amount expected to be owed by a customer at the time of a customer's default.
Forbearance	Forbearance takes place when a concession is made on the contractual terms of a loan in response to borrowers' financial difficulties; or for where the contractual terms have been cancelled for credit cards. Forbearance options are determined by assessing the customer's personal circumstances.
Full Time Equivalent ***(FTE)***	A full time employee is one that works a standard five day week. The hours worked by part time employees are measured against this standard and accumulated along with the number of full time employees and counted as full time equivalents.
Funding for Lending Scheme ***(FLS)***	The Bank of England launched the Funding for Lending Scheme in 2012 to allow banks and building societies to borrow from the Bank of England at cheaper than market rates for up to four years. This was designed to increase lending to households and businesses by lowering interest rates and increasing access to credit.
Funding Risk	The inability to raise and maintain sufficient funding in quality and quantity to support the delivery of the business plan.
Group	Virgin Money Holdings (UK) PLC and its subsidiaries (including controlled entities)
Impairment Allowance - IAS 39 (2017 and prior periods)	Impairment allowances are a provision held on the balance sheet as a result of the raising of a charge against profit for the incurred loss inherent in the lending book. An impairment allowance may either be individual or collective.
Impairment Losses	An impairment loss is the reduction in value that arises following an impairment review of an asset that determined that the asset's value is lower than its carrying value.
Interest Rate Risk	The risk of a reduction in the present value of the current balance sheet or earnings as a result of adverse movement in interest rates.
Interest Rate Risk in the Banking Book ***(IRRBB)***	The risk of a reduction in the present value of the current balance sheet or earnings as a result of an adverse movement in interest rates arising as a consequence of carrying out and supporting core business activities.
Internal Capital Adequacy Assessment Process ***(ICAAP)***	The part of the Pillar 2 assessment to be undertaken by a bank. The ICAAP allows financial institutions to assess the level of capital that adequately supports all relevant current and future risks in their business. In undertaking an ICAAP, a financial institution should be able to ensure that it has appropriate processes in place to ensure compliance with CRD IV.
Internal Liquidity Adequacy Assessment Process ***(ILAAP)***	The ILAAP provides comprehensive documentation of the Company's Liquidity Risk Management framework, including: identifying the key liquidity and funding risks to which Virgin Money is exposed; describing how these risks are identified, monitored and measured and describing the techniques and resources used to manage and mitigate these risks.
Leverage Ratio	Total Tier 1 Capital expressed as a percentage of total assets (adjusted in accordance with CRD IV).
Liquidity Coverage Ratio ***(LCR)***	Stock of high quality liquid assets as a percentage of expected net cash outflows over the following 30 days according to CRD IV requirements.
Liquidity Risk	The inability to accommodate liability maturities and withdrawals, fund asset growth, and otherwise meet the Company's contractual obligations to make payments as they fall due.
Loan-to-Value ratio ***(LTV)***	The amount of a secured loan as a percentage of the appraised value of the security, e.g. the outstanding amount of mortgage loan as a percentage of the property's value.
Loss Emergence Period - IAS 39 (2017 and prior periods)	Under IAS 39, the loss emergence period allows for the recognition of impairment in respect of losses that have been incurred but not reported. The emergence period is measured as time between the emergence of impairment triggers and the time at which the loss is incurred.
Loss Given Default ***(LGD)***	The estimated loss that will arise if a customer defaults. LGD comprises the actual loss (the part that is not expected to be recovered), after taking account of credit risk mitigation, for example, any security held over collateral and the economic costs associated with the recovery process.
Master Netting Agreement	An agreement between two counterparties that have multiple derivative contracts with each other that provides for the net settlement of all contracts through a single payment, in a single currency, in the event of default on, or termination of, any one contract.

Main Glossary (continued)

Net Interest Income	The difference between interest received on assets and interest paid on liabilities.
Percentage Point ***(pp)***	Unit for measuring the difference of two percentages. A change from 1% to 2% is 1 percentage point.
Pillar 1	The part of CRD IV that sets out the process by which regulatory capital requirements should be calculated for credit, market and operational risk.
Pillar 2	The part of CRD IV that ensures financial institutions hold adequate capital to support the relevant risks in their business. It also encourages financial institutions to develop and use enhanced risk management techniques in monitoring and managing their risks.
Pillar 3	The part of CRD IV that sets out the information banks must disclose in relation to their risks, the amount of capital required to absorb them, and their approach to risk management. The aim is to strengthen market discipline.
Probability of Default ***(PD)***	The probability of a customer defaulting over a defined outcome period. Default occurs where a borrower has missed six months of mortgage repayments or three months of credit card repayments, or the borrower is deemed to be unlikely to repay their loan. The outcome period varies for assessment of capital requirements and for assessment of provisions.
Repurchase Agreements (Repos)	A form of short-term funding where one party sells a financial asset to another party with an agreement to repurchase at a specific price and date. From the seller's perspective such agreements are repurchase agreements (repos) and from the buyer's reverse repurchase agreements (Reverse repos).
Risk Appetite	The risk appetite sets limits on the amount and type of risk that the Group is willing to tolerate in order to meet its strategic objectives.
Risk-Weighted Assets ***(RWAs)***	A measure of a bank's assets adjusted for their associated risks. Risk weightings are established in accordance with PRA rules and are used to assess capital requirements and adequacy under Pillar 1.
Securitisation	Securitisation is a process by which a group of assets, usually loans, are aggregated into a pool, which is used to back the issuance of new securities through an SPV.
Sovereign Exposures	Exposures to central governments and central government departments, central banks and entities owned or guaranteed by the aforementioned.
Standardised Approach	In relation to credit risk, a method for calculating credit risk capital requirements using External Credit Assessment Institutions (ECAI) ratings of obligors (where available) and supervisory risk weights. In relation to operational risk, a method of calculating the operational risk capital requirement by the application of a supervisory defined percentage charge to the gross income of specified business lines
Stress Testing	Techniques where plausible events are considered as vulnerabilities to ascertain how this will impact the capital or liquidity resources which are required to be held.
Tier 1 Capital	A measure of banks financial strength defined by the PRA. It captures Common Equity Tier 1 capital plus other Tier 1 securities in issue, but is subject to deductions including in respect of material holdings in financial companies.
Tier 1 Capital Ratio	Tier 1 capital as a percentage of risk-weighted assets.
Tier 2 Capital	A further component of regulatory capital defined by the PRA for the Company. It comprises eligible collective assessed impairment allowances under CRD IV.
Term Funding Scheme ***(TFS)***	The Bank of England launched the Term Funding Scheme in 2016 to allow banks and building societies to borrow from the Bank of England at rates close to Bank Base Rate. The Scheme closed in February 2018.

Abbreviations

AGM Annual General Meeting

AIRB Advanced Internal Ratings Based

AT1 Additional Tier 1

BOE Bank of England

CaR Capital at Risk

CET1 Common Equity Tier 1 Capital

CRD Capital Requirements Directive

CRR Capital Requirements Regulation

DBSP Deferred Bonus Share Plan

DTR Disclosure and Transparency Rules

EAD Exposure at Default

EaR Earnings at risk

EBO Everyone Better Off

EIR Effective Interest Rate

FCA Financial Conduct Authority.

FLS Funding for Lending Scheme

FRC Financial Reporting Council

FSCS Financial Services Compensation Scheme

FTE Full Time Equivalent

FTP Funds Transfer Pricing

FVOCI Fair value through other comprehensive income

FVPL Fair value through profit and loss

GDPR General Data Protection Regulation

HMRC Her Majesty's Revenue and Customs

HPI House Pricing Index

HQLA High Quality Liquid Assets

IAS International Accounting Standards

IASB International Accounting Standards Board

ICAAP Internal Capital Adequacy Assessment Process

IFRS International Financial Reporting Standards

ILAAP Internal Liquidity Adequacy Assessment Process

IRRBB Interest Rate Risk in the Banking Book

ISA Individual Savings Account

ISDA International Swaps and Derivatives Association

LCR Liquidity Coverage Ratio

LGD Loss Given Default

LIBOR London Interbank Offered Rate.

LTIP Long Term Incentive Plan

LTV Loan to Value

PD Probability of Default

PRA Prudential Regulation Authority

RMBS Residential mortgage-backed securities

RWA Risk weighted assets

SME Small or Medium sized Enterprises

SONIA Sterling Overnight Interbank Average rate

TFS Term Funding Scheme

TSYS Total Systems Services, Inc

Other information

Country by Country Reporting ('CBCR')

The Capital Requirements (Country-by-Country Reporting) Regulations 2013 came into effect on 1 January 2014 and place certain reporting obligations on financial institutions that are within the scope of the European Union's Capital Requirements Directive (CRD IV). Refer to Virgin Money Holdings (UK) PLC's Annual Report and Accounts for country-by-country reporting disclosures.

Website	www.virginmoney.com/virgin/investor-relations/results-and-presentations/
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Forward-looking statements

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

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