Annual report & consolidated financial statements

Clydesdale Bank PLC

For the year ended 30 September 2018

Company Number: SC001111

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Contents

Overview

Clydesdale Bank PLC ('the Bank'), together with its subsidiary undertakings (which together comprise 'the Group'), operate under the Clydesdale Bank, Yorkshire Bank and B brands. It offers a range of banking services for both retail and business customers through retail branches, Business Banking centres, direct and online banking, including B, and brokers. It is the main operating subsidiary of its immediate parent, CYBG PLC. The results referred to in this annual report and accounts relate to the 12 months up to 30 September 2018, which is a period prior to the acquisition of Virgin Money Holdings (UK) plc (Virgin Money) and therefore do not take into account the results of Virgin Money or its controlled entities.

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 157.

Officers and professional advisers

Directors	David Duffy Ian Smith Clive Adamson David Bennett Paul Coby Adrian Grace Fiona MacLeod Jim Pettigrew Dr Teresa Robson-Capps Tim Wade Geeta Gopalan Darren Pope Amy Stirling
Secretary	Lorna McMillan James Peirson
Registered office	30 St Vincent Place Glasgow G1 2HL
Independent auditors	Ernst & Young LLP Bridgewater Place 1 Water Lane Leeds LS11 5QR

Strategic Report

The Directors of the Bank and its subsidiary undertakings (which together comprise 'the Group') present their Strategic Report for the year ended 30 September 2018.

Principal activities

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

Business review

Summary balance sheet as at 30 September	2018 £m	2017 £m
Customer loans	33,281	31,967
Other financial assets	9,233	10,105
Other non-financial assets	1,069	1,242
Total assets	43,583	43,314
Customer deposits	(28,854)	(27,679)
Wholesale funding	(8,116)	(8,623)
Other liabilities	(3,322)	(3,548)
Total liabilities	(40,292)	(39,850)
Ordinary shareholders' equity	(2,866)	(3,039)
AT1 equity	(425)	(425)
Equity	(3,291)	(3,464)
Total liabilities and equity	(43,583)	(43,314)

Summary income statement [1] for the year ended 30 September	2018 £m	2017 £m
Net interest income	855	845
Non-interest income	156	172
Total operating income	1,011	1,017
Total operating and administrative expenses	(633)	(671)
Operating profit before impairment losses	378	346
Impairment losses on credit exposures [2]	(41)	(48)
Underlying profit on ordinary activities before tax	337	298
Restructuring and related expense	(38)	(67)
RBS alternative remedies package spend	(16)	-
Virgin Money transaction costs	(7)	-
Separation costs	(8)	(8)
Legacy conduct costs	(544)	(592)
Gain on defined benefit pension scheme reforms	-	88
Gain on disposal of VocaLink share	-	20
Statutory loss on ordinary activities before tax	(276)	(261)
Tax credit/(expense)	37	(33)
Statutory loss attributable to equity holders	(239)	(294)

[1] The summary income statement is presented on a statutory and underlying basis. The underlying basis excludes certain items that are included in the statutory results, as management believe that these items are not reflective of the underlying business and do not aid meaningful year on year comparison. Full details on the adjusted items are included in the Glossary on page 148.
[2] Impairment losses on credit exposures relate solely to loans and advances to customers (refer to note 3.5 to the financial statements) and exclude credit risk adjustments on loans at fair value through profit or loss which are incorporated in the movement in other assets and liabilities at fair value within non-interest income (refer to note 2.3 to the financial statements).

Strategic Report (continued)

Business review (continued)

The Group delivered an underlying profit before tax (PBT) of £337m, up £39m (13%). A statutory loss after tax of £239m has been reported (2017: loss of £294m) primarily due to legacy conduct costs of £544m in the year (2017: £592m).

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

1. Sustainable customer growth in customer lending and deposit balances	2018 £m	2017 £m
Mortgages	24,540	23,480
SME lending [(3)] - core	7,202	6,821
- non-core	336	504
Unsecured personal lending	1,203	1,162
Gross loans and advances to customers	33,281	31,967
Current accounts [(4)]	(14,224)	(13,798)
Variable rate savings accounts [(4)]	(8,427)	(7,880)
Fixed rate term deposits [(5)]	(6,202)	(5,983)
Other wholesale deposits	(1)	(18)
Total customer deposits	(28,854)	(27,679)

Mortgages

The mortgage book remains the Group's largest asset portfolio and has a significant impact on our overall financial performance. Our continued focus on customers resulted in growth of 4.5% in the year, higher than system growth[(6)] of 2.5%. Our market share increased from 1.73% to 1.77%.

The mortgage market in 2018 has been more subdued, with high remortgage activity, but lower levels of new lending and the competitive environment has continued to exert pressure on front book pricing. In late 2017, we brought mortgage processing back onshore, as part of our customer journey improvement initiatives. Some servicing and fulfilment delays arose resulting in our broker pipeline build being lower than we had hoped, with mortgage growth slower around the third quarter of the financial year when we felt the impact of lower applications at the start of 2018. These issues are now resolved, with a return to a more normalised level of growth in the final quarter.

We continued to see customers favour fixed rate mortgage products, as they sought to further capitalise on the prevailing low interest rate environment against a backdrop of market sentiment that expects modest short to medium-term interest rate rises. This, combined with our targetted customer retention strategy, has resulted in growth in the fixed rate book to 78% of total mortgage balances (2017: 73%) and accounted for 96% of mortgages drawn in the year (2017: 95%). Longer-term fixed rate mortgages are growing more popular with 5-year fixed mortgages now accounting for 27% of the portfolio (2017: 22%).

In line with our expectations, the buy-to-let (BTL) property market has been more subdued following last year's changes in tax relief for landlords, an increase in Stamp Duty and the Prudential Regulation Authority's (PRA) enhanced affordability assessments. This has led to a shift in the mix of our mortgage book with BTL falling from 33% in the prior year to 31% with owner occupied accounting for a higher proportion of drawdowns in the year (79%, up from 70% in the year to 30 September 2017). Reflecting this change in mix, the average loan to value ratio (LTV) of new lending was 70% (30 September 2017: 71%) and the average LTV of the mortgage book increased from 57.5% to 58.8%. Our proportion of residential mortgages 90 days in arrears has remained stable at 0.56% (2017: 0.52%).

3 Includes financial assets at fair value of £362m (September 2017: £477m)
4 £150m of current account balances were reclassified as variable rate savings in the comparative period.
5 Includes financial liabilities at fair value of £15m (September 2017: £26m)
6 System growth is sourced from the Bank of England (BoE) 'Mortgages outstanding by type of lender, UK (BoE)' report (MM4).

Strategic Report (continued)

Business review (continued)

1. Sustainable customer growth in customer lending and deposit balances (continued)

Small or medium enterprises (SME) lending

Our core SME lending portfolio increased by £381m (5.6%) in the year, in line with market guidance and ahead of system growth[(7)] of 2.1%. Growth has been delivered across term lending, asset finance and invoice finance. We are outperforming the market, despite the subdued demand resulting from Brexit uncertainty, as a result of our strong propositions and sector focus, while maintaining high credit underwriting standards. We are delivering on our pledge to support small and medium sized businesses across the UK as part of our commitment to lend £6bn in the three years to 2019. Lending origination targets have been achieved or exceeded in each of our core regions and this, coupled with lower attrition in the year, has contributed to the overall increase in balances.

The SME portfolio remains well positioned. Underlying asset quality is resilient and stable, reflective of the diversity within the portfolio as a result of controlled risk appetite and an economic environment which continues to support business performance. The impaired asset portfolio has reduced to £83m (2017: £126m) which is at its lowest level for more than 10 years.

In line with our strategy we continued to proactively run down our non-core portfolio, which reduced from £504m to £336m through the managed exit of non-core balances.

Unsecured personal lending

Unsecured personal lending has grown by 3.5% or £41m in the year to £1,203m. This has been driven largely by a focus on the fixed rate personal loans portfolio which increased by 13% from a low base of £658m to £743m. We have improved our presence on aggregator websites and offered existing customers enhanced accessibility to our products, introducing in-app purchase functionality and allowing customers that are pre-assessed for credit worthiness to secure a loan at the click of a mouse. The fixed rate personal loan market remains highly competitive, resulting in some margin erosion, as market rates have dipped to near historical lows and are yet to respond to the rising rate environment.

Growth in the fixed rate personal loan book was offset by a fall in credit card balances of £15m to £381m (2017: £396m). Variable rate personal loans and overdrafts fell by £32m in the year from £111m to £79m. Variable rate loan balances continue to reduce as, although these products remain on sale, they are not actively promoted or targeted.

Current accounts

Current account funding increased by £426m in the year from £13,798m to £14,224m due principally to continued growth in business current account balances (up £328m) with the Group continuing to see new customer recruitment from the 25-month fee free offer launched in December 2016. An unprecedented number of new personal current accounts (PCAs) were opened following our high profile national PCA recruitment campaign, which had a market leading customer switching incentive. The B current account was the main beneficiary of the campaign (with balances up £256m) while there was a reduction of £158m in the Current Account Plus and other PCA products. The new B account openings were in line with our strategy to sustainably grow this portfolio in a way that recruits new customers with whom we have an opportunity to build a long-term relationship.

Variable rate savings accounts

Funding from variable rate savings accounts increased by £547m principally driven by £783m of growth in B savings accounts and £116m in business savings accounts, the latter being driven through targeted relationship management. Partially offsetting this is attrition of £228m in cash ISA balances following continued product simplification and repricing of the portfolio. There has been a change in book mix, with a higher proportion of balances being held in longer-term notice products, providing an additional liquidity benefit.

[7] System growth is sourced from the BoE 'Industrial analysis of monetary financial institutions' lending to UK residents' report (C1,2), and excludes individuals and individual trusts, activities auxiliary to financial intermediation, insurance companies and pension funds, and financial intermediation (excluding insurance and pension funds) results.

Strategic Report (continued)

Business review (continued)

1. Sustainable customer growth in customer lending and deposit balances (continued)

Fixed rate term deposits

Our fixed rate term deposit book increased by £219m to £6,202m as a result of deposit raising initiatives taken primarily in the first quarter of the year, including the successful launch of our second online digital bond along with two further cash ISA fixed rate bonds designed to retain maturing term deposits. As a result of close margin management and deposit initiatives, funding costs have fallen as the number of longer-term higher priced products were allowed to mature without replacement.

Funding and liquidity

The Group continues to maintain its strong funding and liquidity position and seeks to achieve an appropriate balance between profitability, liquidity risk and capital optimisation. Reflecting our retail deposit-led funding strategy, our loan to deposit ratio (LDR) was stable over the year at 115% (2017: 115%).

In addition to retail deposits, we ensure appropriate diversification in our funding base through a number of wholesale funding programmes. In the first half of the year we made further drawings from the BoE Term Funding Scheme (TFS), taking overall drawings at 30 September 2018 to £2.25bn. We have accessed TFS judiciously – we have not relied on it to fund our growth and our drawings are at a level that can be refinanced comfortably over time. We have also maintained our access to public markets – we successfully completed further issuances of mortgage-backed securities through the Group's Lanark programme across USD and GBP tranches, raising approximately £500m and £550m in January and July respectively. The Group's liquidity surplus continues to comfortably exceed our regulatory minimum and internal risk appetite, with a Liquidity Coverage Ratio (LCR) of 137% as at 30 September 2018 (2017: 164%). Net Stable Funding Ratio (NSFR) was 125% at 30 September 2018 (2017: 118%).

The issue of £500m of senior debt in September provided further funding to the Group and reflects our progression towards meeting the BoE's Minimum Requirement for Own Funds and Eligible Liabilities (MREL) by 2022.

2. Delivering on our efficiency programme	2018 £m	2017 £m
Operating and administrative expenses		
Personnel expenses	223	248
Depreciation and amortisation expense	89	87
Other operating and administrative expenses	321	336
Total underlying operating and administrative expenses	633	671
Restructuring and related expense	38	67
RBS alternative remedies package spend	16	-
Virgin Money transaction costs	7	-
Separation costs	8	8
Conduct charges	544	592
Gain on defined benefit pension scheme reforms	-	(88)
Total statutory operating and administrative expenses	1,246	1,250

In 2016, we committed to delivering a net reduction of £100m in underlying operating expenses. In 2018, we completed our Sustain efficiency programme and achieved run rate benefits that exceeded our targets. On an underlying basis, total operating and administrative expenses have fallen by £38m to £633m.

Personnel expenses fell from £248m to £223m, driven by headcount reductions following last year's voluntary severance programme, as well as the closure of the defined benefit pension scheme to future accrual on 1 August 2017. This reduction has been delivered while building an improved reward package across CYBG which has been a key area of focus in 2018. Improvements have included consolidated pay increases, enhanced defined contribution pension provision and the introduction of a flexible benefits account worth up to 5% (capped at £2,500) of salary from 1 January 2018 for all colleagues below Executive Director. In addition, in recognition of the delivery of an unprecedented level of change in FY2017, all eligible colleagues received £500 of free shares in December 2017 at a cost of £3m.

Strategic Report (continued)

Business review (continued)

Costs related to the restructuring and streamlining of our business have fallen by £29m to £38m, largely due to a lower volume of restructuring initiatives in the year. Costs have been of a similar nature to the prior year but on a smaller scale as the majority of the Sustain initiatives were undertaken in prior financial years.

Transaction related costs of £7m were recognised in regard to the acquisition of Virgin Money Holdings (UK) plc (Virgin Money) and £16m of costs were incurred relating to preparation for the RBS alternative remedies package.

In line with the rest of the industry, the Group has experienced a sustained period of elevated Payment Protection Insurance (PPI) complaints during the year, ahead of the August 2019 industry deadline. The Group has reassessed the level of provision that is considered appropriate to meet current and future expectations in relation to the mis-selling of PPI policies. The Board noted that weekly incoming complaint volumes have been reducing in the second half of FY2018. Notwithstanding this improvement the Board concluded that an additional charge of £500m is required. We continue to expect a slowdown in complaint volumes into FY2019 due to the impact of the Financial Guidance and Claims Act that became effective in July which implemented a fee cap and limits to cold-calling for Claims Management Companies. The Group has also recognised additional costs of £44m for other less significant conduct related matters. The Group continues to assess the impact of resolving legacy conduct issues on an ongoing basis.

3. Capital optimisation

The Group's fully loaded total capital ratio was 15.9% and the Common Equity Tier 1 capital (CET1) ratio stood at 10.7% at September 2018. The reduction in the capital ratios related primarily to legacy conduct charges.

Formal Internal Ratings-Based approach (IRB) accreditation for the mortgages and SME portfolios was received in October 2018. The adoption of IRB models is expected to result in a material reduction in the Group's credit risk-weighted assets (RWAs) and a consequential significant increase in the Group's CET1 ratio of 350bps. The pro forma CET1 ratio on the IRB basis at 30 September 2018 was 14.2%. The pro forma Capital Requirements Directive and Regulation (CRD IV) Leverage ratio on the IRB basis at 30 September 2018 was 5.6%.

Strategic Report (continued)

Business review (continued)

Reconciliation of statutory to underlying results

The underlying results presented within this Business review reflect the Group's results prepared on an underlying basis. These exclude certain items that are included in the statutory results, as management believes that these items are not reflective of the underlying business and do not aid meaningful year-on-year comparison. The table below reconciles the statutory results to the underlying basis, and full details on the adjusted items are included in the Glossary on page 148:

2018 income statement	Statutory results £m	Legacy conduct costs £m	Busines restruct-uring £m	RBS alternative remedies package spend £m	Virgin Money transaction costs £m	Separation costs £m	Underlying basis £m
Net interest income	855	-	-	-		-	855
Non-interest income	156	-	-	-		-	156
Total operating income	1,011	-	-	-		-	1,011
Total operating and administrative expenses before impairment losses	(1,246)	544	38	16	7	8	(633)
Operating (loss)/profit before impairment losses	(235)	544	38	16	7	8	378
Impairment losses on credit exposures[1]	(41)	-	-	-	-	-	(41)
(Loss)/profit on ordinary activities before tax	(276)	544	38	16	7	8	337
Tax credit/(expense)	37	(40)	(6)	(3)	(1)	(2)	(15)
(Loss)/profit attributable to equity holders	(239)	504	32	13	6	6	322

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

Strategic Report (continued)

Business review (continued)

Reconciliation of statutory to underlying results (continued)

2017 income statement	Statutory results £m	Legacy conduct costs £m	Busines restruct-uring £m	Separation costs £m	Pension scheme reforms £m	AFS invest-ment disposal £m	Underlying basis £m
Net interest income	845	-	-	-	-	-	845
Non-interest income	192	-	-	-	-	(20)	172
Total operating income	1,037	-	-	-	-	(20)	1,017
Total operating and administrative expenses before impairment losses	(1,250)	592	67	8	(88)	-	(671)
Operating profit before impairment losses	(213)	592	67	8	(88)	(20)	346
Impairment losses on credit exposures[1]	(48)	-	-	-	-	-	(48)
Profit on ordinary activities before tax	(261)	592	67	8	(88)	(20)	298
Tax expense	(33)	(55)	(9)	(2)	31	(2)	(70)
Profit attributable to equity holders	(294)	537	58	6	(57)	(22)	228

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

Key performance indicators

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

Strategic Report (continued)

Principal risks and mitigating actions

The Board is responsible for determining the nature and extent of the principal risks it is willing to take in order to achieve its strategic objectives. The Directors have performed a robust assessment of the principal risks facing the Group, including those that would threaten its business model and future performance, solvency or liquidity.

Principal risks	Key mitigating actions
Credit risk is the risk of loss of principal or interest stemming from a borrower's failure to meet contracted obligations to the Group in accordance with the terms agreed. Credit risk is evident at both a portfolio and transactional level.	• Significant credit risk strategies, credit risk appetite and tolerances for credit risk are approved and reviewed by the Board and Board's Risk Committee. • The credit portfolio is closely monitored with actions initiated where required.
Balance sheet and prudential regulation risk covers a number of categories of risk, which affect the manner in which the Group can support its customers in a safe and sound manner. The risks include the need to withstand times of stress for the loss of funding (liquidity), the impact of restricted access to future sources of deposits (funding), the impact of providing a defined benefit scheme to colleagues (pension) and the need to withstand severe unexpected losses (capital).	• Liquidity is managed in accordance with standards that are approved by the Board and supported by annual Funding and Contingency Funding Plans. • The Group completes a formal annual assessment of both its capital and liquidity adequacy requirements which is shared with the PRA. • The Group has implemented a range of pension reforms to reduce its exposure to pension risk including the closure of the defined benefit scheme to future accrual for the majority of members from August 2017.
Regulatory and compliance risk is the risk of failing to identify, understand, monitor and comply with relevant laws, regulations, licence conditions, supervisory requirements, self-regulatory industry codes of conduct and voluntary initiatives. In doing so, the Group risks damaging its relationship with its regulators. It is also the failure of not keeping regulators informed of relevant issues and not responding effectively to information requests and regulatory reviews.	• Continued and significant Board and senior management focus is directed towards maintaining regulatory compliance. The Board or Executive Risk Committee approves all material changes to regulatory policy and protocols.
Conduct risk is the risk of undertaking business in a way which is contrary to the interests of our customers, resulting in the delivery of inappropriate customer outcomes, customer detriment, regulatory censure, redress costs and/ or reputational damage.	• The Group has a Conduct Framework, with supporting target outcomes and operating principles. Governance oversight and reporting are in place to ensure those objectives are met.
Operational risk (including resilience and information security) is the risk of loss resulting from inadequate or failed internal processes and systems or from external events. It includes legal risk, and operational risks associated with the execution of the strategy.	• The Group has an established Operational Risk Framework to enable identification, management and mitigation of operational risks. Risk categories are used to facilitate the consistent identification, assessment, mitigation, monitoring and reporting of risks and events.
Financial crime risk is the risk that the Group's products and services will be used to facilitate financial crime against the Group, its customers or third parties.	• The Group has an established Financial Crime Framework supporting ongoing management, monitoring and mitigation of financial crime risk. The Group operates zero tolerance for financial crime risk.
Strategic, business and financial performance risk is the risk of significant loss, loss of earnings and/or damage arising from business decisions that impact the long-term interests of stakeholders or from an inability to adapt to external developments.	• The Board approves and oversees the execution of the Strategic Plan and associated strategic risk following the recommendations of the CEO and Executive Leadership Team. The Group's Risk Appetite Statement (RAS) sets out the risks it is able and willing to take to achieve its strategic objectives.
People risk is the risk of not having sufficiently skilled and motivated colleagues who are clear on their responsibilities and accountabilities and who behave in an ethical way.	• Roles, responsibilities and performance expectations are defined in role profiles and expanded through objective setting and ongoing performance management. • The quality and continuity of our leadership is reviewed and assessed through succession planning and talent management activity.

Strategic Report (continued)

Outlook

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

The Strategic Report was approved by the Board of Directors on 26 November 2018 and was signed on its behalf by:

David Duffy

Chief Executive Officer

Clydesdale Bank PLC

Risk Report

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

Risk Principles

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

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

Risk Culture

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

Culture is shaped by many aspects including tangible components such as: the Group's code of conduct; operating principles; policies; standards; the risk management operating model; and an approved articulation of risk appetite that aligns to, and supports, the strategic objectives of the Group. The Group strives to instil a culture that supports compliance with all relevant laws, codes and policies and builds constructive regulatory relationships.

Initiatives that support appropriate risk culture include: the performance management framework with all areas required to have a risk management objective; messaging from the CEO and members of the Executive Leadership Team emphasising the importance of risk identification, management and mitigation and the formal whistle-blowing framework that allows colleagues to raise concerns about matters of conduct in confidence and anonymously.

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

Risk Strategy

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

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

Risk Appetite Statement (RAS)

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

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

Risk Report (continued)

Risk Appetite Statement (RAS) (continued)

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

Risk Policies and Procedures

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

Principal risk categories

See page 9 in the Strategic Report for details on the Group's principal risk categories.

Top and emerging risks

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

Emerging risks	Key mitigating actions
Geopolitical and macroeconomic environment	The Group is exposed to a variety of downstream risks resulting from the geopolitical environment, which have significant business relevance. With a predominantly UK based customer profile, the Group continues to monitor credit portfolios closely. Regular assessments of strategic plans, risk appetite and risk sensitivity analysis are undertaken to minimise and negate potential impacts.
The UK vote to leave the EU ('Brexit')	There is ongoing monitoring of the UK's withdrawal from the EU, with negotiations creating significant economic uncertainty and a potential negative impact for the UK macro economy. The Group continues to consider all potential consequences for its customers, products and operating model with mitigating actions in place as appropriate. The uncertainty and related pace of change is being monitored closely and the Group will react appropriately having given consideration to both potential and actual outcomes, customer and other stakeholder implications.
Competition	The financial services industry is a highly competitive environment. The emergence of new entrants and regulatory initiatives, such as Open Banking, may lead to material changes in the future provision of financial services. The Group recognises both the risks and opportunities resulting from the changes and continues to develop strategies, products and technologies to ensure it can take strategic advantage where possible and mitigate any corresponding risks.
Consumer credit	The Group maintains an awareness of the risk of significant credit losses occurring within a short time period which would have a detrimental impact on earnings and profitability. Credit risk strategies, appetite and tolerance levels are reviewed and approved by the Board and regular monitoring of the credit portfolio, including risk sensitivity analysis and reviews of asset quality metrics, is undertaken to ensure early identification and mitigation of potential risks. Unsecured consumer lending is an area of considerable regulatory focus and one where the Group is particularly alert to the potential regulatory, economic and customer impacts. New strategies have been delivered in response to revised regulatory requirements and reviews are underway to address further, future changes.
Cyber security and IT	With increasing levels of attempted cyber attacks across the industry, the Group remains vigilant, however, acknowledges the potential risks of such attack, including service interruption, data loss, customer and financial detriment and reputational damage. The Group continues to enhance and invest in the control environment, recognising the changing cyber landscape and the increased focus on digital capabilities as well as the changing risk profile of the business.
Financial crime (including cybercrime)	The Group, in conjunction with the wider industry, continues to be subject to increasing fraud attacks. In response the Group continues to enhance its fraud defences with particular focus on behavioural analysis tools. The management of financial crime remains a key area of regulatory focus and the Group continues to enhance its framework for monitoring, management and mitigation of financial crime.

Risk Report (continued)

Top and Emerging risks (continued)

Emerging risks	Key mitigating actions
Regulatory capital change	The Group, in common with the financial services industry as a whole, continues to face a significant agenda of regulatory and legislative change, including those pertaining to taxes. The Group continues to monitor the emerging requirements and ensure it is well placed to respond with effective regulatory change management. The Basel Committee published their final Basel III framework in December 2017. A key objective of the revisions is to reduce excessive variability of RWAs and improve the comparability of banks' capital ratios. Implementation dates range from 2022 to 2027 and the Committee has introduced transitional arrangements to ensure an orderly and timely implementation. The Group will be advised of its final MREL requirements by 2020 and the outcome may result in additional costs to those that have already been incorporated into the Strategic Plan.
Integrating Virgin Money	The risks associated with the acquisition of Virgin Money have been described in detail in the prospectus to the transaction. The acquisition represents a significant programme of change requiring prudent management in order to deliver the benefits from the transaction. There is a risk that issues arise during integration that may lead to additional costs or a delay in the realisation of benefits. The integration programme places customers' interests at the centre of all aspects of change.
Customer detriment	The Group acknowledges the continued risk of historic customer detriment and the risk of issues not being accurately identified at an early stage due to failures to adhere to, or maintain, a robust control framework, leading to potential customer treatment or fairness issues. The Group ensures that the underlying framework is robust and continues to work closely with its Regulators.
Service interruption and operational resilience	There is a reputational risk and/or adverse impact on customer confidence which may result from service interruption to critical operating services. The Group continues to strengthen resilience in its platforms and make upgrades to its core data networks in a bid to mitigate this risk.
Third-party suppliers	The Group acknowledges an increased risk associated with the use of third parties to perform core functions. The Group continues to enhance its third-party management framework and ensures that the procurement of service providers adheres to these requirements.

Risk capability

As discussed earlier in the report, in October 2018 the Group obtained approval for the use of its IRB models for its mortgage and SME/corporate portfolios. This represents a significant milestone in the further development of the Group's risk capability.

Risk Management Framework (RMF)

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

Risk governance and oversight

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

The Group's risk management is governed by a series of committees. During the year the Group completed a review of the executive committee layer in the risk governance structure to ensure it balances regulatory, legal and compliance obligations while making timely, customer focused decisions that drive the business forward.

Three Lines of Defence

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

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

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

Risk Report (continued)

Stress testing

Stress testing is an important and recognised risk management tool, used to assess the vulnerability of financial institutions through the modelling of adverse scenarios. The Group uses stress testing to support the identification of risks and potential vulnerabilities under adverse economic scenarios or specific events. Risk appetite, risk mitigation and contingency planning are informed by stress testing processes.

In addition to supporting risk appetite, stress testing is used within strategic planning, capital funding liquidity plans and for more detailed deep dive analysis within specific portfolios.

The Group undertakes stress testing following the Basel Committee principles and utilising, where appropriate, scenarios provided by the BoE.

The Board and senior management are actively involved in the consideration of stress testing. This involvement works through all aspects of stress testing from the consideration of scenarios or events to be tested to the outcomes and mitigating actions, The involvement of the Board and senior management is considered to be essential for the effective operation of stress testing and the manner in which the results can then inform strategic planning and risk appetite. Reverse stress testing is also undertaken to assess the types of risks that would pose fundamental threats to the viability of the Group's business model.

Risk Management and Internal Controls

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

CREDIT RISK

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

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

Risk appetite

The Group controls its levels of credit risk by placing limits on the amount it is willing to take within credit risk capacity in order to achieve its business objectives. This involves a defined set of qualitative and quantitative limits in relation to its credit risk concentrations to one borrower, or group of borrowers, and to geographical, product and industry segments. The management of credit risk within the Group is achieved through ongoing approval and monitoring of individual transactions, regular asset quality reviews, and independent oversight of credit decisions and portfolios across the Group.

Credit strategies and policies

Credit risks associated with lending are managed through the application of detailed lending policies and standards which outline the approach to lending, underwriting criteria, credit mandates, concentration limits and product terms. Credit risk is managed and monitored using the credit models that underpin the recent IRB approval for the mortgage and SME/corporate portfolios. The Group maintains a dynamic approach to credit management and aims to take necessary steps if individual issues are identified or if credit performance deteriorates, or is expected to deteriorate, due to borrower, economic or sector specific weaknesses.

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

Significant credit risk strategies and policies are approved, and reviewed annually, by the Credit Risk Committee. For complex credit products and services, the Head of Business Risk, Head of Retail Risk and Credit Risk Committee provide a policy framework which identifies and quantifies risks and establishes the means of mitigating such risks. These policies and frameworks are delegated to, and disseminated under the guidance and control of, executive management, with appropriate oversight through governance committees.

Risk Report (continued)

CREDIT RISK (continued)

Exposures

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

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

Measurement

The Group uses a combination of strategies and statistical models that utilise internal and external data to measure the exposure to credit risk within the portfolios. Portfolios are assessed using segmentation for measurement, reporting and monitoring purposes.

In October 2018, the Group obtained permission to use IRB models to measure the credit risk of loans and advances to customers in its mortgage and SME/corporate portfolios. The Group will continue to embed the IRB standard through advanced monitoring and governance of its credit models. For the period to 30 September 2018, all exposures were measured under the standardised approach for regulatory capital.

Maximum exposure to Credit Risk (audited)

The table below shows the maximum exposure to credit risk including derivatives. The maximum exposure is shown gross, before the effect of mitigation through use of master netting and collateral agreements. The table also shows the maximum amount of commitments from the Group's and Bank's banking operations.

	Group		Bank	
	2018	2017	**2018**	2017
	£m	£m	**£m**	£m
Cash and balances with central banks (note 3.1)	**6,573**	6,937	**6,573**	6,937
Due from related entities (note 5.3)	**35**	366	**1,238**	1,547
Due from other banks	**836**	810	**376**	407
Financial assets available for sale (note 3.2)	**1,562**	2,076	**1,556**	2,070
Other financial assets at fair value (note 3.3)	**362**	477	**362**	477
Derivative financial assets (note 3.4)	**262**	282	**151**	136
Loans and advances to customers (note 3.5)	**32,744**	31,293	**31,631**	30,236
Due from customers on acceptances	**4**	4	**4**	4
	42,378	42,245	**41,891**	41,814
Contingent liabilities (note 5.1)	**119**	111	**119**	111
Other credit commitments (note 5.1)	**7,016**	8,408	**6,887**	8,382
Maximum Credit Risk exposure	**49,513**	50,764	**48,897**	50,307

Mitigation

The management and mitigation of credit risk within the Group is achieved through both approval and monitoring of individual transactions and asset quality, analysis of the performance of the various credit risk portfolios, and the independent oversight of credit portfolios across the Group. Portfolio monitoring techniques cover such areas as product, industry or geographic concentrations and delinquency trends.

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

Risk Report (continued)

CREDIT RISK (continued)

Mitigation (continued)

Other mitigating measures are described below:

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

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

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

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

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

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

Derivatives:
The Group maintains control limits on net open derivative positions. At any one time, the amount subject to credit risk is limited to the current fair value of instruments that are favourable to the Group (i.e. assets where their fair value is positive), which in relation to derivatives may only be a small fraction of the contract, or notional values used to express the volume of instruments outstanding. This credit risk is managed as part of the customers' overall exposure together with potential exposures from market movements.

Master netting agreements:
The Group further restricts its exposure to credit losses by entering into master netting arrangements with counterparties with whom it undertakes a significant volume of transactions. Master netting arrangements do not generally result in an offset of balance sheet assets and liabilities, as transactions are usually settled on a gross basis. However, credit risk associated with the favourable contracts is reduced by a master netting arrangement to the extent that if any counterparty failed to meet its obligations in accordance with the agreed terms, all amounts with the counterparty are terminated and settled on a net basis. Derivative financial instrument contracts are typically subject to the International Swaps and Derivatives Association ('ISDA') master netting agreements, as well as Credit Support Annexes ('CSA'), where relevant, around collateral arrangements attached to those ISDA agreements. Derivative exchange or clearing counterparty agreements exist where contracts are settled via an exchange or clearing house.

Risk Report (continued)

CREDIT RISK (continued)

Credit Assessment and Mitigation for Retail & SME Customers

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

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

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

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

Monitoring

Credit policies and procedures, which are subject to ongoing review, are documented and disseminated in a form that supports the credit operations of the Group.

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

Risk Report (continued)

CREDIT RISK (continued)

Concentrations

Industry concentration of assets

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

Gross loans and advances to customers including loans designated at fair value through profit or loss (audited) [1]	Group 2018 £m	Group 2017 £m	Bank 2018 £m	Bank 2017 £m
Property - mortgage	24,540	23,480	23,461	22,442
Agriculture, forestry, fishing and mining	1,676	1,743	1,676	1,743
Instalment loans to individuals and other personal lending (including credit cards)	1,239	1,165	1,238	1,165
Manufacturing	853	724	836	721
Wholesale and Retail	779	778	779	778
Property - construction	246	212	246	211
Financial, investment and insurance	116	90	116	90
Government and public authorities	41	32	40	31
Other commercial and industrial	3,791	3,743	3,775	3,729
	33,281	31,967	32,167	30,910

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

Contingent liabilities and related commitments (audited)	Group 2018 £m	Group 2017 £m	Bank 2018 £m	Bank 2017 £m
Property - mortgage	1,937	2,305	1,808	2,279
Agriculture, forestry, fishing and mining	294	375	294	375
Instalment loans to individuals and other personal lending (including credit cards)	1,800	1,945	1,800	1,945
Manufacturing	587	588	587	588
Wholesale and Retail	477	606	477	606
Property - construction	-	154	-	154
Financial, investment and insurance	84	290	84	290
Government and public authorities	276	426	276	426
Other commercial and industrial	1,680	1,830	1,680	1,830
	7,135	8,519	7,006	8,493

Risk Report (continued)

CREDIT RISK (continued)

Credit Quality of Customer Lending

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

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

Group

As at 30 September 2018

	Retail overdrafts £m	Credit cards £m	Other retail lending £m	Mortgages £m	Lease finance £m	SME lending [1] £m	Total £m
Gross loans and advances:							
Neither past due nor impaired	48	365	749	24,131	636	6,301	32,230
Past due but not impaired	7	16	18	370	23	130	564
Impaired	-	-	-	39	1	83	123
	55	381	767	24,540	660	6,514	32,917

As at 30 September 2017

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

Bank

As at 30 September 2018

	Retail overdrafts £m	Credit cards £m	Other retail lending £m	Mortgages £m	Lease finance £m	SME lending [1] £m	Total £m
Gross loans and advances:							
Neither past due nor impaired	48	365	749	23,084	600	6,301	31,147
Past due but not impaired	7	16	18	344	23	130	538
Impaired	-	-	-	33	1	83	117
	55	381	767	23,461	624	6,514	31,802

As at 30 September 2017

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

[1] SME lending includes business overdrafts.

Risk Report (continued)

CREDIT RISK (continued)

Distribution of loans and advances by credit quality

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

Loans and advances which were past due but not impaired

Loans and advances that are past due but not impaired are classified as such for secured lending where the net current market value of supporting security is sufficient to cover all principal, interest and other amounts (including legal, enforcement, realisation costs etc.) due on the facility.

Unsecured retail lending and credit cards are written off when they reach 180 DPD and are not designated as impaired, in compliance with the EU Payment Accounts Directive.

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

Group 2018 (audited)	Retail overdrafts £m	Credit cards £m	Other retail lending £m	Mortgages £m	Lease finance £m	SME lending [1] £m	Total £m
1 to 29 DPD	6	8	7	174	23	77	295
30 to 59 DPD	-	2	4	40	-	15	61
60 to 89 DPD	-	2	2	18	-	8	30
Past due 90 days and over	1	4	5	138	-	30	178
	7	16	18	370	23	130	564

2017 (audited)	Retail overdrafts £m	Credit cards £m	Other retail lending £m	Mortgages £m	Lease finance £m	SME lending [1] £m	Total £m
1 to 29 DPD	5	6	6	142	22	88	269
30 to 59 DPD	1	2	3	32	-	10	48
60 to 89 DPD	-	1	2	30	-	2	35
Past due 90 days and over	1	3	5	123	-	29	161
	7	12	16	327	22	129	513

[1] SME lending includes business overdrafts.

Risk Report (continued)

CREDIT RISK (continued)

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

Bank

2018 (audited)	Retail overdrafts £m	Credit cards £m	Other retail lending £m	Mortgages £m	Lease finance £m	SME lending [1] £m	Total £m
1 to 29 DPD	6	8	7	162	23	77	283
30 to 59 DPD	-	2	4	38	-	15	59
60 to 89 DPD	-	2	2	16	-	8	28
Past due 90 days and over	1	4	5	128	-	30	168
	7	16	18	344	23	130	538

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

[1] SME lending includes business overdrafts.

Risk Report (continued)

CREDIT RISK (continued)

Movement in impairment provisions throughout the year

Group

2018 (audited)	Retail overdrafts £m	Credit cards £m	Other retail lending £m	Mortgages £m	Lease finance £m	SME lending [1] £m	Total £m
Opening balance	4	7	12	33	2	152	210
Charge for the year	3	8	14	1	-	15	41
Amounts written off	(4)	(10)	(16)	(2)	-	(36)	(68)
Recoveries of amounts written off in previous years	2	3	4	-	-	4	13
Other [2]	-	-	-	-	-	(1)	(1)
Closing balance	5	8	14	32	2	134	195
Specific	-	-	-	12	-	31	43
Collective	5	8	14	20	2	103	152
	5	8	14	32	2	134	195

2017 (audited)	Retail overdrafts £m	Credit cards £m	Other retail lending £m	Mortgages £m	Lease finance £m	SME lending [1] £m	Total £m
Opening balance	3	6	10	39	2	155	215
Charge for the year	2	6	9	(2)	-	33	48
Amounts written off	(4)	(9)	(13)	(4)	-	(45)	(75)
Recoveries of amounts written off in previous years	3	4	6	-	-	5	18
Other [2]	-	-	-	-	-	4	4
Closing balance	4	7	12	33	2	152	210
Specific	-	-	-	13	-	43	56
Collective	4	7	12	20	2	109	154
	4	7	12	33	2	152	210

(1) SME lending includes business overdrafts.

(2) Other includes the recognition of certain impaired loans which were previously recorded at fair value through profit or loss, the unwind of net present value elements of specific provisions and other minor movements.

Risk Report (continued)

CREDIT RISK (continued)

Movement in impairment provisions throughout the year (continued)

Bank

2018 (audited)	Retail overdrafts £m	Credit cards £m	Other retail lending £m	Mortgages £m	Lease finance £m	SME lending [1] £m	Total £m
Opening balance	4	7	12	30	2	152	207
Charge for the year	3	8	14	1	-	15	41
Amounts written off	(4)	(10)	(16)	(2)	-	(36)	(68)
Recoveries of amounts written off in previous years	2	3	4	-	-	4	13
Other [2]	-	-	-	-	-	(1)	(1)
Closing balance	5	8	14	29	2	134	192
Specific	-	-	-	10	-	31	41
Collective	5	8	14	19	2	103	151
	5	8	14	29	2	134	192

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

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

Risk Report (continued)

CREDIT RISK (continued)

Collateral

Collateral held as security and other credit enhancements

The Group evaluates each customer's creditworthiness on a case by case basis. The amount of collateral obtained, if deemed necessary by the Group upon extension of credit, is based on management's credit evaluation of the counterparty. Collateral held can vary, but may include:

- specific charges over defined assets of the counterparty;
- a floating charge over all assets and undertakings of an entity, including uncalled capital and called but unpaid capital;
- specific or interlocking guarantees; and
- loan agreements which include affirmative and negative covenants and, in some instances, guarantees of counterparty obligations.

Generally, the Group does not take possession of collateral it holds as security or call on other credit enhancements that would result in recognition of an asset on its balance sheet.

It is the Group's policy to dispose of repossessed properties with the proceeds used to reduce or repay the outstanding balance. In general, the Group does not occupy repossessed properties for its own business use.

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

LTV ratio (audited) [(1)]	2018 %	2017 %
Less than 50%	31	33
50% to 75%	51	49
76% to 80%	6	7
81% to 85%	5	4
86% to 90%	4	4
91% to 95%	2	1
96% to 100%	-	-
Greater than 100%	-	-
Unknown	1	2
	100	100

[(1)] LTV of the mortgage portfolio is defined as mortgage portfolio weighted by balance and indexed using the MIAC Acadametrics indices at a given date. Unknown represents loans where data is not currently available due to front book data matching still to be completed and a *de minimis* amount due to weaknesses in historic data capture processes.

Residential mortgages

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

Commercial property

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

Risk Report (continued)

CREDIT RISK (continued)

Collateral (continued)

Non-property related collateral

In addition to residential and commercial property based security, the Group also takes other forms of collateral when lending. This can involve obtaining security against the underlying loan through the use of cash collateral and / or netting agreements, both of which reduce the original exposure by the amount of collateral held, subject to volatility and maturity adjustments where applicable.

The Group also operates a policy of obtaining security against the underlying loan via the use of guarantees, which can be either limited or unlimited, making the guarantor liable for only a portion or all of the debt.

The following table shows the total non-property collateral held by sector at 30 September in terms of cash, guarantees (these guarantors are predominantly other financial institutions who are considered to be of a high credit quality) and netting. The exposure amount shown below is the total gross exposure (before any credit risk mitigation and credit conversion factors have been applied where applicable) for arrangements which have some form of associated collateral held against it and is not the total exposure for each asset class, as disclosed elsewhere in this section.

Group (audited) 2018	Cash £m	Guarantee £m	Netting £m	Total £m	Exposure £m
Central Government or Central Bank	3,057	-	-	3,057	4,525
Corporates	28	15	75	118	180
Financial institutions	-	-	-	-	-
Exposures in default	-	-	-	-	1
Regional Government or local authorities	-	-	83	83	83
Secured by mortgages on commercial real	-	-	-	-	38
Secured by mortgages on residential property	-	-	-	-	4
	3,085	15	158	3,258	4,831

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

The decrease in cash collateral held and corresponding exposure is due to movements within repurchase (repo) and similar transactions outstanding at 30 September 2018 (including TFS drawings), reflected within Central Governments or Central Banks, The decrease in cash collateral held and corresponding exposure in financial institutions is due to the maturity of a repo and no outstanding reimbursement receivable from National Australia Bank Limited (NAB) previously held in relation to the conduct indemnity deed (described further in note 3.14).

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

Risk Report (continued)

CREDIT RISK (continued)

Forbearance

Forbearance is considered to take place when the Group grants concessions to assist customers who are experiencing, or who are about to experience, difficulties in meeting their financial commitments to the Group. The Group's forbearance policies and definitions comply with the guidance established by the European Banking Authority for FINREP reporting. Forbearance concessions include the granting of more favourable terms and conditions than those provided either at drawdown of the facility or which would not ordinarily be available to other customers with a similar risk profile. Forbearance parameters are regularly reviewed and refined as necessary to ensure they are consistent with the latest industry guidance and prevailing practice as well as ensuring that they adequately capture and reflect the most recent customer behaviours and market conditions. The Group makes every effort to treat customers fairly and aligns its forbearance practices to that principle.

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

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

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

- Facilities that have been temporarily extended pending review and no concession has been granted for reasons relating to the actual or apparent financial stress of a customer.
- A reduction in asset quality to a level where actual, or apparent, financial stress is not evident.
- Where changes are made to the terms of a borrower's interest structure or repayment arrangement on a commercial basis.
- Late provision of financial information, in the absence of other indicators of financial difficulty, is not in all cases considered a 'non commercial' breach of non-financial covenants.

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

Retail forbearance

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

Debt management for mortgage customers in financial difficulty

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

Risk Report (continued)

CREDIT RISK (continued)

Retail forbearance (continued)

Debt management for mortgage customers in financial difficulty (continued)

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

One component of the Group's approach is to contact customers showing signs of financial difficulty to discuss their circumstances and offer solutions to prevent their accounts falling into arrears.

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

Group (audited) As at 30 September 2018	Total Retail loans and advances subject to forbearance measures			Impairment allowance on Retail loan and advances subject to forbearance measures	
	Number of loans	Gross carrying amount £m	% of total portfolio	Impairment allowance £m	Coverage %
Formal arrangements	1,497	168	0.68	3.3	2.00
Temporary arrangements	1,275	161	0.66	2.3	1.45
Interest only conversion	231	32	0.13	0.1	0.18
Term extension	150	12	0.05	0.1	0.48
Other	41	4	0.02	-	0.36
Legal	148	15	0.06	0.5	3.34
	3,342	392	1.60	6.3	1.61

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

The Group also has a number of customers with interest only mortgages past maturity, not subject to forbearance. The Group has formal processes embedded to proactively track and facilitate pre-maturity customer engagement to bring the cases to a formal conclusion which is generally aimed to be achieved within six months after the loan has reached maturity. Complex cases can take longer than this to reach conclusion. At 30 September 2018, the Group had 117 (2017: 97) customers with interest only mortgages not subject to forbearance and which were post six month maturity with a total value of £19m (2017: £14m).

Risk Report (continued)

CREDIT RISK (continued)

Retail forbearance (continued)

A further forbearance reserve of £4m (2017: £4m) is presently held within the overall collective provision. The effect of this on the above tables would be to increase the impairment allowance noted above to £10.3m (2017: £12.1m) and to increase overall coverage to 2.63% (2017: 3.05%). When all other avenues of resolution including forbearance have been explored, the Group will take steps to repossess and sell underlying collateral. In the year to 30 September 2018 there were 38 repossessions of which 16 were voluntary (2017: 50 including 13 voluntary).

Retail forbearance – unsecured consumer credit

The Group currently exercises limited forbearance strategies in relation to other types of consumer credit, including current accounts, unsecured loans and credit cards. The Group has assessed the total loan balances subject to forbearance on other types of consumer credit lending to be £12m at 30 September 2018 (2017: £11m), representing 1.02% of the unsecured Retail portfolio (2017: 1.02%). Impairment provisions on forborne balances totalled £4.2m at 30 September 2018 (2017: £3.1m), providing overall coverage of 34.36% (2017: 27.18%).

SME lending

For SME lending, the Group has an internally developed credit rating system, as defined under the Group's credit risk management policy, which uses data drawn from a number of sources to assess the potential risk in lending to the Group's customers. This system assigns an indication of the PD for each customer and can be broadly mapped to external agencies rating scales. Impaired assets consist of SME lending and secured Retail lending where current circumstances indicate that losses of loan principal and / or interest may be incurred.

Description	eCRS	PD
Senior investment grade	1 to 5	0 < 0.11
Investment grade	6 to 11	0.11 < 0.55
Sub-investment grade	12 to 23	0.55 < 99.99

Mitigation and Management of Credit Risk

The credit quality of the portfolio of loans and advances that were neither past due nor impaired can be assessed by reference to the Group's standard credit rating system. The credit rating system is supported by a variety of financial analytics, combined with processed market information to provide the main inputs for the measurement of counterparty risk. All internal risk ratings are tailored to the various categories and are derived in accordance with the Group's ratings policy.

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

	Group		Bank	
	2018	2017	**2018**	2017
	£m	£m	**£m**	£m
Senior investment grade	**839**	946	**835**	943
Investment grade	**1,731**	1,807	**1,722**	1,802
Sub-investment grade	**4,367**	3,873	**4,344**	3,862
	6,937	6,626	**6,901**	6,607

Risk Report (continued)

CREDIT RISK (continued)

Mitigation and Management of Credit Risk (continued)

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

	Group		Bank	
	2018	2017	2018	2017
	£m	£m	£m	£m
Senior investment grade	1	3	1	3
Investment grade	157	231	157	231
Sub-investment grade	200	237	200	237
	358	471	358	471

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

SME Forbearance

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

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

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

Risk Report (continued)

CREDIT RISK (continued)

SME forbearance (continued)

Group (audited) As at 30 September 2018	Total SME loans and advances subject to forbearance measures			Impairment allowance on SME loans and advances subject to forbearance measures	
	Number of loans	Gross carrying amount £m	% of total portfolio	Impairment allowance £m	Coverage %
Term extension	179	162	2.15	10.5	6.48
Deferral of contracted capital repayments	103	129	1.73	15.6	12.02
Reduction in contracted interest rate	2	1	0.01	-	4.05
Alternative forms of payment	4	25	0.33	7.5	30.46
Debt forgiveness	4	11	0.14	0.6	5.64
Refinancing	17	10	0.13	1.0	9.87
Covenant breach/reset/waiver	61	207	2.75	9.2	4.43
	370	545	7.24	44.4	8.14

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

Included in other financial assets at fair value is a portfolio of loans that is included in the above table. The principal value of fair value loans subject to forbearance at 30 September 2018 is £15m (2017: £45m), representing 0.19% of the total SME portfolio (2017: 0.61%). Impairment allowances on these amounts totalled £2m (2017: £4m), a coverage of 11.65% (2017: 8.89%).

Risk Report (continued)

CREDIT RISK (continued)

Other Credit Risks

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

Offsetting of financial assets and liabilities

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

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

Group 2018 (audited)				**Net amounts not offset in the balance sheet**		
	Gross Amounts £m	**Gross amounts offset in the balance sheet [1] £m**	**Net Amounts presented on balanace sheet [1] £m**	**Financial instruments £m**	**Cash Collateral Pledged/ Received £m**	**Net Amount £m**
Assets						
Derivative financial instruments [2]	262	-	262	(99)	(26)	137
Liabilities						
Derivative financial instruments [2]	361	-	361	(99)	(234)	28
Securities sold under repurchase agreement	802	-	802	(802)	-	-

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

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

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

Risk Report (continued)

CREDIT RISK (continued)

Offsetting of financial assets and liabilities (continued)

Bank 2018 (audited)	Gross Amounts £m	Gross amounts offset in the balance sheet (1) £m	Net Amounts presented on balanace sheet (1) £m	Net amounts not offset in the balance sheet: Financial instruments £m	Net amounts not offset in the balance sheet: Cash Collateral Pledged/ Received £m	Net Amount £m
Assets						
Derivative financial instruments (2)	151	-	151	(99)	(26)	26
Liabilities						
Derivative financial instruments (2)	361	-	361	(99)	(234)	28
Securities sold under repurchase agreement	802	-	802	(802)	-	-

Bank 2017 (audited)	Gross Amounts £m	Gross amounts offset in the balance sheet (1) £m	Net Amounts presented on balanace sheet (1) £m	Net amounts not offset in the balance sheet: Financial instruments £m	Net amounts not offset in the balance sheet: Cash Collateral Pledged/ Received £m	Net Amount £m
Assets						
Contingent liabilities and related com	136	-	136	(72)	(22)	42
(audited)						
Derivative financial instruments (2)	376	-	376	(72)	(203)	101
Securities sold under repurchase agreement	1,864	-	1,864	(1,864)	-	-

(1) Collateral amounts (cash and non-cash financial collateral) are reflected at their fair value; however this amount is limited to the net balance sheet exposure in order to exclude any over collateralisation.
(2) Derivative financial instruments comprise of both trading and hedging derivative assets and liabilities.

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

BALANCE SHEET & PRUDENTIAL REGULATION RISKS

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

10.7%	115%	137%
CET1	LDR	LCR

Risk appetite

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

Risk appetite is approved for balance sheet risks by the Board, with authority delegated to the Asset and Liability Committee (ALCO) for subsequent implementation and monitoring. The Board has established a range of measures of risk appetite for capital including CET1, leverage and minimum holdings of capital. Measures for funding and liquidity risks consider the structure of the balance sheet and the Group's overall funding profile and Overall Liquidity Asset Rule (OLAR). The OLAR covers the Board's appetite in relation to regulatory liquidity requirements and also covers the need to maintain a volume of high quality liquid assets that is sufficient to accommodate outflows of funds in a range of stress scenarios over a three-month period.

The Group’s participation in wholesale markets, along with its use of financial instruments, is to fund its banking activities and to manage the liquidity and interest rate risks arising from these activities. The Group establishes an appetite for these risks based on an overriding principle that the Group will not engage in proprietary risk taking.

Capital

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

Measurement

The Group manages capital in accordance with prudential rules issued by the PRA and Financial Conduct Authority (FCA), which implemented CRD IV legislation with effect from 1 January 2014. The Group’s approach to Pillar 1 for the year ended 30 September 2018 was to use the standardised approaches to calculate RWAs. The standardised approaches are inherently conservative and the Group has been developing the capability to utilise IRB methods for the calculation of credit risk capital. A waiver to utilise IRB models was submitted to the PRA during 2017 and subsequently approved in October 2018 for its mortgage and SME/corporate portfolios.

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

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

Capital Buffers

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

The CCyB has been effective from 1 May 2014 and is dependent upon the BoE view of credit conditions in the economy. The CCyB was 0.5% of RWAs at 30 September 2018 with this rising to 1.00% in November 2018.

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

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

Monitoring

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

Mitigation

The Group's Capital Risk Policy Standard provides the framework for the manner in which capital is managed within the Group. The objectives of the policy standard are to efficiently manage the capital base to optimise shareholder returns while maintaining robust capital adequacy, meeting regulators' requirements, managing the rating agencies' assessment of the Group and ensuring that excessive leverage is not taken.

The Group is able to accumulate additional capital through the retention of profit over time, by cutting costs, by raising new equity via, for example, a rights issue or debt exchange, by reducing or cancelling distributions on capital instruments, and by raising Additional Tier 1 (AT1) and Tier 2 capital. The availability and cost of additional capital is dependent upon market conditions and perceptions at the time. The Group is also able to manage the demands for capital through management actions including adjusting its lending strategy.

Capital optimisation remains a key strategic priority of the Group and a waiver application was submitted to the PRA during 2017 to utilise IRB models. Approval for the use of the IRB models for the mortgage and SME/corporate portfolios was subsequently obtained in October 2018.

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

Capital position

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

Regulatory capital (unaudited) [1]	2018 £m	2017 £m
CET1 capital		
Capital instruments	1,013	502
Retained earnings and other reserves	1,843	2,527
Regulatory adjustments and deductions		
Defined benefit pension fund assets (net of deferred tax liabilities) [2]	(138)	(135)
Prudent valuation adjustment [3]	(3)	(4)
Intangible assets [4]	(412)	(339)
Deferred tax asset relying on future profitability [5]	(192)	(110)
Cash flow hedge reserve	37	(1)
	2,148	2,440
Tier 1 capital		
Additional Tier 1 (AT1) capital instruments	425	425
Total Tier 1 capital	2,573	2,865
Tier 2 capital		
Subordinated debt	477	476
Credit Risk adjustments	152	154
Total Tier 2 capital	629	630
Total capital	3,202	3,495

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

Reconciliation of statutory total equity to regulatory capital (unaudited)	2018 £m	2017 £m
Statutory total equity	3,291	3,464
Deductions from capital	(553)	(478)
Deferred tax asset relying on future profitability	(192)	(110)
Cash flow hedge reserve	37	(1)
Foreseeable AT1 dividends and charges	(10)	(10)
Regulatory Tier 1 capital	2,573	2,865

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

Regulatory capital flow of funds (unaudited)	CRD IV 2018 £m	CRD IV 2017 £m
CET1 capital		
CET1 capital at 1 October	2,440	2,393
Share capital: ordinary share new issuance	511	178
Retained earnings and other reserves (including structured entities)	(684)	55
Prudent valuation adjustment	1	3
Intangible assets	(73)	(83)
Deferred tax asset relying on future profitability	(82)	(39)
Defined benefit pension fund assets	(3)	(135)
Cash flow hedge reserve	38	68
CET1 capital at 30 September	2,148	2,440
Tier 1 capital		
Tier 1 capital at 1 October	425	425
Tier 1 capital at 30 September	425	425
Total Tier 1 capital	2,573	2,865
Tier 2 capital		
Tier 2 capital at 1 October	630	630
Credit Risk adjustments	(2)	3
Subordinated debt redemption	1	(3)
Total Tier 2 capital at 30 September	629	630
Total capital	3,202	3,495

Minimum Pillar 1 capital requirements (unaudited)	2018 £m	2017 £m
Credit Risk	1,449	1,449
Operational risk	134	131
Counterparty risk	10	11
Credit valuation adjustment	17	13
Tier 1 regulatory capital requirements	1,610	1,604

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

RWA movements

RWA flow statement (unaudited)	2018 £m	2017 £m
RWA at 1 October	20,055	19,017
Book size growth / (reduction)	58	918
Book quality deterioration/(improvement)[1]	4	(28)
Methodology and policy	-	148
RWAs at 30 September	20,117	20,055

[1] The marginal deterioration in book quality in 2018 is primarily due to the continued diversification in the Liquid Asset Buffer.

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

Capital requirements for calculating RWAs	At 30 September 2018			At 30 September 2017		
	Capital required £m	RWA £m	Exposure £m	Capital required £m	RWA £m	Exposure £m
Central Governments or Central Banks	-	1	11,361	-	-	12,582
Regional Governments or Local Authorities	1	12	143	2	19	156
Public Sector Entities	-	2	155	-	5	155
Multilateral development banks	-	-	155	-	-	205
Financial Institutions	11	136	630	13	163	1,089
Corporates	316	3,956	4,311	302	3,782	4,155
Retail	90	1,124	1,499	72	905	1,207
Secured by mortgages on immovable property	938	11,708	28,423	961	12,001	28,203
Exposures in default	45	562	465	47	590	483
Collective investments undertakings	-	1	1	-	1	1
Equity exposures	-	5	4	-	5	3
Items associated with particularly high risk	4	49	33	3	40	26
Covered bonds	5	61	615	4	48	477
Other items	39	487	715	45	557	585
Total Credit Risk	1,449	18,104	48,510	1,449	18,116	49,327
Operational risk	134	1,670		131	1,634	
Counterparty risk	10	125		11	138	
Credit valuation adjustment	17	218		13	167	
	1,610	20,117		1,604	20,055	

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

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

Regulatory capital (unaudited)	2018 £m	2017 £m
RWAs [1]		
Retail mortgages	9,002	8,646
Business lending	7,407	7,359
Other retail lending	981	932
Other lending	109	148
Other [2]	605	1,031
Credit risk	18,104	18,116
Operational risk	1,670	1,634
Counterparty risk	125	138
Credit valuation adjustment	218	167
Total RWAs	20,117	20,055
Capital ratios		
CET1 ratio [3]	10.7%	12.2%
Tier 1 ratio	12.8%	14.3%
Total capital ratio	15.9%	17.4%

[1] RWAs are calculated under the standardised approach.
[2] The items included in the 'other' exposure class that attract a capital charge include items in the course of collection, cash in hand, fixed assets and deferred tax assets that are not deducted.
[3] CET1 capital is comprised of shares and related share premium, retained earnings and other reserves less specified regulatory adjustments.

The Group measures the amount of capital it requires and holds by applying CRD IV as implemented in the UK by the PRA and supplemented through additional regulation under the PRA Rulebook. The table below summarises the amount of capital in relation to RWAs the Group is currently required to hold, excluding any PRA Buffer. These ratios apply at the consolidated Group level.

	As at 30 Sep 2018	
Minimum Requirements	CET1	**Total Capital**
Pillar 1 [1]	4.5%	8.0%
Pillar 2A [2]	2.5%	4.5%
Individual Capital Guidance	7.0%	**12.5%**
Capital conservation buffer [3]	1.9%	1.9%
UK countercyclical capital buffer [4]	0.5%	0.5%
Total (excluding PRA buffer) [5]	9.4%	**14.9%**

[1] The minimum amount of capital under Pillar 1 of the regulatory framework is determined as 8% of RWAs, of which at least 4.5% of RWAs is required to be covered by CET1 capital.
[2] Growth in RWAs at CB PLC has meant that as 30 September 2018 the Group's Pillar 2A total capital requirement, as set by the PRA's Individual Capital Guidance (ICG_ has reduced from 4.6% to 4.5% At least 56.25% of this needs to be met with CET1, equating to approximately 2.5% of RWAs.
[3] The CCB is being phased in over the period from 1 January 2019. The CCB has been set at 2.5% of RWAs, with 1.875% applicable for 2018.
[4] The YK CCyB may be set between 0% and 2.5%. On 27 June 2018 the YK CCyB increased from 0% to 0.5% and the FPC reaffirmed that it expects to increase the UK CCyB from 0.5% to 1% from 26 November 2018. The FPC will conduct a comprehensive assessment of the resilience of the UK banking system in the 2018 stress test and review the adequacy of the 1% CCyB rate.
[5] The Group may be subject to a PRA buffer as set by the PRA but is not permitted to disclose the level of any buffer. A PRA buffer can consist of two components:
- A risk management and governance buffer that is set as a scalar of the Pillar 1 and Pillar 2A requirements
- A buffer relating to the results of the BoE stress tests.

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

As announced on 11 October 2018, the Group has received IRB accreditation for both its mortgage and SME/corporate portfolios. The Group's estimated IRB RWAs and capital ratios, as at 30 September 2018, are as follows:

Regulatory capital (unaudited)	2018 £m
RWAs [1]	
Retail mortgages	4,460
Business lending	6,598
Other retail lending	981
Other lending	109
Other [2]	474
Credit risk	12,622
Operational risk	1,674
Counterparty risk	125
Credit valuation adjustment	185
Total RWAs	14,606
Capital ratios	
CET1 ratio	14.4%
Tier 1 ratio	17.3%
Total capital ratio	21.6%

The Group's credit RWAs on an IRB basis would have been c.£4.5bn lower in the mortgage portfolio and c.£0.8bn lower in the SME/corporate portfolio. These reductions would have resulted in a pro forma increase in CET1 ratio of approximately 350 basis points (bps) to c.14.4% as at 30 September 2018.

The Basel Committee published their final Basel III framework in December 2017. A key objective of the revisions is to reduce excessive variability of current RWAs and improve the comparability of banks' capital ratios. Implementation dates range from 2022 to 2027 and the Committee has introduced transitional arrangements to ensure an orderly and timely implementation. The Group's initial analysis suggests that the new requirements will not have a material impact on the total amount of capital it is required to hold.

Dividend

As announced in the Strategic Report the Board has recommended a 3.1p per share dividend. The dividend would equate to approximately £44m of CET1 (equivalent to 22bps of CET1 based on RWAs as at 30 September 2018).

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

Leverage

Leverage ratio (unaudited)	2018 £m	2017 £m
Total Tier 1 capital for the leverage ratio		
Total CET1 capital	2,148	2,440
AT1 capital	425	425
Total Tier 1	2,573	2,865
Exposures for the leverage ratio		
Total statutory assets	43,583	43,314
Adjustment for off-balance sheet items	1,763	2,019
Adjustment for derivative financial instruments	(134)	(228)
Adjustment for securities financing transactions (SFTs)	1,468	1,461
Other adjustments	(708)	(589)
Leverage ratio exposure	45,972	45,977
CRD IV Leverage ratio	5.6%	6.2%
UK leverage ratio (1)	6.5%	7.3%

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

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

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

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

Other regulatory adjustments consist of adjustments that are required under CRD IV to be deducted from Tier 1 capital. The removal of these from the exposure measure ensures consistency is maintained between the capital and exposure components of the ratio. The Group's leverage ratio is 5.6% which exceeds the Basel Committee's proposed minimum of 3%, applicable from 2018.

The UK leverage ratio framework, which came into force on 1 January 2016, is relevant to PRA regulated banks and building societies with consolidated retail deposits equal to or greater than £50bn. As at 30 September 2018 the Group was excluded from these requirements. On 3 October 2017, the PRA published a Policy Statement - 'UK Leverage Ratio treatment of claims on central banks'.

The PRA Rulebook has been amended to:

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

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

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

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

If these modifications are applied to the Group this results in an increase in the leverage ratio from 5.6% under CRD IV to 6.5% on the PRA modified basis as a result of the Group's significant exposures to Central Banks within its Liquid Asset Portfolio and Note Cover.

On 14 November 2018, the PRA published a policy statement – 'UK leverage ratio: Applying the framework to systemic ring-fenced bodies and reflecting the systemic risk buffer', confirming that from 1 January 2019 the UK leverage ratio framework will apply on a sub-consolidated basis to ring-fenced bodies in scope.

The Group's pro forma CRD IV Leverage ratio, including the estimated impact of IRB accreditation at CB PLC, at 30 September 2018 was 5.5%.

Funding and liquidity risk

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

Liquidity risk is the risk that the Group is unable to meet its current and future financial obligations as they fall due at acceptable cost. These obligations include the repayment of deposits on demand or at their contractual maturity dates, the repayment of borrowings and loan capital as they mature, the payment of operating expenses and tax, the payment of dividends and the ability to fund new and existing loan commitments.

Risk assessment

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

Liquidity risk exposures are subject to assessment under both regulatory and internal requirements. Exposures relate to the outflow of funds under a series of stress scenarios less the impact of inflows from assets, liquidation of high quality liquid assets or through other actions instigated by the Group. The Treasury function is responsible for the development and execution of strategy subject to oversight from the Risk Management function. In relation to funding and liquidity risk, the primary management committee is ALCO.

The Group continues to maintain its strong funding and liquidity position and seeks to achieve an appropriate balance between profitability, liquidity risk and capital optimisation. Funding is predominantly provided by Retail and SME customers and this is supported by medium-term secured funding issuance (e.g. the Group's Lanark securitisation programme), its RCB platform and unsecured medium-term notes (the Group also raised funds through the Term Funding Scheme prior to the Scheme's closure to new drawings in early 2018). These funding programmes are a source of strength for the Group and leverage the Group's high quality mortgage book as a source of collateral for secured funding.

Monitoring

Funding and liquidity risks are subject to a range of measures contained within the Group's RAS and a series of limits agreed by ALCO. These measures provide a view of risks both under normal and stressed conditions with a focus on cash outflows and inflows under stress concentration risks, refinancing risks, readiness of mitigating action, and provide a short and long term view of risks. An early warning framework is also operated to ensure quick escalation of any issues (see Contingency Funding Plan below).

The Group operates a Funds Transfer Pricing (FTP) system. A key purpose of FTP is to ensure that liquidity risk is a factor in the pricing of loans and deposits.

Mitigation

The Group has several sources of funding which are well diversified in terms of the type of instrument and product, counterparty, term structure and market. Refinancing risks are carefully managed and are subject to controls overseen by ALCO.

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

Funding and liquidity risk (continued)

The Group holds a portfolio of High Quality Liquid Assets (HQLA) that can be utilised to raise funding in times of stress. The size of the HQLA portfolio is calibrated based on a view of potential outflows under both systemic and idiosyncratic stress events. In addition, the Group can use the repo market to generate funds and can also participate in BoE operations through the Sterling Monetary Framework.

Contingency Funding Plan

A Contingency Funding Plan has been established for management of an escalated liquidity requirement if the Group experiences either restricted access to wholesale funding or a significant increase in the withdrawal of funds. The plan identifies triggers for escalation, details the action required, allocates the key tasks to individuals, provides a time frame and defines a management committee to manage the action plan.

External credit ratings

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

	Outlook as at	As at	
	30 Sep 2018 [(1)]	30 Sep 2018	30 Sep 2017
CYBG PLC			
Fitch	Stable	BBB+	BBB+
Standard & Poor's	Stable	BBB-	BBB-
Clydesdale Bank PLC			
Fitch	Stable	BBB+	BBB+
Standard & Poor's	Stable	BBB+	BBB+
Moody's [(2)]	On Review	Baa1	Baa2

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

On 7 December 2017, Moody's upgraded the long-term deposit rating of Clydesdale Bank PLC by one notch to Baa1. This reflected Moody's view on the improvement in the Group's management and risk and compliance frameworks, together with the delivery of the strategic plan and return to profitability. As part of the same rating action, Moody's revised the outlook on Clydesdale Bank PLC's long-term deposit rating to 'positive' in anticipation of ongoing senior unsecured issuance from CYBG PLC to meet MREL.

In November 2017, S&P revised their view of UK economic risk for the UK banking sector, which led to the outlooks for Clydesdale Bank PLC and CYBG PLC being revised from negative to stable. On 23 March 2018, S&P affirmed the ratings of Clydesdale Bank PLC and CYBG PLC, with a stable outlook.

In June 2018, following the announcement of the Group's offer for Virgin Money, all three rating agencies released updates relating to the Group Baseline Credit Assessment. S&P and Fitch affirmed the Group's rating and outlook whilst Moody's placed Clydesdale Bank PLC's Adjusted Baseline Credit Assessment of Baa2, on Review for Upgrade, and its long-term Deposit Rating of Baa1, on Review for Downgrade. At the same time, Moody's placed Virgin Money's Baa2 long-term local-currency deposit ratings and Baa2 long-term issuer ratings on review for upgrade, as well as its Baa2 Baseline Credit Assessment and adjusted Baseline Credit Assessment.

Moody's noted that, "The review for upgrade on both banks Baseline Credit Assessments is driven by (i) the substantial potential for cost savings; (ii) the two banks' complementary business mixes, providing new revenue opportunities; and (iii) Moody's expectations that the combined entity will retain a strong capital position and stable funding profile."

As at 26 November there have been no changes to the Group's long term credit ratings or outlooks since the report date.

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

Assets and liabilities by maturity

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

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

Group 2018 (audited)	Call £m	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	No specified maturity £m	Total £m
Assets							
Cash and balances with central banks	4,917	-	-	-	-	1,656	6,573
Due from related entities	-	35	-	-	-	-	35
Due from other banks	307	529	-	-	-	-	836
Financial assets available for sale	-	5	79	658	810	10	1,562
Other financial assets at fair value	-	8	36	144	174	-	362
Derivative financial instruments	-	13	26	164	59	-	262
Loans and advances to customers	1,093	1,196	983	4,623	24,468	381	32,744
Due from customers on acceptances	-	4	-	-	-	-	4
All other assets	-	128	62	-	-	1,015	1,205
Total assets	6,317	1,918	1,186	5,589	25,511	3,062	43,583
Liabilities							
Due to other banks	53	502	300	2,250	-	-	3,105
Other financial liabilities at fair value	-	2	6	7	-	-	15
Derivative financial instruments	-	10	19	133	199	-	361
Due to customers	23,142	981	1,787	2,994	-	-	28,904
Liabilities on acceptances	-	4	-	-	-	-	4
Due to related entities	36	1	6	474	796	-	1,313
Debt securities in issue	-	359	625	1,989	725	-	3,698
All other liabilities	2,254	90	110	-	-	438	2,892
Total liabilities	25,485	1,949	2,853	7,847	1,720	438	40,292
Off balance sheet items							
Contingent liabilities	-	26	36	12	45	-	119
Other credit commitments	7,016	-	-	-	-	-	7,016
Total off balance sheet items	7,016	26	36	12	45	-	7,135

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

Assets and liabilities by maturity (continued)

Group 2017 (audited)	Call £m	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	No specified maturity £m	Total £m
Assets							
Cash and balances with central banks	5,430	-	-	-	-	1,507	6,937
Due from related entities	-	366	-	-	-	-	366
Due from other banks	701	109	-	-	-	-	810
Financial assets available for sale	-	3	256	1,334	473	10	2,076
Other financial assets at fair value	-	4	16	225	232	-	477
Derivative financial instruments	-	19	72	116	75	-	282
Loans and advances to customers	1,783	292	764	5,048	23,010	396	31,293
Due from customers on acceptances	-	4	-	-	-	-	4
All other assets	-	202	48	-	-	819	1,069
Total assets	7,914	999	1,156	6,723	23,790	2,732	43,314
Liabilities							
Due to other banks	44	1,164	700	1,900	-	-	3,808
Other financial liabilities at fair value	-	-	-	26	-	-	26
Derivative financial instruments	-	21	31	132	192	-	376
Due to customers	22,185	917	2,220	2,396	-	-	27,718
Liabilities on acceptances	-	4	-	-	-	-	4
Due to related entities	28	-	3	475	303	-	809
Debt securities in issue	-	620	499	2,138	749	-	4,006
All other liabilities	2,197	174	-	-	-	732	3,103
Total liabilities	24,454	2,900	3,453	7,067	1,244	732	39,850
Off balance sheet items							
Contingent liabilities	-	19	40	10	42	-	111
Other credit commitments	8,408	-	-	-	-	-	8,408
Total off balance sheet items	8,408	19	40	10	42	-	8,519

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

Assets and liabilities by maturity (continued)

Bank
2018 (audited)

	Call £m	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	No specified maturity £m	Total £m
Assets							
Cash and balances with central banks	4,917	-	-	-	-	1,656	6,573
Due from related entities	1,093	17	45	-	-	83	1,238
Due from other banks	307	69	-	-	-	-	376
Financial assets available for sale	-	5	79	658	810	4	1,556
Other financial assets at fair value	-	8	36	144	174	-	362
Derivative financial instruments	-	12	26	94	19	-	151
Loans and advances to customers	1,093	1,189	977	4,564	23,427	381	31,631
Due from customers on acceptances	-	4	-	-	-	-	4
All other assets	-	132	62	-	-	1,021	1,215
Total assets	7,410	1,436	1,225	5,460	24,430	3,145	43,106
Liabilities							
Due to other banks	53	502	300	2,250	-	-	3,105
Other financial liabilities at fair value	-	2	6	7	-	-	15
Derivative financial instruments	-	10	19	133	199	-	361
Due to customers	23,142	981	1,787	2,994	-	-	28,904
Liabilities on acceptances	-	4	-	-	-	-	4
Due to related entities	220	150	387	2,475	648	5	3,885
Debt securities in issue	-	-	10	-	698	-	708
All other liabilities	2,254	89	107	-	-	439	2,889
Total liabilities	25,669	1,738	2,616	7,859	1,545	444	39,871
Off balance sheet items							
Contingent liabilities	-	26	36	12	45	-	119
Other credit commitments	6,887	-	-	-	-	-	6,887
Total off balance sheet items	6,887	26	36	12	45	-	7,006

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

Assets and liabilities by maturity (continued)

Bank
2017 (audited)

	Call £m	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	No specified maturity £m	Total £m
Assets							
Cash and balances with central banks	5,430	-	-	-	-	1,507	6,937
Due from related entities	1,051	383	34	-	-	79	1,547
Due from other banks	407	-	-	-	-	-	407
Financial assets available for sale	-	3	255	1,335	473	4	2,070
Other financial assets at fair value	-	4	16	225	232	-	477
Derivative financial instruments	-	19	32	67	18	-	136
Loans and advances to customers	1,781	285	758	4,985	22,031	396	30,236
Due from customers on acceptances	-	4	-	-	-	-	4
All other assets	-	209	48	-	-	822	1,079
Total assets	8,669	907	1,143	6,612	22,754	2,808	42,893
Liabilities							
Due to other banks	44	1,164	700	1,900	-	-	3,808
Other financial liabilities at fair value	-	-	-	26	-	-	26
Derivative financial instruments	-	21	31	132	192	-	376
Due to customers	22,185	917	2,220	2,396	-	-	27,718
Liabilities on acceptances	-	4	-	-	-	-	4
Due to related entities	193	395	294	2,534	308	-	3,724
Debt securities in issue	-	-	10	-	698	-	708
All other liabilities	2,197	172	-	-	-	732	3,101
Total liabilities	24,619	2,673	3,255	6,988	1,198	732	39,465
Off balance sheet items							
Contingent liabilities	-	19	40	10	42	-	111
Other credit commitments	8,382	-	-	-	-	-	8,382
Total off balance sheet items	8,382	19	40	10	42	-	8,493

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

Cash flows payable under financial liabilities by contractual maturity

Group
2018 (audited)

	Call £m	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	No specified maturity £m	Total £m
Due to other banks	53	502	314	2,282	-	-	3,151
Other financial liabilities at fair value	-	3	6	8	-	-	17
Trading derivative financial instruments	-	13	31	40	17	-	101
Due to customers	23,143	981	1,788	2,995	-	-	28,907
Liabilities on acceptances	-	4	-	-	-	-	4
Debt securities in issue	-	359	647	2,119	822	-	3,947
Due to related entities	36	6	49	627	845	-	1,563
All other financial liabilities	2,254	90	110	-	-	438	2,892
Hedging derivative liabilities							
Contractual amounts payable	-	8	42	253	235	-	538
Total assets	25,486	1,966	2,987	8,324	1,919	438	41,120

Group
2017 (audited)

	Call £m	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	No specified maturity £m	Total £m
Due to other banks	44	1,164	708	1,912	-	-	3,828
Other financial liabilities at fair value	-	-	1	27	-	-	28
Trading derivative financial instruments	-	26	36	79	28	-	169
Due to customers	22,185	918	2,220	2,397	-	-	27,720
Liabilities on acceptances	-	4	-	-	-	-	4
Debt securities in issue	32	620	521	2,268	878	-	4,319
Due to related entities	27	5	32	573	317	-	954
All other financial liabilities	2,197	174	-	-	-	732	3,103
Hedging derivative liabilities							
Contractual amounts payable	-	6	39	225	194	-	464
Total assets	24,485	2,917	3,557	7,481	1,417	732	40,589

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

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

Bank
2018 (audited)

	Call £m	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	No specified maturity £m	Total £m
Due to other banks	53	502	314	2,282	-	-	3,151
Other financial liabilities at fair value	-	3	6	8	-	-	17
Trading derivative financial instruments	-	13	31	40	17	-	101
Due to customers	23,143	981	1,788	2,995	-	-	28,907
Liabilities on acceptances	-	4	-	-	-	-	4
Debt securities in issue	-	-	32	130	795	-	957
Due to related entities	220	375	688	2,695	845	5	4,828
All other financial liabilities	2,254	89	107	-	-	439	2,889
Hedging derivative liabilities							
Contractual amounts payable	-	8	42	253	235	-	538
Total assets	25,670	1,975	3,008	8,403	1,892	444	41,392

Bank
2017 (audited)

	Call £m	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	No specified maturity £m	Total £m
Due to other banks	44	1,164	708	1,912	-	-	3,828
Other financial liabilities at fair value	-	-	1	27	-	-	28
Trading derivative financial instruments	-	26	36	79	28	-	169
Due to customers	22,185	918	2,220	2,397	-	-	27,720
Liabilities on acceptances	-	4	-	-	-	-	4
Debt securities in issue	32	-	32	130	828	-	1,022
Due to related entities	193	837	674	4,946	322	-	6,972
All other financial liabilities	2,197	172	-	-	-	732	3,101
Hedging derivative liabilities							
Contractual amounts payable	-	6	39	225	194	-	464
Total assets	24,651	3,127	3,710	9,716	1,372	732	43,308

The balances in the cash flow tables above will not agree directly to the balances in the consolidated balance sheet as the table incorporates all cash flows, on an undiscounted basis, related to both principal as well as those associated with all future coupon payments.

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

Market risk

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

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

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

Exposures

The focus of the Group's activity is to provide high quality banking services to its customers. These services include the provision of foreign exchange products and derivative products to enable customers to manage risks within their businesses. As a result of these activities, the Group may be exposed to forms of market risk that would arise from movements in price on these products. Controls include the hedging of these products as and when they arise.

Measurement

Interest rate risk in the banking book (IRRBB) is measured, monitored, and managed from both an internal management and regulatory perspective. The RMF incorporates both market valuation and earnings-based approaches. In accordance with the Group IRRBB Policy Standard, risk measurement techniques include: basis point sensitivity; Value at Risk ('VaR'), Earnings at Risk ('EaR'), interest rate risk stress testing, repricing analysis, cash flow analysis, and scenario analysis.

The key features of the internal interest rate risk management model are:

- the use of basis point sensitivity analysis;
- historical simulation approach utilising instantaneous interest rate shocks including parallel rate movements and twists in the yield curve to explore risks around exposures to movements in short or long term interest rates;
- static balance sheet (i.e. any new business is assumed to be matched, hedged or subject to immediate repricing);
- VaR and EaR are measured on a statistical basis: 99% confidence level with appropriate holding periods depending on varying risk types;
- investment term for capital is modelled with a benchmark term agreed by the ALCO;
- investment term for core non-interest bearing assets and liabilities is modelled on a behavioural basis with a benchmark term agreed by the ALCO; and
- assumptions covering the behavioural life of products and customer behaviour for optionality are reviewed and approved by ALCO.

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

Mitigation measures

Market risks are overseen by the ALCO with delegation for day to day management given to Treasury. Treasury use a number of techniques and products to manage market risks including interest rate swaps, cash flow netting and foreign exchange. Basis risk is managed through a combination of wholesale market basis risk management products, pricing strategies and product innovation.

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

Market risk (continued)

Fair value hedges

The Group hedges part of its existing interest rate risk, resulting from potential movements in the fair value of fixed rate assets and liabilities, using interest rate swaps. The fair value of these swaps is disclosed in note 3.4. There were no transactions for which fair value hedge accounting had to be discontinued in the year.

Cash flow hedges

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

Monitoring

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

The VaR and EaR calculation parameters were changed effective from 31 March onwards. The changes improved the modelling and measurement and did not represent a change in the Group's risk appetite for Interest Rate Risk.

The changes consisted of three main elements:

1) Changes to the modelling methodologies of rate movements in a low rate environment.

2) History set revised from 8 years to 2 years so that the measure is more responsive to recent rate movements.

3) Revisions to assumptions for interest rate yield curve used for valuing liquid asset securities to better capture asset swap spread risk.

The reported values for the first five months have been compared to the 2017 disclosures which were calculated on the same basis.

Interest rate risk (audited)	Group			
	Value at risk		Earnings at risk	
	2018	2017	**2018**	2017
	£m	£m	**£m**	£m
5 months to 28 Feb 2018				
As at 30 September	**n/a**	25	**n/a**	4
Average value during the year	**26**	23	**5**	2
Minimum value during the year	**13**	15	**4**	1
Maximum value during the year	**36**	36	**7**	4

Interest rate risk (audited)	Group			
	Value at risk		Earnings at risk	
	2018	2017	**2018**	2017
	£m	£m	**£m**	£m
7 months to 30 Sep 2018				
As at 30 September	**16**	n/a	**4**	n/a
Average value during the year	**11**	n/a	**4**	n/a
Minimum value during the year	**9**	n/a	**3**	n/a
Maximum value during the year	**16**	n/a	**5**	n/a

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

Market risk (continued)

Principal financial assets and liabilities (audited)

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

	2018 £m	Liquidity risk	Interest rate risk	Foreign exchange risk	Credit risk
Assets					
Cash and balances with central banks	6,573				✔
Financial assets available for sale	1,562	✔	✔		✔
Loans and advances to customers	32,744	✔	✔	✔	✔
Derivative financial instruments	262	✔	✔	✔	✔
Other financial assets at fair value	362	✔	✔		✔
Liabilities					
Due to customers	28,904	✔	✔	✔	
Due to other banks	3,105	✔	✔	✔	
Derivative financial instruments	361	✔	✔	✔	
Other financial liabilities at fair value	15	✔	✔		
Debt securities in issue	3,698	✔	✔	✔	

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

Foreign currency assets and liabilities split by type

The Group does not incur material foreign currency exposure.

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

Market risk (continued)

Repricing periods of assets and liabilities by asset/liability category

The following table shows the repricing periods of the Group's assets and liabilities as assessed by the Group. This repricing takes account of behavioural assumptions where material and the Group's policy to hedge capital in accordance with a benchmark term agreed by ALCO in order to reduce variability in net interest income.

Items are allocated to time buckets in the table below by reference to the earlier of the next contractual interest rate repricing data and the residual maturity date.

Group 2018	Overnight	3 months or less	3 to 12 months	1 to 5 years	Over 5 years	Non interest bearing	Total
Assets	£m	£m	£m	£m	£m	£m	£m
Cash and balances with central banks	6,374	10	30	159	-	-	6,573
Due from related entities	35	-	-	-	-	-	35
Due from other banks	835	1	-	-	-	-	836
Financial assets available for sale	189	393	-	300	680	-	1,562
Other financial assets at fair value	362	-	-	-	-	-	362
Loans and advances to customers	8,389	4,778	6,299	12,997	433	(152)	32,744
Other assets	-	-	-	-	-	1,471	1,471
Total assets	16,184	5,182	6,329	13,456	1,113	1,319	43,583
Liabilities							
Due to other banks	3,104	-	1	-	-	-	3,105
Due to related entities	38	-	-	475	800	-	1,313
Due to customers	11,495	1,281	3,465	12,662	1	-	28,904
Other financial liabilities at fair value	15	-	-	-	-	-	15
Debt securities in issue	-	3,698	-	-	-	-	3,698
Other liabilities	1,004	47	142	760	-	1,304	3,257
Equity	191	155	466	2,479	-	-	3,291
Total liabilities and equity	15,847	5,181	4,074	16,376	801	1,304	43,583
Off balance sheet items							
Notional value of derivatives managing interest rate sensitivity	(206)	2,203	596	(2,572)	(21)	-	-
Total interest rate gap sensitivity	805	(2,202)	1,659	(348)	333	(247)	-
Cumulative interest rate gap sensitivity	805	(1,397)	262	(86)	247	-	-

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

Market risk (continued)

Group 2017	Overnight	3 months or less	3 to 12 months	1 to 5 years	Over 5 years	Non interest bearing	Total
Assets	£m	£m	£m	£m	£m	£m	£m
Cash and balances with central banks	6,756	9	24	148	-	-	6,937
Due from related entities	363	-	-	-	-	3	366
Due from other banks	761	49	-	-	-	-	810
Financial assets available for sale	234	362	100	1,020	360	-	2,076
Other financial assets at fair value	477	-	-	-	-	-	477
Loans and advances to customers	8,537	5,356	5,496	11,811	247	(154)	31,293
Other assets	-	-	-	-	-	1,355	1,355
Total assets	17,128	5,776	5,620	12,979	607	1,204	43,314
Liabilities							
Due to other banks	3,283	517	8	-	-	-	3,808
Due to related entities	809	-	-	-	-	-	809
Due to customers	10,708	1,107	3,923	11,965	15	-	27,718
Other financial liabilities at fair value	26	-	-	-	-	-	26
Debt securities in issue	42	3,964	-	-	-	-	4,006
Other liabilities	2,612	44	116	711	-	-	3,483
Equity	-	165	441	2,858	-	-	3,464
Total liabilities and equity	17,480	5,797	4,488	15,534	15	-	43,314
Off balance sheet items							
Notional value of derivatives managing interest rate sensitivity	89	3,044	(478)	(2,767)	112	-	-
Total interest rate gap sensitivity	(441)	(3,065)	1,610	212	480	1,204	-
Cumulative interest rate gap sensitivity	(441)	(3,506)	(1,896)	(1,684)	(1,204)		-

Bank 2018	Overnight	3 months or less	3 to 12 months	1 to 5 years	Over 5 years	Non interest bearing	Total
	£m	£m	£m	£m	£m	£m	£m
Assets							
Cash and balances with central banks	6,374	10	30	159	-	-	6,573
Due from related entities	1,234	1	-	-	-	3	1,238
Due from other banks	376	-	-	-	-	-	376
Financial assets available for sale	183	393	-	300	680	-	1,556
Other financial assets at fair value	362	-	-	-	-	-	362
Loans and advances to customers	7,276	4,778	6,299	12,997	433	(152)	31,631
Other assets	-	-	-	-	-	1,370	1,370
Total assets	15,805	5,182	6,329	13,456	1,113	1,221	43,106
Liabilities							
Due to other banks	3,104	-	1	-	-	-	3,105
Due to related entities	297	3,588	-	-	-	-	3,885
Due to customers	11,495	1,281	3,465	12,662	1	-	28,904
Other financial liabilities at fair value	15	-	-	-	-	-	15
Debt securities in issue	-	-	-	-	708	-	708
Other liabilities	1,001	47	142	760	-	1,304	3,254
Equity	135	155	466	2,479	-	-	3,235
Total liabilities and equity	16,047	5,071	4,074	15,901	709	1,304	43,106
Off balance sheet items							
Notional value of derivatives managing interest rate sensitivity	(206)	2,203	596	(2,572)	(21)	-	-
Total interest rate gap sensitivity	115	(2,092)	1,659	127	425	(234)	-
Cumulative interest rate gap sensitivity	115	(1,977)	(318)	(191)	234	-	-

Risk Report (continued)

BALANCE SHEET & PRUDENTIAL REGULATION RISKS (continued)

Market risk (continued)

Bank 2017	Overnight £m	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	Non interest bearing £m	Total £m
Assets							
Cash and balances with central banks	6,756	9	24	148	-	-	6,937
Due from related entities	1,544	-	-	-	-	3	1,547
Due from other banks	358	49	-	-	-	-	407
Financial assets available for sale	228	362	100	1,020	360	-	2,070
Other financial assets at fair value	477	-	-	-	-	-	477
Loans and advances to customers	7,480	5,356	5,496	11,811	247	(154)	30,236
Other assets	-	-	-	-	-	1,219	1,219
Total assets	16,843	5,776	5,620	12,979	607	1,068	42,893
Liabilities							
Due to other banks	3,283	517	8	-	-	-	3,808
Due to related entities	606	3,118	-	-	-	-	3,724
Due to customers	10,708	1,107	3,923	11,965	15	-	27,718
Other financial liabilities at fair value	26	-	-	-	-	-	26
Debt securities in issue	9	699	-	-	-	-	708
Other liabilities	2,610	44	116	711	-	-	3,481
Equity	-	165	441	2,822	-	-	3,428
Total liabilities and equity	17,242	5,650	4,488	15,498	15	-	42,893
Off balance sheet items							
Notional value of derivatives managing interest rate sensitivity	89	3,044	(478)	(2,767)	112	-	-
Total interest rate gap sensitivity	(488)	(2,918)	1,610	248	480	1,068	-
Cumulative interest rate gap sensitivity	(488)	(3,406)	(1,796)	(1,548)	(1,068)	-	-

PENSION RISK

The Group operates a defind benefit pension scheme, the Yorkshire and Clydesdale Bank Pension Scheme (the 'Scheme').

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

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

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

Risk Report (continued)

PENSION RISK (continued)

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

The triennial valuation (the valuation) uses the Trustee's actuarial assumptions and a liability discount rate based on gilt yields. The last scheme funding valuation was at 30 September 2016 with a calculated deficit of £290m. In the latest recovery plan dated 31 January 2018, the Group agreed to eliminate the deficit through the following scheduled contributions: a single contribution of £25m on 15 October 2018, thereafter equal monthly contributions totalling £50m per annum until 31 March 2022, and £55m in the year to 31 March 2023.

Details of retirement benefit obligations are included in note 3.16 of the consolidated financial statements.

STRUCTURAL REFORM – RING-FENCING

Over 2018, the Group has been taking steps to manage the impact of ring-fencing legislation that comes into effect from 1 January 2019. Ring-fencing legislation and the associated PRA Supervisory Statements apply to banks with core deposits greater than £25bn. Banks that meet this threshold must ring-fence their core banking from other activities. The Group is subject to ring-fencing legislation however there is very little impact on customers arising from the Group's compliance activities because there is no need for material changes to business operations or corporate structures.

A SRB for ring-fenced banks will be applied to individual banks by the BoE and will be introduced from 2019. In accordance with current guidance, firms with balance sheet assets less than £175bn will have an SRB of 0% therefore although the framework applies to the Group there is currently no buffer impact. This position does not change with the acquisition of Virgin Money.

Risk Report (continued)

REGULATORY, COMPLIANCE & CONDUCT RISK

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

Risk appetite

The Group has no appetite for actions resulting in breaches of regulation or for inaction in addressing identified control failures that result in non-compliance.

Mitigation measures

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

Monitoring

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

CONDUCT RISK

Conduct Risk is the risk of undertaking business in a way which is contrary to the interests of our customers resulting in the delivery of inappropriate outcomes. customer detriment, regulatory censure, redress costs and / or reputational damage.

Risk appetite

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

Mitigation measures

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

Products are designed and sold to meet customer needs and expectations with governance processes embedded to ensure those objectives are met.

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

Exposures

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

Risk Report (continued)

CONDUCT RISK (continued)

Monitoring

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

OPERATIONAL RISK (including resilience and information security)

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

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

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

Risk Appetite

The Group is prepared to tolerate a level of operational risk exposure within agreed thresholds and limits. A level of resilience risk from internal and external events is tolerated however immediate steps must be taken to minimise customer disruption through recovery within defined timelines. Operational risks arise from day to day business activities, which may result in direct or indirect losses and could adversely impact the Group's financial performance, levels of customer care and reputation.

Approach to Monitoring and Mitigating Exposures

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

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

Risk Report (continued)

OPERATIONAL RISK (including people risks) (continued)

Stress testing

The Group develops and maintains a suite of operational risk scenarios using internal and external data. These scenarios provide insights into the stresses the business could be subject to given extreme circumstances. Scenarios cover all material operational risks including execution of change, failures to core processes or contagion risk from a Third Party. Scenarios are owned by senior management custodians with review and challenge provided by Risk Management, Executive Risk Committee and Board Risk Committee, as part of the ICAAP process. Management actions are agreed and monitored and linked with business resilience and continuity testing where appropriate.

Risk Category	
Operational resilience risk	The risks associated with the ability of the Group to quickly adapt to disruptions while maintaining continuous business operations and safeguarding people, assets and overall brand equity, even in the face of adverse events, shocks and chronic or incremental changes. **How this risk is managed** – the Group has a well defined and embedded resilience framework that is designed to both prevent disruptions from occurring and, where they do occur, to minimise the impact to customers and colleagues through speedy resolution.
Information security risk	The risks associated with inadequate and failed information technology processes and components (including hardware, software and networking components). **How this risk is managed** – the Group continues to enhance and invest in the control environment, recognising the changing cyber landscape and the increased focus on digital capabilities, as well as the changing risk profile of the business.
Change risk	The risks associated with a failure to execute and deliver change that could result in an inability to meet our strategic objectives, including failing to meet our customer, regulator, colleague or shareholder expectations at a Group level and local management level. **How this risk is managed** – the Group maintains a centralised view of change to ensure that the risks of individual changes are managed effectively, and that change is prioritised to minimise the overall risks to the organisation in line with risk appetite.
Third Party risk	The risks associated with ensuring the Group's outsourced and offshoring arrangements are controlled effectively, including the risk of failure to service existing and new Customers, and the potential cessation of specific activities, or the risk of personally identifiable information or Group sensitive data being exposed or exploited, or the risk of financial, reputational and regulatory censure if the third party enters into any illegal or unethical activities. **How this risk is managed** – the Group continues to strengthen its third party management framework and oversight, and ensures that the procurement of service providers adheres to these requirements.
Data risk	The risks associated with the accuracy, management and use of data that underpins decision making at every level across the organisation. **How this risk is managed** – the Group has a data management framework for the development, use, monitoring, management and ownership of data. Data quality is assessed against three key attributes: completeness; appropriateness; and accuracy. Furthermore, the Group has strengthened its data protection management and GDPR compliance framework.
Integration risk	The operational risks associated with management of a large scale integration plan including the need for effective governance and clear accountability, increased threat of cyber security incident, risks associated with systems migration or inadequate testing or poor management of external and internal communications and a poor risk culture. **How this risk is managed** – the Group will establish integration programme activities to mitigate the risks, including: - the preparation and delivery of the FSMA Part VII transfer; - the development, validation and implementation of Group re-branding requirements; - migration support for enterprise systems implementation; - inputs for ongoing programme management reporting, dependencies and resource management; and - Risk SME input to provide support and challenge to the overall programme.

Risk Report (continued)

FINANCIAL CRIME RISK

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

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

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

Risk Report (continued)

FINANCIAL CRIME RISK (continued)

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

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

Exposures

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

Mitigation measures

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

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

Monitoring

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

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

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

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

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

Risk Report (continued)

STRATEGIC, BUSINESS & FINANCIAL PERFORMANCE RISK

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

Risk appetite

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

Exposures

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

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

Mitigation measures

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

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

Monitoring

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

Risk Report (continued)

PEOPLE RISK

People risk is the risk associated with not having the right number of people in the right roles, appropriately trained and competent; engaged; motivated; clear on their responsibilities and accountabilities; who behave in an ethical way; and are treated fairly, with dignity and respect. People risk is inherent and controlled through a set of values, behaviours and policies.

Risk appetite

The Group is evolving its structure to enable it to deliver on the core objectives of becoming a commercially focussed, high performing business. While the organisational structural changes being implemented to support the commercial objectives will drive an inherent increase in people risk, the Group is also focussed on cultural transformation, which aims to create a high performing, customer centric organisation and drive accountability and responsibility, alongside appropriate reward structures.

The Group will not accept a material increase in risk as a result of colleagues not conducting themselves in the manner expected, not will the Group act in a manner that may affect the health and wellbeing of colleagues. The Group will not take intentional action that may impact on its ambition to build an inclusive culture and will continue to embed activities that support the required cultural change.

Approach to monitoring and mitigating exposures

People risk is managed in three core ways:

- Managing people risk across the Group: The changing internal and external environment raises challenges relative to the Group's ability to manage people risk, as part of the overall business strategy. The transformation of the banking industry is changing the demand for skills, particularly in relation to technology, information security, servicing customers digitally and responding to market developments. The Group's operating controls are effective in managing these risks and there is a focus on the Group's ability to plan and predict resource needs during this period of cost challenges, and increased use of technology.
- Managing the people management framework: Controls are deployed effectively by people leaders and senior management in the day to day management of people risk. People risk indicators are constantly reviewed to determine if any systemic issues exist, and to agree appropriate remediation.
- The role of the HR function: HR partners support the CYBG Leadership Team and provides broader support to all colleagues regarding all matters impacting the colleague life cycle which runs from recruitment to leaving the Group. The Group has a three-tier model incorporating: ourPeople (web based); HR Services, supported by specialist teams like Reward; Organisational Development; Payroll; and Case Management; and finally, full business partnering to the CYBG Leadership Team.

The Group 's operational controls are designed to mitigate the risks associated through each element of the colleague life cycle. Bankwide systems provide tools and online guidance to all colleagues to support them in discharging their accountabilities,

Stress Testing

The people risks associated within a stressed scenario are automatically captured and analysed through the Group's suite of operational risk scenarios. These scenarios consider both the colleagues needed to maintain business as usual services to customers as well as the key subject matter experts needed to keep critical functions operating while under duress.

Report of the Directors

The Directors of the Bank and its subsidiary undertakings (which together comprise the 'Group') submit their report and consolidated financial statements for the year ended 30 September 2018.

Corporate Governance

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

Profits and appropriations

The Group loss before tax for the year ended 30 September 2018 was £276m (2017: loss of £261m). The loss attributable to the shareholders for the year ended 30 September 2018 amounted to £239m (2017: loss of £294m). A dividend of £44m has been proposed in respect of the ordinary shares for this financial year (2017: £9m). The Group's strategic highlights and business developments are set out in the Strategic Report.

Future developments and financial risk management objectives and policies

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

Directors and Directors' interests

The current Directors are shown on page 1. Geeta Gopalan, Darren Pope and Amy Stirling were appointed as Directors on 15 October 2018. David Browne resigned on 30 June 2018 and Debbie Crosbie resigned on 19 November 2018. Directors who are not full-time employees of the Group or a related body corporate are appointed in accordance with the Articles of Association and may be eligible for reappointment thereafter. No Directors retired by rotation during the year.

Directors' interests

No Director had any interest in the shares of the Bank or its subsidiaries at any time during the year.

Directors' liabilities

During the year, CYBG PLC paid a premium for a contract insuring the Directors and officers of CYBG PLC, its subsidiaries and controlled entities against personal liabilities which may arise in the course of the performance of their duties, as well as protecting the Group itself to the extent that it is obligated to indemnify Directors and officers for such liability.

Directors' Indemnities

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

Report of the Directors (continued)

Directors' Indemnities (continued)

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

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

Colleagues

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

Engagement and communication

We have continued to evolve and enhance the way we communicate with colleagues. We have launched new digital channels such as our weekly CEO email and delivered diverse strategic content via our intranet relating to customers, our culture, business performance and community engagement. We continue to have a highy visible CEO and Leadership Team and have expanded our interactive Let's Talk events. We have increased colleague engagement with social features, such as likes and comments, and generated greater interaction with polls and surveys. This year our internal communications team lifted the 'Brilliance in Internal Communications Campaign' accolade at the IC Brilliance Awards.

It is the policy of the Group to promote equality of employment opportunities by giving full and fair consideration to applications from people with disabilities. If existing colleagues become disabled, every effort is made to retain them within the workforce wherever reasonable and practicable. The Group also endeavours to provide equal opportunities in the training, promotion and general career development of disabled colleagues.

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

Political donations

No political donations were made during the year (2017: £Nil).

Management of risk

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

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

Significant contracts

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

Report of the Directors (continued)

Share capital

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

Research and Development Activities

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

Going concern

The Group's Directors have made an assessment of the Group's ability to continue as a going concern and are satisfied that the Group has the resources to continue in business for the foreseeable future.

The Group's use of the going concern basis for preparation of the accounts is discussed in note 1.4 of the Group's consolidated financial statements.

Events after the balance sheet date

On 10 October 2018, the Group received IRB accreditation from the PRA for both its mortgage and SME portfolios. The Group continues to progress its Retail unsecured lending IRB application.

On 15 October 2018, CYBG PLC acquired all of the voting rights in Virgin Money by means of a Scheme of Arrangement under Part 26 of the UK Companies Act 2006 for a purchase consideration of £1.6bn. Following completion, the Bank subsequently acquired all the voting rights in Virgin Money for a consideration of £1.6bn.

On 26 October 2018 the High Court ruled on a landmark pensions case relating to the defined benefit pension schemes operated by Lloyds Banking Group. The Group is currently assessing the impact of this recent ruling on its defined benefit pension scheme, and will work with its key advisors to ensure compliance with the recent findings as appropriate.

For further details of events after the balance sheet, refer to note 5.5 of the consolidated financial statements.

Auditors

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

The Directors who were members of the Board at the time of approving the Report of the Directors are listed on page 1. Having made enquiries of fellow Directors and of the Group's auditor, each of these Directors confirms that:

- to the best of each Director's knowledge and belief, there is no information relevant to the preparation of their report of which the Group's auditor is unaware; and
- each Director has taken all the steps a Director might reasonably be expected to have taken to be aware of relevant audit information and to establish that the Group's auditor is aware of that information.

By order of the Board

Lorna McMillan
Company Secretary
26 November 2018

Statement of Directors' responsibilities

The Directors are responsible for preparing the Strategic Report, Directors' Report and the financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have elected to prepare the financial statements in accordance with International Financial Reporting Standards ('IFRSs') as adopted by the EU and applicable law. Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and Bank and of the profit or loss of the Group and Bank for that year. In preparing these financial statements the Directors are required to:

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

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Group and Bank's transactions and disclose with reasonable accuracy at any time the financial position of the Group and Bank and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Group and Bank and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Lorna McMillan
Company Secretary
26 November 2018

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

Opinion

In our opinion:

- Clydesdale Bank PLC's Group financial statements and parent company financial statements (the 'financial statements') give a true and fair view of the state of the Group's and of the parent company's affairs as at 30 September 2018 and of the Group's loss for the year then ended;
- the Group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006, and, as regards the Group financial statements, Article 4 of the IAS Regulation.

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

Group	Parent company
Consolidated Income Statement for the year ended 30 September 2018	
Consolidated Statement of Comprehensive Income for the year ended 30 September 2018	
Consolidated Balance Sheet as at 30 September 2018	Company Balance Sheet as at 30 September 2018
Consolidated Statement of Changes in Equity for the year ended 30 September 2018	Company Statement of Changes in Equity for the year ended 30 September 2018
Consolidated Statement of Cash Flows for the year ended 30 September 2018	Company Statement of Cash Flows for the year ended 30 September 2018
Related notes 1.1 to 5.5 to the financial statements	Related notes 1.1 to 6.2 of the financial statements
Certain required disclosures have been presented elsewhere in the Annual Report and Accounts, rather than in the notes to the financial statements. These have been cross-referenced from the financial statements and are identified as audited.	

The financial reporting framework that has been applied in their preparation is applicable law and IFRSs as adopted by the European Union and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report below. We are independent of the group and parent company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the Financial Reporting Council (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 principal risks, going concern and viability statement

We have nothing to report in respect of the following information in the annual report, in relation to which the ISAs(UK) require us to report to you whether we have anything material to add or draw attention to:

- the disclosures in the annual report on page 9 that describe the principal risks and explain how they are being managed or mitigated;
- the Directors' confirmation on page 9 in the annual report that they have carried out a robust assessment of the principal risks facing the entity, including those that would threaten its business model, future performance, solvency or liquidity;
- the Directors' statement on page 65 in the financial statements about whether they considered it appropriate to adopt the going concern basis of accounting in preparing them, and their identification of any material uncertainties to the entity's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements;
- whether the Directors' statement in relation to going concern required under the Listing Rules in accordance with Listing Rule 9.8.6R(3) is materially inconsistent with our knowledge obtained in the audit; or
- the Directors' explanation on page 82 in the annual report as to how they have assessed the prospects of the entity, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the entity will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

Overview of our audit approach

Key audit matters	• PPI provision • SME lending impairment provisions • Revenue recognition – Effective Interest method accounting
Audit scope	• Our Group audit scope included the complete financial information of the Clydesdale Bank PLC Group including all its subsidiaries. • All audit work performed for the purposes of the Group audit was undertaken by the primary audit team.
Materiality	• Group, and Parent company materiality of £15m which represents 4.5% of underlying PBT.

Key audit matters

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

Key audit matters	Our response to the risk	Key observations communicated to the Board's Audit Committee
Payment Protection Insurance (PPI) Provision The Group has recorded £275m in relation to PPI redress provisions. Please refer to pages 116 to 119 (Provisions for liabilities and charges note), pages 138 to 139 (Contingent liabilities and commitments note). The Group has a material provision relating to its conduct towards its past and present customers linked to its historic practices of PPI sales. In 2016, the Group entered into a conduct indemnity deed, granted by its former parent, under which all qualifying remediation costs for past conduct issues were reimbursed up to a capped amount. As set out on page 119, the capped amount was reached during the first half of the year. Since that point, all further PPI related costs are fully borne by the Group. During the year, the Group completed its remediation exercise for previously closed PPI complaints. The FCA has set a deadline of 29 August 2019 for customers to lodge PPI related complaints. Significant judgements and assumptions are required to be made by the Directors in relation to the timing, volume and quantum of future redress payments and associated administration costs that will be required. The most significant assumption is the volume of future new PPI complaints. Details of this assumption, including the reduction in volumes anticipated in advance of the August 2019 time bar, are reported on pages 117 to 118 in Note 3.14. The effects of these judgements are material, so this was considered to be a key audit matter.	We considered the results of the testing of key controls operating within the PPI and other conduct case handling and recording processes which supported the data used in the determination of key provision assumptions. We found that we could place reliance on these controls. We examined the models used by the Directors to determine a best estimate of the provisions for mis-sold PPI. We assessed the appropriateness of PPI provision model assumptions, including case volumes, redress per claim, up-hold rates and case processing costs, which were informed by the Group's historic experience. We tested the clerical accuracy of the Directors' provision calculations and sensitivity analysis. We determined an independent range of reasonable future PPI cost outcomes using the Group's historical experience of PPI claims, and we compared this range to the Directors' estimate. In evaluating the Directors' provision assumptions, we considered the Group's historical forecasting accuracy in this area, and we examined correspondence during the year between the Group and the FCA, and other regulatory pronouncements. We compared the Directors' assumptions to our own expectations based on the Group's historical experience, current trends and our industry knowledge.	We communicated to the Audit Committee that provisions for PPI redress and other conduct related matters held by the Group were reasonably estimated. We noted that the Group's disclosures describe the uncertainties and risks associated with determining the provisions, and the sensitivity of the provisions to changes in key assumptions. The Directors' best estimate for future PPI claims and associated costs involved probability weighting a number of possible outcomes. We reported to the Audit Committee that the estimation of provisions for PPI claims is inherently uncertain and requires significant judgements to be made by the Directors. We observed that, based on past experience, there continues to remain the potential for future costs relating to PPI claims to be materially higher than the Directors' estimate at 30 September 2018.

Key audit matters	Our response to the risk	Key observations communicated to the Board's Audit Committee
SME lending impairment provisions The Group has recorded £136m in relation to impairment provisions held on non-retail credit exposures. Please refer to pages 105 to 107 (Impairment provisions on credit exposures note). The majority of the Group's non-retail lending portfolio relates to small and medium sized enterprises ('SMEs') which can be vulnerable to both domestic and foreign market volatility. Estimating the Group's collective and specific provisioning is subjective, requires the Directors to exercise significant judgement, and incorporates the use of assumptions, the most significant of which are the probability of default and loss given default assumptions used in the Group's collective modelling process, and the identification and judgments made in respect of loan files subject to specific assessment. Due to the materiality of the provisions and level of judgment and audit resources involved, this was considered to be a key audit matter.	We tested controls over impairment calculations and the generation of portfolio data for use in these calculations. These controls included those covering the identification and assessment of potentially impaired loans, the transfer of data from source systems to impairment models, and the calculation of specific impairment provisions. We determined that we could rely on these controls for the purposes of our audit. We performed loan file testing on a sample of impaired loans to determine whether the specific provisions held by the Group were, in our judgement, sufficient and appropriate. Our approach included the use of our own valuation specialists to independently test key assumptions underpinning a sample of collateral values used in provision calculations. We tested the collective impairment provision model by using our modelling specialists to examine the logic of the model calculations, the accuracy of data inputs, and assessing the appropriateness of key assumptions and loan ratings used within the model. Using our experience of impairment provisioning in the sector, we assessed the appropriateness of overlays to the collective impairment models applied by the Directors and tested the accuracy of calculations in the overlays. We evaluated the completeness of SME loans assessed for impairment by the Directors and examined a sample of loans where no impairment provisions were held.	We communicated to the Audit Committee that the impairment models, calculations and assumptions employed by the Group were reasonable as at 30 September 2018 and that these resulted in impairment provisions that were appropriately estimated. We also concluded that the disclosures presented were in compliance with IFRSs. Our communications to the Audit Committee presented an independent range for the level of incurred but not reported losses existing in the Group's loan portfolio, and we compared this range to the Directors' own post model adjustments. We found no material differences in this comparison. We assessed and challenged the calculations and related judgements for a sample of specific impairment provisions and communicated to the Audit Committee that these procedures did not identify any material differences to the provisions determined by the Directors.
Revenue recognition – Effective Interest method As set out on page 104 in Note 3.5, the Group has recorded £25m of net deferred income in relation to fee income and expenses deferred under the Group's effective interest method	We gained an understanding of key controls and assessed the appropriateness of key assumptions used within the Group's effective interest model, primarily the average loan life assumption, which we corroborated against underlying loan data, our	We communicated to the Audit Committee that the effective interest adjustments recognised in interest income had been appropriately derived. We also communicated that the assumptions made by the Directors were reasonable in the context of the

Key audit matters	Our response to the risk	Key observations communicated to the Board's Audit Committee
of accounting. Please also refer to page 91 (net interest income accounting policy). For certain product fees, the Group operates a model to recognise fee income (included within interest income) under the effective interest method. The effective interest method spreads the recognition of product fee income over the life of a financial instrument, as these are in substance an integral part of the overall yield. Effective interest models are sensitive to judgements about the expected lives of the product portfolios to which they relate. Due to the complexity of calculations, the degree of judgement exercised by the Directors in respect of the expected lives of the product portfolios and the different products for which fees are recognised, this is considered a key audit matter.	knowledge of market conditions and observed practice in the UK banking sector. We performed data integrity testing on the key sources of information feeding the effective interest calculation. This involved sample testing data from business systems to the loan data used in the model and vice-versa. We examined the journals recording the deferral and amortisation of fee income to verify that the revenue deferred and amortised over the life of the underlying loans was appropriate and aligned with the effective interest model output.	Group's lending portfolios and current observable customer behaviours.

In the prior year our conduct provisions key audit matter covered PPI and other conduct related provisioning. As programmes relating to other conduct provisions have substantially been completed during the year, our key audit matter for the current year relates solely to PPI provisions.

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 Group and Parent to be £15 million (2017: £17 million), which represents 4.5% of underlying profit on ordinary activities before tax (consistent with the approach prior year, this is defined as the Group's PBT adjusted to exclude one-off expenditure incurred during the year and those related to conduct provisions and restructuring). A reconciliation between statutory profit and the adjusted PBT is shown below:

Starting point

- Statutory loss on ordinary activities before tax
- £276m loss

Adjustments

- Deduct:
  - Restructuring and related expenditure: £38m
  - Virgin Money acquisition costs: £7m
  - RBS alternative remedies spend: £16m
  - Separaton cost: £8m
  - Legacy conduct costs: £544m

Materiality

- Total £337m (Underlying PBT)
- Materiality of £15m (4,5% of Underlying PBT)

Performance materiality

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

On the basis of our risk assessments, together with our assessment of the Group's overall control environment, our judgement was that performance materiality was 75% (2017: 75%) of our planning materiality, namely £11.25m (2017: £12.75m). We have set performance materiality at this percentage due to our previous experience as auditors of the Group, from which we concluded that there is a lower expectation of material financial statement inaccuracies due to the effective control environment and only minor audit differences resulting from our prior and current year work. Our approach is consistent with prior year.

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 £0.75m (2017: £0.85m), 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 evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations in forming our opinion.

Other information

The other information comprises the information included in the annual report set out on pages 1 to 66, and the additional information set out on pages 147 to 157 other than the financial statements and our auditor's report thereon. The Directors are responsible for the other information. Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in this report, we do not express any form of assurance conclusion thereon.

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

We have nothing to report in this regard.

Opinions on other matters prescribed by the Companies Act 2006

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

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

Matters on which we are required to report by exception

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

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

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

Responsibilities of Directors

As explained more fully in the Directors' responsibilities statement set out on page 66, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the Directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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

Auditor's responsibilities for the audit of the financial statements

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

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

The objectives of our audit, in respect 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 Group and determined that the most significant were the regulations, licence conditions and supervisory requirements of the PRA and the FCA.
- We understood how the Group complies with these legal and regulatory frameworks by making enquiries of management, internal audit, and those responsible for legal and compliance matters. We also reviewed correspondence between the Group and UK regulatory bodies; reviewed minutes of the Board and Executive Risk Committee; and gained an understanding of the Group's approach to governance, demonstrated by the Board's approval of the Group's governance framework and the Board's review of the Group's risk management framework ('RMF') and internal control processes.
- We assessed the susceptibility of the Group's financial statements to material misstatement, including how fraud might occur, by considering the controls that the Group has established to address risks identified by the entity, or that otherwise seek to prevent, deter or detect fraud. We also considered performance and incentive plan targets and their potential to influence management to manage earnings or influence the perceptions of investors.
- Based on this understanding we designed our audit procedures to identify non-compliance with such laws and regulations identified in the paragraphs above. Our procedures involved inquiries of legal counsel, executive management, internal audit, and focused testing, as referred to in the Key Audit Matters section above.

- The Group operates in the banking industry which is a highly regulated environment. As such, the Senior Statutory Auditor considered the experience and expertise of the engagement team to ensure that the team had the appropriate competence and capabilities, which included the use of specialists where appropriate.

A further description of our responsibilities for the audit of the financial statements is located on the FRC'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

- Following the recommendation of the NAB Group Audit Committee, we were appointed as External Auditor at the AGM on 31 January 2005 to audit the financial statements for the year ending 30 September 2005 of the National Australia Bank Group of companies, which at the time included Clydesdale Bank PLC. The period of total uninterrupted engagement as auditors of Clydesdale Bank PLC including previous renewals and reappointments, is 13 years, covering the years ending 30 September 2005 to 30 September 2018.

- The non-audit services prohibited by the FRC's Ethical Standard were not provided to the Group or the Company and we remain independent of the Group and the Company in conducting the audit.

- The audit opinion is consistent with the additional report to the audit committee.

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
26 November 2018

Notes:

1. The maintenance and integrity of the CYBG PLC website is the responsibility of the Directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.

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

Consolidated income statement for the year ended 30 September

	Note	2018 £m	2017 £m
Interest income and similar income		1,113	1,075
Interest expense and similar charges		(258)	(230)
Net interest income	2.2	855	845
Gains less losses on financial instruments at fair value		(3)	6
Other operating income		159	186
Non interest income	2.3	156	192
Total operating income		1,011	1,037
Total operating and administrative expenses before impairment losses	2.4	(1,246)	(1,250)
Operating loss before impairment losses		(235)	(213)
Impairment losses on credit exposures	3.6	(41)	(48)
Loss on ordinary activities before tax		(276)	(261)
Tax credit/(expense)	2.5	37	(33)
Loss for the year attributable to equity holders		(239)	(294)

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

The notes on pages 82 to 146 form an integral part of these financial statements.

Statements of comprehensive income for the year ended 30 September

	Group		Bank	
	2018	2017	2018	2017
	£m	£m	£m	£m
Loss for the year	(239)	(294)	(260)	(288)
Items that may be reclassified to the income statement				
Change in cash flow hedge reserve				
Losses during the year	(58)	(84)	(57)	(82)
Transfers to the income statement	8	(5)	8	(5)
Taxation thereon	12	21	12	21
	(38)	(68)	(37)	(66)
Change in available for sale reserve				
Losses during the year	-	(7)	-	(8)
Transfers to the income statement	-	(20)	-	(20)
Taxation thereon	-	7	-	7
	-	(20)	-	(21)
Total items that may be reclassified to the income statement	(38)	(88)	(37)	(87)
Items that will not be reclassified to the income statement				
Change in asset revaluation reserve				
Taxation thereon	1	-	1	-
	1	-	1	-
Remeasurement of defined benefit pension plans	(9)	154	(9)	154
Taxation thereon	3	(35)	3	(35)
	(6)	119	(6)	119
Total items that will not be reclassified to the income statement	(5)	119	(5)	119
Other comprehensive (losses)/income net of tax	(43)	31	(42)	32
Total comprehensive losses for the year, net of tax	(282)	(263)	(302)	(256)
Total comprehensive losses attributable to equity holders of the parent	(282)	(263)	(302)	(256)

The notes on pages 82 to 146 form an integral part of these financial statements.

Balance sheets
as at 30 September

		Group		Bank	
	Note	2018	2017	2018	2017
		£m	£m	£m	£m
Assets					
Cash and balances with central banks	3.1	6,573	6,937	6,573	6,937
Due from related entities	5.3	35	366	1,238	1,547
Due from other banks		836	810	376	407
Financial assets available for sale	3.2	1,562	2,076	1,556	2,070
Other financial assets at fair value	3.3	362	477	362	477
Derivative financial instruments	3.4	262	282	151	136
Loans and advances to customers	3.5	32,744	31,293	31,631	30,236
Due from customers on acceptances		4	4	4	4
Current tax assets		-	-	4	5
Property, plant and equipment	3.8	88	86	88	86
Investment properties	3.9	7	14	7	14
Investments in controlled entities and associates	6.2	-	-	10	10
Intangible assets	3.10	412	339	412	339
Deferred tax assets	3.11	298	236	294	231
Defined benefit pension assets	3.16	212	207	212	207
Other assets		188	187	188	187
Total assets		43,583	43,314	43,106	42,893
Liabilities					
Due to other banks	3.12	3,105	3,808	3,105	3,808
Other financial liabilities at fair value	3.3	15	26	15	26
Derivative financial instruments	3.4	361	376	361	376
Due to customers	3.13	28,904	27,718	28,904	27,718
Liabilities on acceptances		4	4	4	4
Current taxes		1	1	-	-
Provisions for liabilities and charges	3.14	331	554	331	554
Due to related entities	5.3	1,313	809	3,885	3,724
Debt securities in issue	3.15	3,698	4,006	708	708
Retirement benefit obligations	3.16	3	3	3	3
Deferred tax liabilities	3.11	77	75	77	75
Other liabilities	3.17	2,480	2,470	2,478	2,469
Total liabilities		40,292	39,850	39,871	39,465
Equity					
Share capital	4.1	1,013	502	1,013	502
Other equity instruments	4.1	425	425	425	425
Other reserves	4.1	(28)	373	(28)	372
Retained earnings		1,881	2,164	1,825	2,129
Total equity		3,291	3,464	3,235	3,428
Total liabilities and equity		43,583	43,314	43,106	42,893

The notes on pages 82 to 146 form an integral part of these financial statements.
These financial statements were approved by the Board of Directors on 26 November 2018 and were signed on its behalf by:

David Duffy
Chief Executive Officer

Ian Smith
Chief Financial Officer

Company name: Clydesdale Bank PLC
Company number: SC001111

Statements of changes in equity

Group	Notes	Share capital £m	Other equity instruments £m	Asset revaluation reserve £m	Available for sale reserve £m	Cash flow hedge reserve £m	Capital contribution reserve £m	Retained earnings £m	Total equity £m
As at 1 October 2016		324	425	1	27	69	7	2,368	3,221
Loss for the year		-	-	-	-	-	-	(294)	(294)
Other comprehensive (losses)/income		-	-	-	(20)	(68)	-	119	31
Total comprehensive losses, net of tax		-	-	-	(20)	(68)	-	(175)	(263)
AT1 distribution paid (net of tax)		-	-	-	-	-	-	(29)	(29)
Shares issued - ordinary		178	-	-	-	-	-	-	178
Capital contribution		-	-	-	-	-	357	-	357
As at 30 September 2017	4.1	502	425	1	7	1	364	2,164	3,464
Loss for the year		-	-	-	-	-	-	(239)	(239)
Other comprehensive income/(losses)		-	-	1	-	(38)	-	(6)	(43)
Total comprehensive income/(losses), net of tax		-	-	1	-	(38)	-	(245)	(282)
AT1 distribution paid (net of tax)		-	-	-	-	-	-	(29)	(29)
Dividend paid		-	-	-	-	-	-	(9)	(9)
Shares issued - ordinary	4.1	511	-	-	-	-	-	-	511
Capital contribution	4.1	-	-	-	-	-	(364)	-	(364)
As at 30 September 2018	4.1	1,013	425	2	7	(37)	-	1,881	3,291

The notes on pages 82 to 146 form an integral part of these financial statements.

Statements of changes in equity

Bank		Share capital £m	Other equity instruments £m	Asset revaluation reserve £m	Available for sale reserve £m	Cash flow hedge reserve £m	Capital contribution reserve £m	Retained earnings £m	Total equity £m
As at 1 October 2016		324	425	1	27	67	7	2,327	3,178
Loss for the year		-	-	-	-	-	-	(288)	(288)
Other comprehensive (losses)/income		-	-	-	(21)	(66)	-	119	32
Total comprehensive losses, net of tax		-	-	-	(21)	(66)	-	(169)	(256)
AT1 distribution paid (net of tax)		-	-	-	-	-	-	(29)	(29)
Shares issued - ordinary		178	-	-	-	-	-	-	178
Capital contribution		-	-	-	-	-	357	-	357
As at 30 September 2017	4.1	502	425	1	6	1	364	2,129	3,428
Loss for the year		-	-	-	-	-	-	(260)	(260)
Other comprehensive income/(losses)		-	-	1	-	(37)	-	(6)	(42)
Total comprehensive income/(losses), net of tax		-	-	1	-	(37)	-	(266)	(302)
AT1 distribution paid (net of tax)		-	-	-	-	-	-	(29)	(29)
Dividends paid		-	-	-	-	-	-	(9)	(9)
Shares issued - ordinary	4.1	511	-	-	-	-	-	-	511
Capital contribution	4.1	-	-	-	-	-	(364)	-	(364)
As at 30 September 2018	4.1	1,013	425	2	6	(36)	-	1,825	3,235

The notes on pages 82 to 146 form an integral part of these financial statements.

Statement of cash flows
for the year ended 30 September

		Group		Bank	
		2018	2017	2018	2017
	Notes	£m	£m	£m	£m
Operating activities					
Loss on ordinary activities before tax		(276)	(261)	(302)	(260)
Adjustments for:					
Non cash or non operating items included in loss before tax	5.2	(761)	(735)	(731)	(711)
Changes in operating assets	5.2	(1,423)	(1,497)	(1,359)	(2,098)
Changes in operating liabilities	5.2	(122)	917	(123)	930
Interest received		1,108	1,124	1,074	1,077
Interest paid		(169)	(260)	(174)	(259)
Tax (paid)/received - Group relief		(1)	(8)	4	5
Net cash used in operating activities		(1,644)	(720)	(1,611)	(1,316)
Cash flows from investing activities					
Interest received		12	12	12	10
Proceeds from maturity of investments		245	20	245	20
Proceeds from sale of investments		822	60	822	60
Proceeds from sale of tangible fixed assets [1]		9	19	9	19
Purchase of tangible fixed assets [1]		(22)	(21)	(22)	(21)
Purchase and development of intangible fixed assets		(144)	(148)	(144)	(148)
Purchase of investments		(593)	(492)	(593)	(492)
Net cash provided by/(used) in investing activities		329	(550)	329	(552)
Cash flows from financing activities					
Interest received		1	-	18	25
Interest paid		(94)	(89)	(198)	(95)
Proceeds from ordinary shares issued		511	178	511	178
Redemption and principal repayment on RMBS	3.7	(1,372)	(740)	-	-
Issuance of RMBS and covered bonds	3.7	1,049	750	-	-
Amounts drawn down under the TFS		1,250	1,900	1,250	1,900
Amounts repaid under the TFS		(900)		(900)	
Net (increase)/decrease in amounts due from related entities		-	(2)	(23)	420
Net increase/(decrease) in amounts due to related entities		505	311	259	478
AT1 distributions paid		(36)	(36)	(36)	(36)
Ordinary dividends paid		(9)	-	(9)	-
Net cash provided by/(used) in financing activities		905	2,272	872	2,870
Net increase/(decrease) in cash and cash equivalents		(410)	1,002	(410)	1,002
Cash and cash equivalents at the beginning of the year		6,952	5,950	6,952	5,950
Cash and cash equivalents at the end of the year [2]	5.2	6,542	6,952	6,542	6,952

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

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

Statement of cash flows (continued)
for the year ended 30 September

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

Group	Term Funding Scheme £m	Debt securities in issue £m	Intercompany loans £m	Total £m
At 1 October 2017	1,901	4,006	809	**6,716**
Cash flows:				
Issuances	-	1,049	497	**1,546**
Redemptions	-	(1,372)	-	**(1,372)**
Draw downs	1,250	-	15	**1,265**
Repayment	(700)	-	(6)	**(706)**
Maturity	(200)	-	-	**(200)**
Non-cash flows				
Movement in accrued interest	3	1	-	**4**
Unrealised FX movements	-	30	(2)	**28**
Unamortised costs	-	(16)	-	**(16)**
Other movement	-	-	-	**-**
At 30 September 2018	2,254	3,698	1,313	7,265

Bank	Term Funding Scheme £m	Debt securities in issue £m	Intercompany loans £m	Total £m
At 1 October 2017	1,901	708	3,724	**6,333**
Cash flows:				
Issuances	-	-	497	**497**
Redemptions	-	-	-	**-**
Draw downs	1,250	-	28	**1,278**
Repayment	(700)	-	(266)	**(966)**
Maturity	(200)	-	-	**(200)**
Non-cash flows				
Movement in accrued interest	3	-	(10)	**(7)**
Unrealised FX movements	-	-	-	**-**
Unamortised costs	-	-	(1)	**(1)**
Other movement	-	-	(87)	**(87)**
At 30 September 2018	2,254	708	3,885	6,847

The notes on pages 82 to 146 form an integral part of these financial statements.

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

Overview

This section sets out the Group's accounting policies that relate to the consolidated financial statements as a whole. Where an accounting policy is specific to one note, the policy is described in the note to which it relates. This section also shows new accounting standards, amendments and interpretations relevant to the Group, and whether they are effective in 2018 or later years. We explain how these changes are expected to impact the financial position and performance of the Group.

1.1 General information

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

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

1.2 Basis of accounting

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

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

1.3 Presentation of risk, offsetting and maturity disclosures

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

1.4 Going concern

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

In assessing the Group's going concern position as at 30 September 2018, the Directors have considered a number of factors, including the current balance sheet position, the principal and emerging risks which could impact the performance of the Group, the Group's strategic and financial plan and the impact of the acquisition of Virgin Money. The assessment concluded that, for the foreseeable future, the Group has sufficient capital to support its operations; has a funding and liquidity base which is strong, robust and well managed with future capacity; and has expectations that performance will continue to improve as the Group's strategy is executed.

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

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

1.5 Basis of consolidation

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

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

The consolidated financial statements have been prepared using uniform accounting policies.

1.6 Foreign currency

Functional and presentation currency
Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the 'functional currency'). The consolidated financial statements are presented in pounds sterling (GBP), which is also the Group's presentation currency, rounded to the nearest million pounds sterling (£m) unless otherwise stated.

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

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

1.7 Financial assets and liabilities

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

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

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

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

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

1.8 Critical accounting estimates and judgements

The preparation of financial statements requires the use of certain critical accounting estimates and judgements that affect the reported amounts of assets, liabilities, revenues and expenses and the disclosed amount of contingent liabilities. Assumptions made at each balance sheet date are based on best estimates at that date. Although the Group has internal control systems in place to ensure that estimates can be reliably measured, actual amounts may differ from those estimates. The Group considers the most significant use of accounting estimates and judgements relate to the following areas:

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

1.9 New accounting standards and interpretations

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

- amendments to IAS 12: 'Recognition of Deferred Tax Assets for Unrealised Losses' issued in January 2016 and effective for financial years beginning on or after 1 January 2017. The amendments clarify the requirements on the recognition of deferred tax assets for unrealised losses;

- amendments to IAS 7: 'Disclosure initiative' issued in January 2016 and effective for financial years beginning on or after 1 January 2017. The amendments to IAS 7: 'Statement of Cash Flows' require disclosures that enable users of the financial statements to evaluate changes in liabilities arising from an entity's financing activities; and

- 'Annual Improvements to IFRS Standards 2014-2016 Cycle', issued December 2016 and effective for financial years beginning on or after 1 January 2017. The amendment relates to IFRS 12: 'Disclosure of Interests in Other Entities' and clarifies the scope of the standard.

New accounting standards and interpretations not yet adopted

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

There are a number of other standards, interpretations and amendments that have not been applied by the Group in preparing these financial statements as they are either not available for adoption in the EU or are not mandatory for the Group as at 30 September 2018. The pronouncements, while relevant to the Group, are not anticipated to have a material impact and include:

- amendments to IFRS 2: 'Classification and Measurement of Share-based Payment Transactions' issued in June 2016 and effective for financial years beginning on or after 1 January 2018. The amendments provide guidance on the effects of vesting and non-vesting conditions on the measurement of cash-settled share-based payments; classification of share-based payments with a net settlement feature for withholding tax obligations; and accounting for modifications to a share-based payment that change the classification from cash-settled to equity-settled;

- 'Annual Improvements to IFRS Standards 2014-2016 Cycle', issued December 2016 and effective for financial years beginning on or after 1 January 2018. The amendment relates to IAS 28: 'Investments in Associates and Joint Ventures' and the measurement of an associate or joint venture at fair value;

- IFRIC interpretation 22: 'Foreign Currency Transactions and Advance Consideration', issued December 2016 and effective for financial years beginning on or after 1 January 2018. The new interpretation provides requirements on which exchange rate to use in reporting foreign currency transactions (such as revenue transactions) when payment is made or received in advance;

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

1.9 New accounting standards and interpretations (continued)

New accounting standards and interpretations not yet adopted (continued)

- amendments to IFRS 9: 'Prepayment Features with Negative Compensation' issued in October 2017 and effective for financial years beginning on or after 1 January 2019. The amendments allow companies to measure particular prepayable financial assets with so-called negative compensation at amortised cost or fair value through other comprehensive income if a specified condition is met, instead of these being measured at fair value through profit or loss. The Group expects to early adopt this amendment with effect from 1 October 2018 in line with the adoption of IFRS 9;
- IFRIC interpretation 23: 'Uncertainty over Income Tax Treatments', issued June 2017 and effective for financial years beginning on or after 1 January 2019. The new interpretation applies to any situation in which there is uncertainty as to whether an income tax treatment is acceptable under tax law and is not limited to actual ongoing disputes;
- 'Annual Improvements to IFRS Standards 2015-2017 Cycle'(1), issued December 2017 and effective for financial years beginning on or after 1 January 2019. The IASB has made amendments to the following standards: IFRS 3 'Business Combinations'; IFRS 11 'Joint arrangements'; IAS 12 'Income Taxes'; and IAS 32 'Borrowing Costs';
- 'Amendment to IAS 19 – plan amendment, curtailment or settlement'(1) issued in February 2018 and effective prospectively for financial years beginning on or after 1 January 2019. The amendments clarify that after a plan event companies should use these updated assumptions to measure current service cost and net interest for the remainder of the reporting period; and
- amendments to References to the 'Conceptual Framework in IFRS Standards'(1), issued in March 2018 and effective for financial years beginning on or after 1 January 2020. The amendments were issued following the IASB's publication of a revised version of its Conceptual Framework for Financial Reporting and updates the references in IFRS standards to previous versions of the Conceptual Framework.

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

IFRS 9
IFRS 9 'Financial Instruments' was issued by the IASB in July 2014 and endorsed for use in the EU in November 2016. It is effective for accounting periods beginning on or after 1 January 2018 and replaces IAS 39 'Financial Instruments: Recognition and Measurement' for the Group with effect from 1 October 2018.

In addition, the IASB also issued 'Prepayment Features with Negative Compensation (Amendment to IFRS 9)' in October 2017. This is a narrow scope amendment that enables the use of the amortised cost classification for some financial assets with a prepayable option that could result in the option's holder receiving compensation (referred to as 'negative compensation') for early termination. It is effective for accounting periods beginning on or after 1 January 2019 (with early adoption permitted) and was endorsed for use in the EU in March 2018. The Group will early adopt the amendment to IFRS 9 with effect from 1 October 2018, with no significant impact expected.

Classification and measurement
The existing IAS 39 financial asset classification categories are replaced under IFRS 9 as follows:

Financial assets categories	IAS 39	IFRS 9
Loans and receivables at amortised cost	✓	✓
Held to maturity (HTM)	✓	x
Available for sale (AFS)	✓	x
Fair value through profit or loss (FVTPL)	✓	✓
Fair value through other comprehensive income (FVOCI)	x	✓

(1) Not yet endorsed by the EU.

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

1.9 New accounting standards and interpretations (continued)

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

IFRS 9 introduces a two-stage process for the classification of financial assets:

1. The business model assessment

Financial assets with a 'hold to collect' contractual cash flows business model should be classified at amortised cost. Where the business model is 'hold to collect and sell', the financial asset should be classified at fair value through other comprehensive income (FVOCI). To be considered under the FVOCI category, the selling of financial instruments must be integral to the underlying business model.

Final classification is dependent on the financial asset passing the cash flow characteristics assessment. If the financial asset is held in a business model that is neither 'hold to collect' nor 'hold to collect and sell', it must be held at fair value through profit or loss (FVTPL). The option to classify a financial asset at FVTPL under certain circumstances that exists under IAS 39 is also retained in IFRS 9.

2. The cash flow characteristic assessment

The second stage in classification is to assess whether the contractual terms of the financial asset give rise to cash flows which are consistent with that of 'solely payments of principal and interest' (SPPI). IFRS 9 considers financial assets that meet the SPPI criteria as being consistent with a 'basic lending arrangement'.

Any financial asset which fails the SPPI test must be held at FVTPL.

The Group has assessed the financial assets that come under the scope of IFRS 9 and determined that they will transition to IFRS 9 on 1 October 2018 as follows:

	IAS 39				IFRS 9		
	Loans and receivable	FVTPL	AFS		Amortised cost	FVTPL	FVOCI
Financial assets							
Cash and balances with central banks	✓				✓		
Due from other banks	✓				✓		
Listed securities			✓				✓
Unlisted securities			✓			✓	
Other financial assets			✓			✓	
Other financial assets at fair value		✓				✓	
Derivative financial instruments		✓				✓	
Loans and advances to customers	✓				✓		
Due from customers on acceptances	✓				✓		

The only significant change in classification will be for the Group's Treasury financial assets, which will move from the IAS 39 AFS category to the new FVOCI category under IFRS 9[1].

Impairment
The most significant impact of IFRS 9 is the change in credit loss methodology, which moves from the 'incurred loss' basis under IAS 39 to an 'expected loss' basis under IFRS 9.

[1] As with the AFS category, fair value movements in the FVOCI category will pass through a reserve account which can be recycled through profit or loss.

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

1.9 New accounting standards and interpretations (continued)

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

The single impairment loss methodology (for all financial assets held at either amortised cost or FVOCI) requires the calculation of either a 12-month expected credit loss (ECL) allowance where the financial asset has not experienced a significant increase in credit risk since origination or a lifetime ECL calculation where this significant increase has been observed. Loan commitments and financial guarantees not measured at fair value through profit or loss are also in scope for impairment. IFRS 9 does not define what is meant by a significant increase in credit risk since origination, with the Group exercising judgement in determining how this should be interpreted. The Group has developed a suite of both quantitative and qualitative factors that will determine whether there has been a significant increase in credit risk since origination. Portfolio specific factors are used within the Group's Retail and SME portfolios, with the treatment of customers in receipt of the Group's forbearance programmes being a common trigger in both portfolios that would indicate there has been a significant increase in credit risk since origination. The Group will also utilise the 30 days past due (DPD) backstop in moving to a lifetime ECL calculation, but expects other triggers to have moved a customer to a lifetime ECL calculation before this point.

The concepts of 12-month and lifetime ECL calculations are not a feature of IAS 39, which requires objective evidence of impairment on a financial asset or group of financial assets due to the identification of a loss event after initial recognition but before the balance sheet date for an impairment loss to be calculated. The move to an expected loss basis will therefore have an initial impact and is generally expected to require an increase in the level of impairment provision held.

IFRS 9 also requires that the ECL calculation reflects an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes; the time value of money; and reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

In meeting this requirement, the Group has incorporated a number of relevant economic parameters within the credit loss models such as base, inflation and unemployment rates. These are included for the full forecast period and will vary between the three economic scenarios the Group will utilise for IFRS 9 purposes (base case, upside and downside). The economic parameters used and the relative weightings of the scenarios are validated internally by an economic scenarios panel which comprises representation from a number of internal stakeholder functions[(1)].

Hedging
While IFRS 9 introduces revised hedge accounting requirements, the IASB is still considering the approach to accounting for dynamic risk management. Consequently, IFRS 9 includes an accounting policy option to continue hedge accounting under the requirements of IAS 39 until such time as the IASB's overall hedge accounting strategy is complete. The Group will exercise the accounting policy option to continue hedge accounting under IAS 39 but will look to provide the new hedge accounting disclosures, where applicable, in the 2019 annual financial statements.

IFRS 9 implementation strategy and transitional impact
During 2018, the Group has continued the development and refinement of IFRS 9 compliant credit loss models. These models adhere to the Group's internal model standards and policies and have been subject to review, challenge and approval from the Group's internal model governance pathway. The IFRS 9 Project team has provided updates to the Board's Audit Committee on a regular basis throughout the year on the outputs from the parallel run process and the improvements in the reporting of the outputs over the same period.

The Group will continue to review and evaluate the credit loss model methodology and overall ECL calculation mechanics and related controls in advance of further IFRS 9 disclosure requirements in 2019. While the Group has calculated the impairment impact of IFRS 9 based on the current view of forward-looking economic conditions and parameters, these are inherently difficult to predict with any great certainty and require an element of management judgement. This is particularly relevant in relation to the eventual outcome of the UK Government's Brexit negotiations, which will not be finalised until March 2019. Consequently, the Group's estimation of expected credit losses under IFRS 9 and the impact this has on results and other related disclosures remain subject to change until finalisation of the Group's results for the year ended 30 September 2019.

[(1)] This is supplemented by a third-party supplier of economic data.

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

1.9 New accounting standards and interpretations (continued)

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

The change to the basis of impairment loss provisioning is currently expected to result in a transitional impact of £21m (net of tax) due to the increased level of credit impairments required under IFRS 9 compared with IAS 39. As IFRS 9 does not require the restatement of comparative information, the transitional impact will result in a net decrease in the Group's total equity at 1 October 2018.

The transitional impact of IFRS 9 on the Group's reported CET1 ratio at 1 October 2018 will be a reduction of 14bps[1] on a fully loaded basis. As a result of the transitional capital rules option, which the Group has already confirmed it will exercise[2], the effect on the transitional CET1 ratio is negligible[1].

Transitional disclosures, required by IFRS 7, will be included within the CYBG Group's interim financial statements for the six months to 31 March 2019.

IFRS 15
IFRS 15 was issued in May 2014 and is endorsed for use in the EU. It is effective for financial years beginning on or after 1 January 2018, and will be adopted by the Group with effect from 1 October 2018. The core principle of IFRS 15 is that revenue reflects the transfer of goods or services to customers in an amount that reflects the consideration to which an entity expects to be entitled. The standard provides a principles based five-step model for recognition.

The majority of the Group's revenue is in the form of interest income from financial instruments, which is not in scope for IFRS 15. Interest income from lease contracts is also not in scope. Fees and commissions together with certain elements of non-interest income do fall within the scope of the standard. In nearly all cases the Group's current accounting policy is consistent with the requirements of IFRS 15, accordingly there is no material impact in relation to the timing of when the Group recognises revenues.

IFRS 16
IFRS 16 was issued in January 2016 and is endorsed for use in the EU. It is effective for financial years beginning on or after 1 January 2019, and will be adopted by the Group with effect from 1 October 2019. For lessees, operating leases will be brought onto the Group's balance sheet with an asset recognised for the contractual 'right of use' and a financial liability recognised for the contractual payments. This change will mainly impact the properties that the Group currently accounts for as operating leases. There are no substantial changes to the accounting for leases by lessors, nor for finance leases. An implementation plan is in place and the Group continues to assess the impact of the standard.

(1) Unaudited.

(2) This has the effect on phasing the Day 1 impact of the transition to IFRS 9 over five years for capital purposes, with 95% of the impact added back in the first year.

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

2.1 Segment information

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

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

SME banking

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

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

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

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

Retail banking

The Group has a comprehensive regional and national retail banking product proposition comprising:

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

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

2.1 Segment information (continued)

Geographical areas

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

Operating Segments 2018	SME banking £m	Retail banking £m	Central functions £m	Other [(1)] £m	Total £m
Net interest income	261	641	(47)	-	855
Non-interest income	76	99	(19)	-	156
Operating income	337	740	(66)	-	1,011
Operating and administrative expenses	(63)	(94)	(476)	(613)	(1,246)
Impairment losses on credit exposures [(2)]	(15)	(26)	-	-	(41)
Segment operating profit/(loss) before tax	259	620	(542)	(613)	(276)
Average interest earning assets [(3)]	7,391	25,198	6,828	-	39,417

Operating Segments 2017	SME Banking £m	Retail Banking £m	Central Functions £m	Other [(1)] £m	Total £m
Net interest income	251	644	(50)	-	845
Non-interest income	83	100	(11)	20	192
Operating income	334	744	(61)	20	1,037
Operating and administrative expenses	(61)	(97)	(512)	(580)	(1,250)
Impairment losses on credit exposures [(2)]	(33)	(15)	-	-	(48)
Segment operating profit/(loss) before tax	240	632	(573)	(560)	(261)
Average interest earning assets [(3)]	7,209	23,522	6,966	-	37,697

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

(2) The impairment losses on credit exposures of £26m (2017: £15m) for Retail banking includes losses on certain retail products attributable to SME (private banking) customers.

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

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

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

2.2 Net interest income

Accounting policy

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

When calculating the effective interest rate, cash flows are estimated considering all contractual terms of the financial instrument (e.g. prepayment, call and similar options) excluding future credit losses. The calculation includes all amounts paid or received that are an integral part of the effective interest rate such as transaction costs and all other premiums or discounts. Where it is not possible to reliably estimate the cash flows or the expected life of a financial instrument (or group of financial instruments), the contractual cash flows over the full contractual term of the financial instrument (or group of financial instruments) are used.

Loan origination and commitment fees are recognised within the effective interest rate calculation. Non-utilisation of a commitment fee is recognised as revenue upon expiry of the agreed commitment period. Loan related administration and service fees are recognised as revenue over the period of service.

Interest income and interest expense on hedged assets and liabilities and financial assets and liabilities designated as fair value through profit or loss are also recognised as part of net interest income.

Where a trading derivative is economically hedging an interest bearing financial asset or liability designated at fair value through profit or loss, the interest income and expense attributable to the derivative is recognised within net interest income (in a manner consistent with hedging derivatives) and not as part of the fair value movement of the trading derivative.

	2018 £m	2017 £m
Interest income and similar income		
Loans and advances to other banks	26	11
Financial assets available for sale	12	11
Loans and advances to customers	1,057	1,030
Financial assets at fair value through profit or loss	15	18
Other interest income	3	5
Total interest income and similar income	1,113	1,075
Less: interest expense and similar charges		
Due to other banks	18	15
Due to customers	148	126
Debt securities in issue	59	63
Due to related entities	33	26
Total interest expense and similar charges	258	230
Net interest income	855	845

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

2.3 Non-interest income

Accounting policy

Gains less losses on financial instruments at fair value

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

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

Fees and commissions

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

	2018 £m	2017 £m
Gains less losses on financial instruments at fair value		
Interest rate derivatives	16	45
Other assets and liabilities at fair value [1]	(13)	(35)
Ineffectiveness arising from fair value hedges (note 3.4)	-	(4)
Ineffectiveness arising from cash flow hedges (note 3.4)	(6)	-
	(3)	6
Other operating income		
Fees and commissions	141	146
Margin on foreign exchange derivative brokerage	18	18
Gains on disposal of available for sale financial assets	-	20
Net fair value movement on investment properties	-	(1)
Other income	-	3
	159	186
Total non-interest income	156	192

[1] A credit risk gain on other assets and liabilities at fair value of £3m, offset by a fair value loss of £16m, has been recognised in the current year (2017: £6m gain and £41m loss, respectively).

On 28 April 2017, Mastercard completed its acquisition of 94.2% of VocaLink. resulting in a gain of £20m, which was included within 'Gains on disposal of available for sale financial assets' in the year ended 30 September 2017.

2.4 Operating and administrative expenses

Accounting policy

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

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

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

	2018 £m	2017 £m
Personnel expenses	223	166
Restructuring expenses (note 3.14)	38	67
Virgin Money acquisition costs	7	-
RBS alternative remedies package spend	16	-
Depreciation and amortisation expense (notes 3.8, 3.10)	89	87
Other operating and administrative expenses	873	930
Total operating and administrative expenses	1,246	1,250

Personnel expenses comprises the following items:

	2018 £m	2017 £m
Salaries, wages and non-cash benefits and social security costs	139	171
Defined contribution pension expense	33	19
Defined benefit pension expense/(income) (note 3.16)	2	(54)
Equity based compensation (note 4.2)	9	6
Other personnel expenses	40	24
Personnel expenses	223	166

In the year to 30 September 2017, the Group recognised gains in relation to its defined benefit pension scheme. A past service credit of £88m was included in personnel expenses as a result of the closure of the Scheme to future accrual for the majority of members. In addition, a curtailment gain of £13m was recognised in respect of redundancies which did not attract an enhancement entitlement and was offset against the related restructuring costs.

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

	2018 Number	2017 Number
Managers	2,161	2,234
Clerical staff	3,608	3,806
	5,769	6,040

The average monthly number of employees was 6,461 (2017: 6,818).

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

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

	2018 £m	2017 £m
Operating lease charges	26	29
PPI redress expense (note 3.14)	500	494
Other conduct expenses (note 3.14)	44	98
Separation costs	8	8
Auditor's remuneration	2	2

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

2.4 Operating and administrative expenses (continued)

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

	2018 £'000	2017 £'000
Fees payable to the Bank's auditor for the audit of the Bank's financial statements	1,518	1,182
Fees payable to the Bank's auditor for the audit of the Bank's subsidiaries	75	69
Total audit fees	1,593	1,251
Other assurance services	700	308
Fees payable to the Bank's auditor in respect of associated pension schemes	84	63
Total fees payable to the Bank's auditor	2,377	1,622

Non-audit services of £700k (2017: £278k) performed by the auditor during the year included agreed upon procedures under the Conduct Indemnity arrangement with NAB; preparation of a comfort letter for the global medium-term note programme issuance; and a TFS assurance review. The increase in the year is principally due to reporting accountant procedures in relation to the Virgin Money transaction.

In addition to the above, out of pocket expenses of £48k (2017: £16k) were borne by the Group, principally related to reimbursement of travel expenses incurred by staff when performing the above services.

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

2.5 Taxation

Accounting policy

Income tax on the profit or loss for the year comprises current and deferred tax. Income tax is recognised in the income statement except to the extent that it is related to items recognised directly in equity, in which case the tax is also recognised in equity.

Current tax is the expected tax payable or receivable on the taxable profit or loss for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years. Deferred tax assets and liabilities are recognised on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred tax is determined using tax rates and laws that have been enacted or substantively enacted by the balance sheet date and are expected to apply when the related deferred tax asset is realised or the deferred tax liability is settled.

	2018 £m	2017 £m
Current tax		
UK corporation tax		
Current year	8	9
Adjustment in respect of prior years	-	1
	8	10
Deferred tax (note 3.11)		
Current year	(33)	17
Adjustment in respect of prior years	(12)	6
	(45)	23
Tax (credit)/expense for the year	(37)	33

The tax assessed for the year differs from that arising from applying the standard rate of corporation tax in the UK of 19%. A reconciliation from the credit implied by the standard rate to the actual tax expense is as follows:

	2018 £m	2017 £m
Loss on ordinary activities before tax	(276)	(261)
Tax credit based on the standard rate of corporation tax in the UK of 19% (2017: 19.5%)	(53)	(51)
Effects of:		
Disallowable expenses	52	64
Deferred tax assets recognised	(8)	(21)
Impact of rate changes	(15)	34
Adjustments in respect of prior years	(13)	7
Tax (credit)/expense for the year	(37)	33

The total amount of tax, current and deferred, recognised directly in equity during the year was a credit of £23m (2017: £1m). Disallowable expenses represent, in the main, the Group's share of incremental conduct charges that are not deductible in computing taxable profits and non-deductible transaction costs.

The prior year adjustment comprises movements in the deferred tax asset recognised for losses following the enactment of the Corporate Loss Restriction in Finance Act (No.2) 2017 in November 2017. These rules allowed, for the first time, certain losses to be relieved against the profits of group entities other than the one in which they arose and also changed the order of precedence for relief of existing losses. The consequence of this change was that historic losses which were previously derecognised are now brought onto the balance sheet in accordance with the Group's established methodology.

The rate change charge arises on the revaluation of assets as a consequence of the UK mainstream rate of tax trending towards the enacted rate of 17%, and where deferred tax assets have been utilised at rates lower than initially forecast.

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

3.1 Cash and balances with central banks

	Group		Bank	
	2018	2017	2018	2017
	£m	£m	£m	£m
Cash assets	1,656	1,507	1,656	1,507
Balances with central banks (including EU payment systems)	4,917	5,430	4,917	5,430
	6,573	6,937	6,573	6,937
Less mandatory deposits with central banks [1]	(75)	(44)	(75)	(44)
Included in cash and cash equivalents (note 5.2)	6,498	6,893	6,498	6,893

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

3.2 Financial assets available for sale

Accounting policy

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

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

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

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

	Group		Bank	
	2018	2017	2018	2017
	£m	£m	£m	£m
Listed securities	1,551	2,066	1,551	2,066
Unlisted securities	5	4	5	4
Other financial assets	6	6	-	-
Total financial assets available for sale	1,562	2,076	1,556	2,070

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

Credit quality of investments	Group		Bank	
	2018	2017	2018	2017
	£m	£m	£m	£m
Available for sale				
Senior investment grade	1,551	2,066	1,551	2,066
Other	11	10	5	4
	1,562	2,076	1,556	2,070

Senior investment grade securities

These include £595m (2017: £1,221m) of UK Government Gilts. The remainder relates to highly liquid, AAA-rated corporate bonds.

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

Accounting policy

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

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

Critical accounting estimates and judgements

Where the fair values of financial assets and financial liabilities recorded on the balance sheet cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The inputs to these models are derived from observable market data where possible, but where such data is not available, judgement is required to establish fair values. The judgements include considerations of liquidity and credit risk.

The most significant judgement is in relation to the Group's fair value loan portfolio. The most significant unobservable input impacting the carrying value of the loans other than interest rates is the future expectation of credit losses. If the lifetime expected losses were 20% greater than predicted, the carrying value of the loans would decrease by £2m and vice versa.

	Group		Bank	
	2018	2017	**2018**	2017
	£m	£m	**£m**	£m
Financial assets at fair value through profit or loss				
Loans and advances	**362**	477	**362**	477
Financial liabilities at fair value through profit or loss				
Due to customers – term deposits	**15**	26	**15**	26

Loans and advances

Included in financial assets at fair value through profit or loss is a historical portfolio of loans (sales ceased in 2012). Interest rate risk associated with these loans is managed using interest rate derivative contracts and the loans are recorded at fair value to avoid an accounting mismatch. The maximum credit exposure of the loans is £362m (2017: £477m) including accrued interest receivable of £2m (2017: £2m). The cumulative loss in the fair value of the loans attributable to changes in credit risk amounts to £8m (2017: £11m) and the change for the current year is a decrease of £3m (2017: decrease of £13m), of which £3m (2017: £6m) has been recognised in the income statement.

Due to customers - term deposits

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

The change in fair value attributable to changes in the Group's credit risk is £Nil (2017: £Nil). The Group is contractually obligated to pay £0.3m (2017: £1m) less than the carrying amount at maturity to the deposit holder.

3.4 Derivative financial instruments

Accounting policy

All derivative instruments manage exposures to interest rates and foreign currency and are recognised on the balance sheet at fair value on trade date. The carrying value of a derivative is measured at fair value throughout the life of the contract. Derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative. The notional amount of a derivative contract is not recorded on the balance sheet but is disclosed as part of this note.

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

Cash flow hedge

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in equity. Specifically, the separate component of equity (note 4.1) is adjusted to the lesser of the cumulative gain or loss on the hedging instrument, and the cumulative change in fair value of the expected future cash flows on the hedged item from the inception of the hedge. Any remaining gain or loss on the hedging instrument is recognised in the income statement. The carrying value of the hedged item is not adjusted. Amounts accumulated in equity are transferred to the income statement in the period in which the hedged item affects profit or loss.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss remains in equity and is recognised when the forecast transaction is ultimately recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the income statement.

Fair value hedge

The carrying value of the hedged item on initial designation is adjusted for the fair value attributable to the hedged risk. Subsequently, changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the income statement, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. The movement in the fair value of the hedged item attributable to the hedged risk is made as an adjustment to the carrying value of the hedged asset or liability.

Where the hedged item is derecognised from the balance sheet, the adjustment to the carrying amount of the asset or liability is immediately transferred to the income statement. When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of a hedged item is amortised to the income statement on an effective interest basis over the remaining life of the asset or liability.

Hedge effectiveness

The Group documents, at the inception of a transaction, the relationship between hedging instruments and the hedged items, and the Group's risk management objective and strategy for undertaking these hedge transactions. The documentation covers how effectiveness will be measured throughout the life of the hedge relationship and its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items. A hedge is expected to be highly effective if the changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated are expected to offset in a range of 80% to 125%.

Derivatives held for trading

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

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

3.4 Derivative financial instruments (continued)

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

	Group		Bank	
	2018	2017	2018	2017
	£m	£m	£m	£m
Fair value of derivative financial assets				
Designated as hedging instruments	203	202	92	56
Designated as held for trading	59	80	59	80
	262	282	151	136
Fair value of derivative financial liabilities				
Designated as hedging instruments	259	229	259	229
Designated as held for trading	102	147	102	147
	361	376	361	376

Cash collateral on derivatives placed with banks totalled £306m (2017: £338m). Cash collateral received on derivatives totalled £37m (2017: £31m). These amounts are included within due from other banks and due to other banks respectively.

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

Group Total derivative contracts as at 30 September 2018	Notional contract amount £m	Fair value of assets £m	Fair value of liabilities £m
Derivatives designated as hedging instruments			
Cash flow hedges			
Interest rate swaps	24,570	88	111
Cross currency swaps	690	70	-
	25,260	158	111
Fair value hedges			
Interest rate swaps	2,180	45	148
Cross currency swaps	-	-	-
Derivatives designated as held for trading			
Foreign exchange rate related contracts			
Spot and forward foreign exchange	1,788	26	23
Cross currency swaps	455	10	10
Options	11	-	-
	2,254	36	33
Interest rate related contracts			
Swaps	811	15	59
Swaptions	33	-	-
Options	501	1	3
	1,345	16	62
Commodity related contracts	53	7	7
Total derivative contracts	31,092	262	361

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

3.4 Derivative financial instruments (continued)

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

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

3.4 Derivative financial instruments (continued)

Bank	Notional contract amount	Fair value of assets	Fair value of liabilities
Total derivative contracts as at 30 September 2018	£m	£m	£m
Derivatives designated as hedging instruments			
Cash flow hedges			
Interest rate swaps	24,570	88	111
Fair value hedges			
Interest rate swaps	1,480	4	148
Derivatives designated as held for trading			
Spot and forward foreign exchange	1,788	26	23
Cross currency swaps	455	10	10
Options	11	-	-
	2,254	36	33
Interest rate related contracts			
Swaps	811	15	59
Swaptions	33	-	-
Options	501	1	3
	1,345	16	62
Commodity related contracts	53	7	7
Total derivative contracts	29,702	151	361

3.4 Derivative financial instruments (continued)

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

Derivatives traded to manage the Group's interest rate exposure on a net portfolio basis are accounted for as cash flow hedges. Derivatives traded to manage interest rate risk on certain fixed rate assets, such as UK Government Gilts, are accounted for as fair value hedges.

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

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

	Group		Bank	
	2018	2017	**2018**	2017
Nominal values per time period	**£m**	£m	**£m**	£m
Within 0 to 3 months	**2,582**	92	**2,541**	83
Between 3 and 12 months	**7,325**	2,986	**7,195**	2,665
1 to 5 years	**14,882**	14,817	**14,363**	14,620
Greater than five years	**471**	590	**471**	590
	25,260	18,485	**24,570**	17,958

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

3.4 Derivative financial instruments (continued)

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

Group	Forecast receivable cash flows 2018 £m	Forecast payable cash flows 2018 £m	Forecast receivable cash flows 2017 £m	Forecast payable cash flows 2017 £m
Within 1 year	109	283	52	399
Between 1 and 2 years	130	366	70	86
Between 2 and 3 years	108	160	70	86
Between 3 and 4 years	63	5	44	122
Between 4 and 5 years	37	3	19	6
Greater than 5 years	60	10	26	18
	507	827	281	717

Bank	Forecast receivable cash flows 2018 £m	Forecast payable cash flows 2018 £m	Forecast receivable cash flows 2017 £m	Forecast payable cash flows 2017 £m
Within 1 year	109	81	52	29
Between 1 and 2 years	130	49	70	29
Between 2 and 3 years	108	17	70	9
Between 3 and 4 years	63	5	44	7
Between 4 and 5 years	37	3	19	6
Greater than 5 years	60	10	26	18
	507	165	281	98

	2018 £m	2017 £m
Gain/(loss) arising from fair value hedges (note 2.3)		
Hedging instrument	14	1
Hedged item attributable to the hedged risk	(14)	(5)
	-	(4)

	2018 £m	2017 £m
Loss from cash flow hedges due to hedge ineffectiveness (note 2.3)	(6)	-

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

3.5 Loans and advances to customers

Accounting policy

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

Loans and advances to customers are initially recognised at fair value including direct and incremental transaction costs. They are subsequently measured at amortised cost, using the effective interest method, adjusted for impairment losses. They are derecognised when the rights to receive cash flows have expired or the Group has transferred substantially all the risks and rewards of ownership.

Leases entered into by the Group as lessor, where the Group transfers substantially all the risks and rewards of ownership to the lessee, are classified as finance leases. The leased asset is not held on the Group balance sheet; instead, a finance lease is recognised representing the minimum lease payments receivable under the terms of the lease, discounted at the rate of interest implicit in the lease. Interest income is recognised in interest receivable, allocated to accounting periods to reflect a constant periodic rate of return.

	Group		Bank	
	2018	2017	**2018**	2017
	£m	£m	**£m**	£m
Mortgages	**24,540**	23,480	**23,461**	22,442
Term lending – SME	**5,009**	4,762	**5,009**	4,762
Term lending – Retail	**767**	709	**767**	709
Overdrafts	**1,525**	1,524	**1,525**	1,524
Lease finance	**660**	594	**624**	575
Credit cards	**381**	396	**381**	396
Trade finance	**35**	23	**35**	23
Gross loans and advances to customers	**32,917**	31,488	**31,802**	30,431
Accrued interest receivable	**79**	75	**75**	72
Unearned income	**(32)**	(28)	**(29)**	(27)
Deferred and unamortised fee income	**(25)**	(32)	**(25)**	(33)
Impairment provisions on credit exposures (note 3.6)	**(195)**	(210)	**(192)**	(207)
	32,744	31,293	**31,631**	30,236

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

The Group and Bank also have a portfolio of fair valued business loans of £362m (2017: £477m) which are held separately as Other financial assets at fair value on the balance sheet (note 3.3). Combined with the above this is equivalent to total loans and advances of £33,106m (2017: £31,770m) in respect of Group and £31,993m (2017: £30,713m) in respect of Bank.

Lease finance

The Group and Bank lease a variety of assets to third parties under finance lease arrangements, including vehicles and general plant and machinery. The cost of assets acquired by the Group and Bank during the year for the purpose of letting under finance leases and hire purchase contracts amounted to £20m (2017: £13m) and £399m (2017: £408m) respectively. The total receivables from finance leases for the Group and Bank were £32m and £Nil (2017: £17m and £Nil) respectively. The total receivables from hire purchase contracts in the Group and Bank were £596m and £595m (2017: £550m and £549m) respectively.

	Group		Bank	
	2018	2017	**2018**	2017
	£m	£m	**£m**	£m
Finance lease and hire purchase receivables				
Gross investment in finance lease and hire purchase receivables:				
Due within 1 year	**269**	241	**261**	236
Due within 1 to 5 years	**376**	346	**356**	334
Due after more than 5 years	**15**	7	**7**	5
	660	594	**624**	575
Unearned income	**(32)**	(27)	**(29)**	(26)
Net investment in finance lease and hire purchase receivables	**628**	567	**595**	549

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

3.6 Impairment provisions on credit exposures

Accounting policy

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

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

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

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

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

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

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

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

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

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

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

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

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

3.6 Impairment provisions on credit exposures (continued)

Accounting policy (continued)

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

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

Following impairment, interest income is recognised using the original effective rate of interest which was used to discount the future cash flows for the purpose of measuring the impairment loss. If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed. The amount of the reversal is recognised in the income statement.

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

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

Critical accounting estimates and judgements

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

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

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

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

Sensitivities within the collective provision
There are interactions between the various assumptions within the provisioning models, which mean that no single factor is likely to move independent of others; however, the sensitivities disclosed below assume all other assumptions remain unchanged.

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

An important element to the PD is the loss emergence period (LEP) which represents the Group's assessment of the period from when a loss event occurs to eventual default. The impact of the LEP differs between the Group's Retail and SME portfolios.

A two-month increase in the LEP would result in a further £2m impairment provision within the SME portfolio, and a further £3m being added to the Retail impairment provision.

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

3.6 Impairment provisions on credit exposures (continued)

Accounting policy (continued)

Critical accounting estimates and judgements (continued)

To the extent that recovery rates improve from those presently used within each of the Group's provisioning models by 5%, the impairment provision on loans and advances would decrease by £14m. Alternatively, if recovery rates deteriorate by 5%, the impairment provision on loans and advances would increase by £24m.

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

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

	Group		Bank	
	2018 £m	2017 £m	2018 £m	2017 £m
Opening balance	210	215	207	212
Charge for the year	41	48	41	48
Amounts written off	(68)	(75)	(68)	(75)
Recoveries of amounts written off in previous years	13	18	13	18
Other [1]	(1)	4	(1)	4
Closing balance (note 3.5)	195	210	192	207
Specific	43	56	41	54
Collective	152	154	151	153
	195	210	192	207

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

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

3.7 Securitisation and covered bond programmes

Accounting policy

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

Securitisation

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

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

Covered bond

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

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

Significant restrictions

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

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

3.7 Securitisations and covered bond programmes (continued)

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

2018	Group			Bank		
		Covered			Covered	
	Securitisation	bonds	Total	Securitisation	bonds	Total
Liabilities	£m	£m	£m	£m	£m	£m
At 1 October 2017	3,242	748	3,990	-	698	698
Issuance of debt	1,049	-	1,049	-	-	-
Repayments	(1,372)	-	(1,372)	-	-	-
Other movements	30	(16)	14	-	-	-
At 30 September 2018	2,949	732	3,681	-	698	698
Assets						
Securitised mortgage loans	6,412	1,389	7,801	6,412	1,389	7,801

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

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

3.7 Securitisations and covered bond programmes (continued)

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

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

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

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

	Group	
	2018	2017
	£m	£m
Fair value of transferred assets	6,248	6,074
Fair value of associated liabilities	(2,948)	(3,262)
	3,300	2,812

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

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

Securitisation programmes

The Bank provides credit support to the structured entities via reserve funds, which are partly funded through subordinated debt arrangements and by holding junior notes. Exposures totalled £23m in subordinated debt (2017: £47m) and £971m in junior notes held (2017: £856m). The Bank has a beneficial interest in the securitised mortgage portfolio held by the structured entities of £1,074m (2017: £711m).

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

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

Covered bond programme

The nominal level of over-collateralisation was £860m (2017: £681m) of the outstanding covered bonds. From time to time the obligations of the Bank to provide over-collateralisation may increase due to the formal requirements of the programme.

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

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

3.8 Property, plant and equipment

Accounting policy

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

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

With the exception of freehold and long-term leasehold land, all items of property, plant and equipment are depreciated or amortised using the straight line method, at rates appropriate to their estimated useful life to the Group. The annual rates of depreciation or amortisation are:

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

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

Group and Bank

	Freehold land and buildings £m	Long-term leasehold land and buildings £m	Building improvements £m	Fixtures and equipment £m	Total £m
Cost or valuation					
At 1 October 2016	6	3	154	100	263
Additions	-	-	14	7	21
Disposals	(1)	-	(25)	(5)	(31)
At 30 September 2017	5	3	143	102	253
Additions	-	-	9	13	22
Disposals	(2)	-	(3)	(1)	(6)
At 30 September 2018	**3**	**3**	**149**	**114**	**269**
Accumulated depreciation					
At 1 October 2016	1	-	90	73	164
Charge for the year	-	-	14	8	22
Disposals	-	-	(16)	(3)	(19)
At 30 September 2017	1	-	88	78	167
Charge for the year (note 2.4)	-	-	10	8	18
Disposals	-	-	(3)	(1)	(4)
At 30 September 2018	**1**	**-**	**95**	**85**	**181**
Net book value					
At 30 September 2018	**2**	**3**	**54**	**29**	**88**
At 30 September 2017	4	3	55	24	86

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

3.8 Property, plant and equipment (continued)

Valuations

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

Group and Bank	2018	2017
	£m	£m
Carrying value as included under the revaluation basis	5	7
Carrying value if the historical cost basis had been used	5	6

3.9 Investment properties

Accounting policy

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

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

Group and Bank	2018	2017
	£m	£m
At 1 October	14	22
Disposals	(7)	(7)
Revaluation	-	(1)
At 30 September 2017	7	14

During the year 90% (2017: 86%) of the investment properties generated total rental income of £1m (2017: £1m) and incurred operating and administrative expenses of £1m (2017: £1m). The operating and administrative expenses of the investment properties that did not generate rental income were £Nil (2017: £Nil).

3.10 Intangible assets

Accounting policy

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

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

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

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

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

3.10 Intangible assets (continued)

Group and Bank

	2018	2017
Capitalised software costs	£m	£m
Cost		
At 1 October	589	463
Additions	144	148
Write-off	-	(22)
At 30 September	733	589
Accumulated amortisation		
At 1 October	250	207
Charge for the year (note 2.4)	71	65
Write-off	-	(22)
At 30 September	321	250
Net book value at 30 September	412	339

£1m (2017: £3m) of the £144m (2017: £148m) software additions do not form part of internally generated software projects.

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

3.11 Deferred tax

Accounting policy

Deferred tax assets and liabilities are recognised on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. A deferred tax asset is recognised for unused tax losses and unused tax credits only if it is probable that future taxable amounts will arise against which those temporary differences and losses may be utilised.

Critical accounting estimates and judgements

The Group has deferred tax assets of £298m (2017: £236m); the increase from the previous balance sheet date is mainly due to increased loss recognition due to the implementation of the Corporate Loss Restriction, losses incurred in the year and additionally previously written off historic losses re-recognised in accordance with IAS 12. The Group has assessed the recoverability of these deferred tax assets at 30 September 2018 and considers it probable that sufficient future taxable profits will be available against which the underlying deductible temporary differences can be utilised over the corporate planning horizon.

At 30 September 2018, the Group had an unrecognised deferred tax asset of £157m (2017: £180m) representing trading losses with a gross value of £926m (2017: £1,058m). Although there is no prescribed period after which losses expire, a deferred tax asset has not been recognised in respect of these losses as the Directors have insufficient certainty over their recoverability in the foreseeable future.

Movement in net deferred tax asset

	Group		Bank	
	2018	2017	2018	2017
	£m	£m	£m	£m
At 1 October	161	192	156	187
Recognised in the income statement (note 2.5)	45	(23)	47	(23)
Recognised directly in equity	15	(8)	15	(8)
	221	161	218	156

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

	Group		Bank	
	2018	2017	2018	2017
Deferred tax assets	£m	£m	£m	£m
Tax losses carried forward	192	111	192	110
Capital allowances	88	120	84	116
Cash flow hedge reserve	12	-	12	-
Transitional adjustment - available for sale reserve	1	3	1	3
Employee equity based compensation	3	2	3	2
Other	2	-	2	-
	298	236	294	231
Deferred tax liabilities				
Defined benefit pension scheme surplus	(74)	(72)	(74)	(72)
Gains on unlisted available for sale investments	(3)	(3)	(3)	(3)
	(77)	(75)	(77)	(75)
Net deferred tax asset	221	161	217	156

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

3.11 Deferred tax (continued)

Since 1 April 2017, the statutory rate of UK corporation tax has been 19% and will fall to 17% from 1 April 2020. In accordance with the appropriate accounting standard, these enacted rates are used to measure the value at which assets are expected to be realised and liabilities settled.

A prior year adjustment to claim capital allowances provisionally disclaimed at 30 September 2017 has resulted in an increase to the residual loss deferred tax asset of £14m and a decrease in the corresponding capital allowance deferred tax asset of £19m. The difference between the two amounts, which arises because the two types of deferred tax assets are recognised at different rates, is taken to the income statement as part of the prior year credit set out in note 2.5.

The acquisition of Virgin Money on 15 October 2018 is not expected to have a material impact on the deferred tax asset recognition.

3.12 Due to other banks

Accounting policy

Repurchase agreements

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

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

	Group		Bank	
	2018	2017	**2018**	2017
	£m	£m	**£m**	£m
Securities sold under agreements to repurchase [1]	**802**	1,864	**802**	1,864
Transaction balances with other banks	**12**	12	**12**	12
Deposits from other banks	**37**	31	**37**	31
Secured loans	**2,254**	1,901	**2,254**	1,901
	3,105	3,808	**3,105**	3,808

(1) The underlying securities sold under agreements to repurchase have a carrying value of £1,172m (2017: £2,660m).

Secured loans comprise amounts drawn under the TFS (including accrued interest).

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

3.13 Due to customers

	Group		Bank	
	2018	2017	2018	2017
	£m	£m	£m	£m
Interest bearing demand deposits	19,895	19,130	19,895	19,130
Term deposits	6,192	5,957	6,192	5,957
Non-interest bearing demand deposits	2,756	2,548	2,756	2,548
Other wholesale deposits	1	18	1	18
	28,844	27,653	28,844	27,653
Accrued interest payable	60	65	60	65
	28,904	27,718	28,904	27,718

3.14 Provision for liabilities and charges

Accounting policy

Provisions for liabilities and charges are recognised when a legal or constructive obligation exists as a result of past events, it is probable that an outflow of economic benefits will be necessary to settle the obligation, and the obligation can be reliably estimated. Provisions for liabilities and charges are not discounted to the present value of their expected net future cash flows except where the time value of money is considered material.

Critical accounting estimates and judgements

PPI redress provision and other conduct related matters

Management has exercised significant judgement around the key assumptions that underpin the estimates and used estimation techniques to quantify them. Ongoing regulatory review and input, as well as rulings from the Financial Ombudsman Service (FOS) over time, and the Group's internal reviews and assessments of customer complaints, will continue to impact upon the nature and extent of conduct related customer redress and associated costs for which the Group may ultimately become liable in future periods.

Significant judgement is required in determining the key assumptions used to estimate the quantum of the provision, including the level of future complaint volumes, uphold rates (how many claims are, or may be, upheld in the customer's favour), and redress costs (the average payment made to customers). Also factored into the estimate is the effect of the judgements required around the outcome of the remediation activity. The provision is therefore subject to inherent uncertainties as a result of the subjective nature of the assumptions used in quantifying the overall estimated position at 30 September 2018, consequently, the provision calculated may be subject to change in future years if outcomes differ to those currently assumed. Sensitivity analysis indicating the impact of reasonably possible changes in key assumptions on the PPI provision is presented within this note.

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

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

3.14 Provision for liabilities and charges (continued)

	Group		Bank	
	2018	2017	2018	2017
	£m	£m	£m	£m
PPI redress provisions				
Opening balance	422	725	422	725
Charge to the income statement (note 2.4)	500	494	500	494
Utilised	(647)	(797)	(647)	(797)
Closing balance	275	422	275	422
Customer redress and other provisions				
Opening balance	109	101	109	101
Charge to the income statement (note 2.4)	44	98	44	98
Utilised	(112)	(90)	(112)	(90)
Closing balance	41	109	41	109
Restructuring provision (1)				
Opening balance	23	26	23	26
Charge to the income statement	15	58	15	58
Utilised	(23)	(61)	(23)	(61)
Closing balance	15	23	15	23
Total provisions for liabilities and charges	331	554	331	554

(1) Restructuring provision includes surplus lease space provision.

PPI redress

In common with the wider UK retail banking sector, the Group continues to deal with complaints and redress issues arising out of historic sales of PPI. During the year, the Group reassessed the level of provision that was considered appropriate to meet current and future expectations in relation to the mis-selling of PPI policies and concluded that a further charge of £500m was required incorporating the Group's estimate of the impact of heightened media coverage, the FCA advertising campaign and increased activity by claims management companies ahead of the August 2019 industry deadline. It also incorporated a reassessment of the costs of processing cases and the impact of experience adjustments. The total provision raised to date in respect of PPI is £2,640m (2017: £2,140m), with £275m of this remaining (2017: £293m)[1] for customer initiated complaints including costs of administration.

The Group implemented a comprehensive new PPI complaint handling process from August 2014 which involved making a number of significant changes to the PPI operations and resulted in an increase in operational and administrative costs. As reported previously, this involved the Group reopening complaints and reviewing the original decision reached in light of the new PPI complaint handling processes. This process has been concluded during the year at an additional cost of £88m.

To 30 September 2018, the Group has received 483,000[2] (2017: 361,000) complaints and has allowed for 83,000 further walk in complaints (2017: 73,000). This reflects an expectation that incoming complaints will reduce from current levels in aggregate reflecting the recently observed decline following the implementation of the fee cap.

(1) Comparitive refers to the remaining provision for customer initiated complaints only, the balance being for the completion of the Remediation exercise.
(2) Of these cases, c12,000 were work in progress as at 30 September 2018 (2017: c11,000).

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

3.14 Provision for liabilities and charges (continued)

PPI redress (continued)

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

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

The table below sets out the key assumptions and the effect on the provision at 30 September 2018 of future, potential, changes in key assumptions:

Assumptions	Change in assumption	Sensitivity [1]
Number of expected future customer initiated complaints (83,000 new complaints)	+/-10%	£24m
Uphold rate	+/-1%	£3m
Average redress costs [2]	+/-1%	£1m

(1) There are inter-dependencies between several of the key assumptions which add to the complexity of the judgements the Group has to make. This means that no single factor is likely to move independently of others, however, the sensitivities disclosed above assume all other assumptions remain unchanged.

(2) Sensitivity to a change in average redress across customer initiated complaints.

Customer redress and other provisions

Other provisions include amounts in respect of a number of non-PPI conduct related matters, legal proceedings, and claims arising in the ordinary course of the Group's business. Over the course of the year, the Group has raised further provisions of £44m for these matters, none of which is covered by the Capped Indemnity. The ultimate cost to the Group of other customer redress matters is driven by a number of factors relating to offers of redress, compensation, offers of alternative products, consequential loss claims and administrative costs. The matters are at varying stages of their life cycle and in certain circumstances, usually early in the life of a potential issue, elements of the potential exposure are contingent. These factors could result in the total cost of review and redress varying materially from the Group's estimate. The final amount required to settle the Group's potential liabilities in these matters is therefore uncertain and further provision could be required.

Conduct Indemnity Deed

The Bank's parent entity, CYBG's economic exposure to the impact of historic conduct related liabilities is mitigated by a Capped Indemnity of £1.7bn from NAB. The full amount of the remaining Capped Indemnity was drawn down in the current year. The Group and NAB had an agreement under which NAB provided the Group with a Capped Indemnity to meet the costs of dealing with conduct matters related to products sold in the period prior to the date of the Group's Demerger (the Conduct Indemnity Deed). The legacy conduct matters covered by the Capped Indemnity are referred to as Relevant Conduct Matters. The Capped Indemnity provided the Group with economic protection against certain costs and liabilities (including financial penalties imposed by a regulator) resulting from conduct issues relating to:

a) PPI, standalone IRHPs voluntary scope tailored business loans and fixed rate tailored business loans; and

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

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

It was agreed that NAB would meet 90.3% of Qualifying Conduct Costs claimed by the Company, up to the amount of the Capped Indemnity.

3.14 Provision for liabilities and charges (continued)

Conduct Indemnity Deed (continued)

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

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

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

	Conduct protection £m
Conduct protection provided by NAB	**1,700**
Capital injected into CYB Investments Limited (CYBI) prior to Demerger [1]	(120)
Drawn in the period to 30 September 2017 [2]	(1,432)
Undrawn Conduct Indemnity as at 30 September 2017	148
Drawn in the year to 30 September 2018	(148)
Balance as at 30 September 2018	-

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

(2) £465m of the £1,432m represented the pre-covered provision amount.

Restructuring provision

Restructuring of the business is currently ongoing and a provision is held to cover redundancy payments, property vacation costs and associated enablement costs. During the year £38m (2017: £67m) was charged to the income statement, of which £23m (2017: £9m) was charged directly to the income statement and £15m (2017: £58m) was provided for in accordance with the requirements of IAS 37. £23m (2017: £61m) of the total provision was utilised in the year.

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

3.15 Debt securities in issue

Accounting policy

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

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

The breakdown of debt securities in issue is shown below:

2018

Group	Securitisation £m	Covered bonds £m	Total £m
Amortised cost	2,949	698	3,647
Fair value hedge adjustments	-	34	34
Total debt securities	2,949	732	3,681
Accrued interest payable	7	10	17
	2,956	742	3,698

2017

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

2018

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

2017

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

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

3.15 Debt securities in issue (continued)

The Group issued the following debt securities during the year:

Issue date	Debt security	Initial Proceeds	Programme
1 February 2018	Lanark 2018-1 1A	$300m	Securitisation
1 February 2018	Lanark 2018-1 2A	£285m	Securitisation
5 July 2018	Lanark 2018-2 1A	$400m	Securitisation
5 July 2018	Lanark 2018-2 2A	£250m	Securitisation

The following redemptions occurred during the year with the final redemption value in line with the scheduled programme terms:

Redemption date	Debt security	Initial Proceeds	Programme
20 November 2017	Lannraig 2011-1 1A	£335m	Securitisation
22 November 2017	Lanark 2012-2 2A	£525m	Securitisation
22 August 2018	Lanark 2014-2 1A	€550m	Securitisation
22 August 2018	Lanark 2015-1 1A	£300m	Securitisation

Further reduction in the carrying value is as a result of scheduled principal repayments on outstanding securitisation notes.

Details of the terms and conditions of the outstanding notes issued under the securitisation and covered bond programmes as at 30 September 2018 are as follows:

Issue date	Currency	Carrying Value £m (1)	Coupon rate	Call date
Class A Lanark RMBS notes				
19 March 2014	GBP	**218**	3M GBP LIBOR + 0.50%	22 November 2018
11 December 2014	GBP	**274**	3M GBP LIBOR + 0.60%	22 February 2020
6 August 2015	EUR	**249**	3M EURIBOR + 0.45%	22 May 2021
4 August 2016	GBP	**419**	3M GBP LIBOR + 1.00%	22 February 2019
5 July 2017	GBP	**349**	3M GBP LIBOR + 0.42%	22 November 2020
5 July 2017	GBP	**399**	3M GBP LIBOR + 0.55%	22 August 2022
1 February 2018	USD	**202**	3M USD LIBOR + 0.42%	22 August 2020
1 February 2018	GBP	**284**	3M GBP LIBOR + 0.42%	22 February 2023
5 July 2018	USD	**306**	3M USD LIBOR + 0.42%	22 February 2021
5 July 2018	GBP	**249**	3M GBP LIBOR + 0.52%	22 August 2023
		2,949		
Covered bonds				
8 June 2012	GBP	**732**	4.625%	8 June 2026
Total securitised notes and covered bonds (note 3.7)		**3,681**		

(1) Excludes accrued interest.

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

3.16 Retirement benefit obligations

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

Defined contribution pension scheme
The Group recognises the obligation for contributions to the scheme as an expense in the income statement as incurred. Prepaid contributions are recognised as an asset to the extent that a cash refund or a reduction in the future payment is available.

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

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

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

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

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

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

Group and Bank	2018 £m	2017 £m
Active members' defined benefit obligation	(24)	(807)
Deferred members' defined benefit obligation [1]	(2,131)	(1,549)
Pensioner and dependant members' defined benefit obligation	(1,591)	(1,618)
Total defined benefit obligation	(3,746)	(3,974)
Fair value of Scheme assets	3,958	4,181
Net defined benefit pension asset	212	207
Post-retirement medical benefits obligations	(3)	(3)

[1] Deferred members' defined benefit obligtion includes employees who became deferred members on 1 August 2017 as part of the Scheme closure exercise.

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

3.16 Retirement benefit obligations (continued)

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

The last scheme funding valuation was at 30 September 2016 with a calculated deficit of £290m. In the latest recovery plan dated 31 January 2018, the Group agreed to eliminate the deficit through the following scheduled contributions: a single contribution of £25m on 15 October 2018; thereafter, equal monthly contributions totalling £50m per annum until 31 March 2022; and £55m in the year to 31 March 2023.

On 26 October 2018 the High Court ruled on a landmark pensions case relating to the defined benefits pension schemes operated by Lloyds Banking Group. Refer to note 5.5 for further information on post balance sheet events.

Group and Bank

Reconciliation of the net defined benefit pension asset	2018 £m	2017 £m
Opening net defined benefit pension scheme asset / (liability)	207	(75)
Service (cost) / credit	(3)	54
Interest on net defined benefit asset / (liability)	5	(1)
Remeasurement effects recognised in SOCI	(9)	154
Employer contributions	18	69
Administrative expenses	(6)	(7)
Curtailments and settlements	-	13
Closing fair value of net defined benefit pension scheme asset	212	207

Reconciliation of the defined benefit pension scheme assets	2018 £m	2017 £m
Opening fair value of defined benefit pension scheme assets	4,181	4,462
Interest income on Scheme assets at discount rate	109	104
Return on scheme assets greater / (less) than discount rate	27	(195)
Employer contributions (note 5.3)	18	69
Benefits paid	(93)	(102)
Transfer payments	(278)	(150)
Administrative costs paid	(6)	(7)
Closing fair value of defined benefit pension scheme assets	3,958	4,181

Reconciliation of the defined benefit pension scheme obligations	2018 £m	2017 £m
Opening defined benefit pension scheme obligations	(3,974)	(4,537)
Current service cost	(1)	(26)
Past service (cost) / credit	(2)	80
Interest expense on the defined benefit obligation	(104)	(105)
Actuarial (loss)/gain - experience adjustments	(35)	76
Actuarial gain - demographic assumptions	19	88
Actuarial (loss)/gain - financial assumptions	(20)	185
Benefits paid from pension Scheme assets	93	102
Transfer payments	278	150
Curtailments and settlements	-	13
Closing defined benefit pension scheme obligations	(3,746)	(3,974)

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

3.16 Retirement benefit obligations (continued)

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

	2018 £m	2017 £m
Quoted:		
Equities	650	804
Government bonds	2,017	1,495
Global sovereign bonds	24	33
Corporate bonds	706	829
Alternative credit	260	97
Infrastructure	255	272
Secure income alternatives	336	209
Derivatives [(1)]	172	169
Other	4	4
Repurchase agreements	(836)	-
Cash	238	124
Unquoted:		
Property	132	145
Fair value of defined benefit pension scheme assets	3,958	4,181

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

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

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

The Trustee has implemented an investment structure (including physical assets and derivatives) that seeks to reduce the Scheme's exposure to inflation and interest rate risks. As at 30 September 2018, both the interest rate and inflation rate hedge ratios were around 60% of liabilities when measured on a self-sufficiency basis. The estimated hedge ratios will be updated pending changes to the Trustee's strategic asset allocation but it expected these have both increased. The strategy reflects the Scheme's liability profile and the Trustee's and the Group's attitude to risk. The Trustee monitors the investment objectives and asset allocation policy on a regular basis.

Amounts recognised in the income statement	2018 £m	2017 £m
Current service cost	1	26
Past service cost	2	8
Past service credit on closure of Scheme	-	(88)
Curtailment and settlement gains	-	(13)
Net interest on net defined benefit (asset) / liability	(5)	1
Defined benefit pension income for the year	(2)	(66)
Administrative costs incurred	6	7
Cost / (credit) recognised in the income statement (note 2.4)	4	(59)

The Group incurred a past service cost of £2m (2017: £8m) in relation to enhanced early retirement entitlements on redundancy; in both years these were fully offset in the income statement by a corresponding release from the restructuring provision. In the prior year, the income statement benefited from a curtailment gain of £13m due to a higher than normal level of redundancies with no enhancement entitlement; this gain was offset against the related restructuring costs.

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

3.16 Retirement benefit obligations (continued)

Amounts recognised in the statement of comprehensive income	2018 £m	2017 £m
Opening cumulative actuarial losses	(695)	(849)
Actuarial (loss)/gain due to liability experience adjustments	(35)	76
Actuarial (loss)/gain due to liability assumption changes	(20)	185
Actuarial gain due to demographic assumption changes	19	88
Return on scheme assets greater/(less) than discount rate	27	(195)
Cumulative actuarial losses recognised in the statement of comprehensive income	(704)	(695)

Actuarial assumptions	2018	2017
	% p.a.	% p.a.
Financial assumptions		
Discount rate	2.75	2.74
Inflation (RPI)	3.30	3.24
Inflation (CPI)	2.30	2.24
Career average revalued earnings (CARE) revaluations:		
Pre 31 March 2012 benefits (RPI)	3.30	3.24
Post 31 March 2012 benefits (CPI capped at 5% per annum)	2.30	2.24
Pension increases (capped at 2.5% per annum)	2.13	2.12
Pension increases (capped at 5% per annum)	3.15	3.10
Rate of increase for pensions in deferment	2.30	2.24

Demographic assumptions	2018	2017
Post retirement mortality:	Years	Years
Current pensioners at 60 - male	28.2	28.2
Current pensioners at 60 - female	29.8	29.7
Future pensioners at 60 - male	29.3	29.3
Future pensioners at 60 - female	31.0	30.9

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

3.16 Retirement benefit obligations (continued)

Critical accounting estimates and judgements

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

- *The discount rate applied.* The discount rate is required to be set with reference to market yields at the end of the reporting period on high quality corporate bonds in the currency and with a term consistent with the Scheme's obligations. The average duration of the Scheme's obligations is approximately 19 years. The market for bonds with a similar duration is illiquid and, as a result, significant management judgement is required to determine an appropriate yield curve on which to base the discount rate.
- *Inflation assumptions.* Inflation is set with reference to market expectations of the Retail Price Index (RPI) measure of inflation for a term consistent with the Scheme's obligations, based on data published by the BoE. Other measures of inflation (such as Consumer Prices Index (CPI), or inflation measures subject to an annual cap) are derived from this assumption.
- *Mortality assumptions.* The cost of the benefits payable by the Scheme will also depend upon the life expectancy of the members. The assumptions for mortality rates are based on standard mortality tables which allow for future improvements in life expectancies.

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

Assumption change	Impact on defined benefit obligation £m	Impact on pension cost £m
Discount rate		
+ 0.25%	(169)	(6)
- 0.25%	182	5
Inflation		
+ 0.25%	115	3
- 0.25%	(113)	(3)
Life expectancy		
+1 year	126	4
-1 year	(120)	(3)

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

The discounted mean term of the defined benefit obligation at 30 September 2018 is 19 years (2017: 20 years). The expected contributions for the year ending 30 September 2019 are £77m (2018: £33m) and expected benefit payments for the year ending 30 September 2019 are £98m (2018: £100m).

The Group and Trustee have entered into a contingent security arrangement (the 'Security Arrangement') (note 5.3).

3.17 Other liabilities

	Group		Bank	
	2018	2017	2018	2017
	£m	£m	£m	£m
Notes in circulation	2,254	2,197	2,254	2,197
Accruals and deferred income	125	162	123	161
Other	101	111	101	111
	2,480	2,470	2,478	2,469

3.18 Fair value of financial instruments

Accounting Policy

Fair value is the price that would be received to sell an asset, or paid to transfer a liability in an orderly transaction between market participants at the valuation date.

When available, the Group measures the fair value of an instrument using quoted prices in an active market for that instrument. Where no such active market exists for the particular asset or liability, the Group uses a valuation technique to arrive at the fair value, including the use of transaction prices obtained in recent arm's length transactions where possible, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants. In doing so, fair value is estimated using a valuation technique that makes maximum possible use of market inputs and that places minimal possible reliance upon entity-specific inputs.

The best evidence of the fair value of a financial instrument at initial recognition is the transaction price, which represents the fair value of the consideration paid or received, unless the fair value of that instrument is evidenced by comparison with other observable current market transactions in the same instrument (i.e. without modification or repackaging) or based on a valuation technique whose variables include only data from observable markets. When such evidence exists, the Group recognises profits or losses on the transaction date.

In certain limited circumstances the Group applies the fair value measurement option to financial assets including loans and advances, where the inherent market risks (principally interest rate and option risk) are individually hedged using appropriate interest rate derivatives. The loan is designated as being carried at fair value through profit or loss to offset the movements in the fair value of the derivative within the income statement and therefore avoid an accounting mismatch. When a loan is held at fair value, a statistical based calculation is used to estimate expected losses attributable to adverse movements in credit risk on the assets held. This adjustment to the credit quality of the asset is then applied to the carrying amount of the loan to arrive at fair value and recognised in the income statement.

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

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

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

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

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

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

3.18 Fair value of financial instruments (continued)

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

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

Group

	30 September 2018					30 September 2017				
			Fair value measurement using:					Fair value measurement using:		
Financial assets	Carrying value £m	Fair value £m	Level 1 £m	Level 2 £m	Level 3 £m	Carrying value £m	Fair value £m	Level 1 £m	Level 2 £m	Level 3 £m
Loans and advances to customers	32,744	32,307	-	1,110	31,197	31,293	31,088	-	1,009	30,079
Financial liabilities										
Due to other banks	3,105	3,040	-	3,040	-	3,808	3,808	-	3,808	-
Due to customers	28,904	28,968	-	28,968	-	27,718	27,833	-	27,833	-
Debt securities in issue	3,698	3,773	-	3,773	-	4,006	4,115	-	4,115	-
Due to related entities	1,313	1,325	-	1,325	-	809	825	-	825	-

Bank

	30 September 2018					30 September 2017				
			Fair value measurement using:					Fair value measurement using:		
Financial assets	Carrying value £m	Fair value £m	Level 1 £m	Level 2 £m	Level 3 £m	Carrying value £m	Fair value £m	Level 1 £m	Level 2 £m	Level 3 £m
Loans and advances to customers	31,631	31,251	-	1,110	30,141	30,236	30,064	-	1,009	29,055
Financial liabilities										
Due to other banks	3,105	3,040	-	3,040	-	3,808	3,808	-	3,808	-
Due to customers	28,904	28,968	-	28,968	-	27,718	27,833	-	27,833	-
Debt securities in issue	708	824	-	824	-	708	852	-	852	-
Due to related entities	3,885	4,263	-	4,263	-	3,724	3,740	-	3,740	-

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

3.18 Fair value of financial instruments (continued)

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

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

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

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

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

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

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

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

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

Group	Fair value measurement at 30 September 2018				Fair value measurement at 30 September 2017			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
	£m	£m	£m	£m	£m	£m	£m	£m
Financial assets								
Derivative financial assets	-	262	-	262	-	282	-	282
AFS Investments - listed	1,551	-	-	1,551	2,066	-	-	2,066
AFS Investments - unlisted	-	-	5	5	-	-	4	4
AFS - Other	-	-	6	6	-	-	6	6
Other financial assets at fair value	-	362	-	362	-	-	477	477
Total financial assets at fair value	1,551	624	11	2,186	2,066	282	487	2,835
Financial liabilities								
Derivative financial liabilities	-	361	-	361	-	376	-	376
Other financial liabilities at fair value	-	15	-	15	-	-	26	26
Total financial liabilities measured at fair value	-	376	-	376	-	376	26	402

Bank	Fair value measurement at 30 September 2018				Fair value measurement at 30 September 2017			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
	£m	£m	£m	£m	£m	£m	£m	£m
Financial assets								
Derivative financial assets	-	151	-	151	-	136	-	136
Investments - AFS - listed	1,551	-	-	1,551	2,066	-	-	2,066
Investments - AFS - unlisted	-	-	5	5	-	-	4	4
Other financial assets at fair value	-	362	-	362	-	-	477	477
Total financial assets measured at fair value	1,551	513	5	2,069	2,066	136	481	2,683
Financial liabilities								
Derivative financial liabilities	-	361	-	361	-	376	-	376
Other financial liabilities at fair value	-	15	-	15	-	-	26	26
Total financial liabilities measured at fair value	-	376	-	376	-	376	26	402

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

3.18 Fair value of financial instruments (continued)

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

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

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

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

(b) *Available for sale - investments*

- *Listed* (Level 1) - The fair values of listed investments are based on quoted closing market prices.
- *Unlisted* (Level 3) – Includes £4m of Visa Inc. preferred stock received as partial consideration for the sale of the Group's share in Visa Europe (note 2.3). The preferred stock is convertible into Visa Inc. common stock or its equivalent at a future date, subject to potential reduction for certain litigation losses that may be incurred by Visa Europe. The fair value of the preference shares has been calculated by taking the period end New York Stock Exchange share price for Visa Inc. and discounting for illiquidity and clawback related to contingent litigation. For other unlisted equity and debt investments, the Group's share of the net asset value or the transaction price respectively are considered the best representation of the exit price and are the Group's best estimates of fair value.
- *Available for sale - other* (Level 3) - The other available for sale financial asset represents deferred consideration receivable and consists of the rights to future commission. The valuation is determined from a discounted cash flow model incorporating estimated attrition rates and investment growth rates appropriate to the underlying funds under management.

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

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

3.18 Fair value of financial instruments (continued)

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

Level 3 movements analysis:	2018		
Group	Financial assets available for sale £m	Other financial assets at fair value £m	Other financial liabilities at fair value £m
Balance at beginning of year	10	477	26
Transfer to Level 2[(1)]	-	(477)	(26)
Fair value gains/(losses) recognised[(2)]			
In profit or loss (unrealised)	(1)	-	-
In profit or loss (realised)	1	-	-
In available for sale reserve (unrealised)	1	-	-
Balance at the end of the year	11	-	-

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

(1) The financial assets at fair value comprise a portfolio of loans which are no longer on sale. The continued run-off of these loans has resulted in the unobservable credit risk inputs no longer being significant to their fair value. As such the loans (and associated liabilities) have been reclassified to Level 2 in the Fair Value Hierarchy. In accordance with the Group's accounting policy, the transfer is deemed to have occurred at the beginning of the reporting period. There were no transfers into or out of Level 3 in the year ended 30 September 2017.

(2) Net gains or losses were recorded in non-interest income or within the available for sale reserve as appropriate.

(3) The sale principally relates to the disposal of the VocaLink investment during the prior year (Note 2.3)

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

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

Level 3 movements analysis:	2018		
Bank	Financial assets available for sale £m	Other financial assets at fair value £m	Other financial liabilities at fair value £m
Balance at beginning of year	4	477	26
Transfer to Level 2[1]		(477)	(26)
Fair value gains/(losses) recognised[2]			
In profit or loss (unrealised)	1	-	-
Balance at the end of the year	5	-	-

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

(1) The financial assets at fair value comprise a portfolio of loans which are no longer on sale. The continued run-off of these loans has resulted in the unobservable credit risk inputs no longer being significant to their fair value. As such the loans (and associated liabilities) have been reclassified to Level 2 in the Fair Value Hierarchy. In accordance with the Group's accounting policy, the transfer is deemed to have occurred at the beginning of the reporting period. There were no transfers into or out of Level 3 in the year ended 30 September 2017.

(2) Net gains or losses were recorded in non-interest income or within the available for sale reserve as appropriate.

(3) The sale principally relates to the disposal of the VocaLink investment during the prior year (Note 2.3)

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

3.18 Fair value of financial instruments (continued)

Qualitative information about significant unobservable inputs in Level 3 valuations

The table below lists key unobservable inputs to Level 3 financial instruments, and provides the range of those inputs as at 30 September 2018.

	Fair value	Valuation Technique	Unobservable inputs	Low range	High range
Financial assets	£m				
AFS – investments - unlisted	5	Discounted cashflow	Contingent litigation risk	0%	100%
AFS – other	6	Discounted cashflow	Funds under management attrition rate	10%	20%

Sensitivity of Level 3 fair value measurements to reasonably possible alternative assumptions

Where valuation techniques use non-observable inputs that are significant to a fair value measurement in its entirety, changing these inputs will change the resultant fair value measurement.

The most significant input impacting the fair value of the available for sale – other asset is the funds under management attrition rate. The Group currently assumes an annual 15% attrition rate. If this rate was 20% the fair value would reduce by £1m, if it was 10% the fair value would increase by £1m.

Other than these significant Level 3 measurements, the Group has a limited remaining exposure to Level 3 fair value measurements, and changing one or more of the inputs for fair value measurements in Level 3 to reasonable alternative assumptions would not change the fair value significantly with respect to profit or loss, total assets, total liabilities or equity on these remaining Level 3 measurements.

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

4.1 Equity

Accounting policy

Equity

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

(a) they include no contractual obligations upon the Company to deliver cash or other financial assets or to exchange financial assets or financial liabilities with another party under conditions that are potentially unfavourable to the Group; and

(b) where the instrument will or may be settled in the Company's own equity instruments, it is either a non-derivative that includes no obligation to deliver a variable number of the Company's own equity instruments or is a derivative that will be settled by the Company exchanging a fixed amount of cash or other financial assets for a fixed number of its own equity instruments.

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

Dividends

Incremental costs directly attributable to the issue of new shares or options or to the acquisition of a business are shown in equity as a deduction, net of tax, from the proceeds.

Final dividends on ordinary shares are recognised as a liability and deducted from equity when they are approved by the Bank's shareholders. Interim dividends are deducted from equity when they are no longer at the discretion of the Bank.

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

4.1.1 Share capital

Group and Bank	**2018**	2017	**2018**	2017
Allotted, called up and fully paid	**Number of shares**	Number of shares	**£m**	£m
Ordinary shares of £0.10 each				
Opening ordinary share capital	**5,024,705,826**	3,237,094,491	**502**	324
Issued during the year	**5,106,832,381**	1,787,611,335	**511**	178
Closing ordinary share capital	**10,131,538,207**	5,024,705,826	**1,013**	502

On 21 December 2017, 3,638,421,052 ordinary shares of £0.10 were issued and on 29 June 2018, 1,468,411,329 ordinary shares of £0.10 were issued. All ordinary shares issued were at par and fully paid up.

The holders of ordinary shares are entitled to dividends as declared from time to time and are entitled to one vote per share at meetings of the shareholders of the Bank. All shares in issue at 30 September 2018 rank equally with regard to the Bank's residual assets. A final dividend of £9m was paid in respect of the year ended 30 September 2017 (2016: £Nil). These dividends were deducted from retained profits in the current year.

The Directors have recommended a final dividend of £44m in respect of the year ended 30 September. The payment of the final dividend is subject to approval of the shareholders at the 2019 Annual General Meeting. The financial statements do not reflect the recommended dividend.

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

4.1 Equity (continued)

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

4.1.2 Other equity instruments

Other equity instruments consist of Perpetual Subordinated Permanent Write Down Notes (fixed 8%) which were issued on 8 February 2016 with a nominal value of £450m to CYBG PLC.

AT1 distributions of £36m were paid during the year, £29m net of tax (2017: £36m paid, £29m net of tax).

4.1.3 Other reserves

4.1.3.1 Asset revaluation reserve

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

4.1.3.2 Available for sale reserve

The available for sale reserve records the gains and losses arising from changes in the fair value of available for sale financial assets.

4.1.3.3 Cash flow hedge reserve

The cash flow hedge reserve represents the cumulative post-tax gains and losses on derivatives designated as cash flow hedging instruments that will be recycled to the income statement when the hedged items affect profit or loss.

As at 30 September 2018, the cash flow hedge reserve reflected a cumulative loss of £37m (2017: £1m cumulative gain) all of which is in relation to ongoing hedges. The fair value of derivatives in cash flow hedges decreased by £58m in the year (2017: £84m decrease), and a £2m loss (2017: £5m gain) was recycled to interest income in line with hedged items affecting profit or loss. A £6m loss (2017: £0.3m loss) was transferred to non-interest income due to ineffectiveness arising from cash flow hedges. These movements were offset by a deferred tax credit of £12m (2017: credit of £21m).

4.1.3.4 Equity based compensation reserve

The Group's equity based compensation reserve records the value of equity settled share based payment benefits provided to the Group's employees as part of their remuneration that has been charged through the income statement and adjusted for deferred tax.

4.1.3.5 Capital contribution reserve

As discussed within note 3.14, where provisions for Relevant Conduct Matters are increased in respect of a reporting period, but proceeds from that claim are not received from NAB prior to the period close, CYBG has put in place an agreement with the Bank in order to mitigate the effect of capital losses at the end of the reporting period. Upon raising a provision for a Relevant Conduct Matter, CYBG indemnifies the Bank for the Qualifying Conduct Costs (excluding the CYBG Group's loss share) until CYBG subscribes for an equivalent amount of capital in the Bank. The Bank recognises and measures amounts receivable from CYBG under this indemnity as a separate asset (note 5.3) in accordance with IAS 37: *Provisions, Contingent Liabilities and Contingent Assets* and recognises an associated capital contribution within equity.

The capital contribution reserve at the year end was £Nil (2017: £364m).

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

4.2 Equity based compensation

Accounting policy

The Group operates a number of equity settled share based compensation plans in respect of services received from certain of its employees. The fair value of the services received is recognised as an expense. The total amount to be expensed is measured by reference to the fair value of CYBG's shares, performance options or performance rights granted, including, where relevant, any market performance conditions and any non-vesting conditions. The impacts of any service and non-market performance vesting conditions are not included in the fair value and instead are included in estimating the number of awards or options that are expected to vest.

The total expense is recognised over the vesting period, which is the period over which all of the specified vesting conditions are to be satisfied. A corresponding credit is recognised in the equity based compensation reserve, adjusted for deferred tax. In some circumstances employees may provide services in advance of the grant date and therefore the grant date fair value is estimated for the purposes of recognising the expense during the period between the start of the service period and the grant date.

At the end of each reporting period, the Group revises its estimates of the number of shares, performance options and performance rights that are expected to vest based on the non-market and service vesting conditions. The impact of the revision to original estimates, if any, is recognised in the income statement, with a corresponding adjustment to the equity based compensation reserve.

The equity settled share based payment charge for the year is £9m (2017: £6m).

CYBG awards

The Group made a number of awards under its share plans:

Plan	Eligible employees	Nature of award	Vesting conditions [1]	Grant dates[2]
Deferred Equity Plan [3]	Selected employees	Conditional rights to shares	Continuing employment or leaving in certain limited circumstances	2016, 2017 and 2018
Long Term Incentive Plan	Selected senior employees	Conditional rights to shares	Continuing employment or leaving in certain limited circumstances and achievement of delivery of the Group's strategic goals and growth in shareholder value	2017 and 2018
Share Incentive Plan	All employees	Non-conditional share award	Continuing employment	2016 and 2017

(1) All awards are subject to vesting conditions and therefore may or may not vest.
(2) The year in which grants have been made under the relevant plan.
(3) Grants made under the Deferred Equity Plan are made the year following the financial year to which they relate.

Further detail on each plan is provided below:

Deferred Equity Plan (DEP)

Under the plan employees were awarded conditional rights to CYBG PLC shares. The shares are subject to forfeiture conditions including forfeiture as a result of resignation, termination by the Group or failure to meet compliance requirements. Awards include:

- The upfront and deferred elements of bonus awards where required to comply with the PRA Remuneration Code or the Group's deferral policy.
- Buyout of equity from previous employment for senior new hires.
- Demerger awards which are also subject to the achievement of performance conditions over a three-year period. Details of the performance conditions are set out in the Directors' remuneration report section of the CYBG Annual Report and Accounts.

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

4.2 Equity based compensation (continued)

Long Term Incentive Plan (LTIP)

Under the plan employees were awarded conditional rights to CYBG PLC shares. The shares are subject to forfeiture conditions including forfeiture as a result of resignation, termination by the Group or failure to meet compliance requirements.

The performance conditions of the plan must be met over a three year period. The measures reflect a balanced approach between financial and non-financial performance and are aligned to the organisation's strategic goals. Measures, relative weightings and the quantum for assessing performance are outlined in the Directors' remuneration report section of the CYBG PLC Annual Report and Accounts.

Share Incentive Plan (SIP)

Employees eligible at the date of the award were awarded CYBG Group shares, which are held in the Share Incentive Plan Trust (SIP Trust). Awards are not subject to performance conditions and participants are the beneficial owners of the shares granted to them, but not the registered owners. Voting rights over the shares are normally exercised by the registered owner at the direction of the participants. For the 2015 Demerger award, leavers (with the exception of gross misconduct) retain their awards but they must withdraw their shares from the SIP Trust.

Awards/rights made during the year:

Plan	Number outstanding at 1 October 2017	Number awarded	Number forfeited	Number released	**Number outstanding at 30 September 2018**	Average fair value of awards at grant pence
DEP						
2015 Demerger	2,038,052	-	-	-	**2,038,052**	196.96
2015 Bonus	135,595	-	-	(80,642)	**54,953**	195.17
2015 Commencement	65,068	-	-	(39,383)	**25,685**	194.67
2016 Bonus	543,195	-	(1,276)	(520,516)	**21,403**	266.03
2016 Commencement	131,996	-	-	(74,725)	**57,271**	266.03
2017 Bonus	-	1,319,049	(4,263)	(721,979)	**592,807**	313.20
2017 Commencement	-	98,499	-	(30,332)	**68,167**	313.20
2018 Commencement	-	7,796	-	(7,796)	**-**	313.20
LTIP						
2016 LTIP	2,243,387	-	(10,996)	-	**2,232,391**	266.03
2017 LTIP	-	2,332,462	(17,975)	-	**2,314,487**	313.20
SIP						
2015 Demerger	1,483,008	-	(1,536)[1]	(184,320)[2]	**1,297,152**	194.67
2017 Free Share	-	998,520	(636)	(91,743)	**906,141**	313.20

[1] Forfeited shares remain in the SIP Trust
[2] Shares withdrawn from SIP Trust on leaving the Group.

Determination of grant date fair values

Participants of the DEP and LTIP plans are not entitled to dividends until the awards vest, but the number of shares which vest may be increased to reflect the value of dividends that would have been paid up to the end of the holding period for the awards, subject to the extent permitted under the relevant remuneration regulation. Accordingly, the grant date fair value of the awards with only service conditions and/or non-market performance conditions has been taken as the market value of CYBG's ordinary shares at the grant date. Where awards are subject to non-market performance conditions, an estimate is made of the number of awards expected to vest in order to determine the overall share-based payment charge to be recognised over the vesting period.

The Group has not issued awards under any CYBG plan with market performance conditions.

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

5.1 Contingent liabilities and commitments

Accounting policy

Financial guarantees
The Group provides guarantees in the normal course of business on behalf of its customers. Guarantees written are conditional commitments issued by the Group to guarantee the performance of a customer to a third party and are primarily issued to support direct financial obligations such as commercial bills or other debt instruments issued by a counterparty. The rating of the Group as a guarantee provider enhances the marketability of the paper issued by the counterparty in these circumstances. Financial guarantee contracts are initially recorded at fair value which is equal to the premium received, unless there is evidence to the contrary.

Operating lease commitments
The leases entered into by the Group are primarily operating leases; with operating lease rentals charged to the income statement on a straight line basis over the period of the lease. The Group discloses its obligations for future minimum payments under non-cancellable leases.

Contingent liabilities
Contingent liabilities are possible obligations whose existence will be confirmed only by uncertain future events or present obligations where the transfer of economic benefit is uncertain or cannot be reliably measured. Contingent liabilities are not recognised on the balance sheet but are disclosed unless they are remote.

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

	Group		Bank	
	2018 £m	2017 £m	2018 £m	2017 £m
Financial guarantees				
Guarantees and assets pledged as collateral security:				
Due in less than 3 months	26	19	26	19
Due between 3 months and 1 year	36	40	36	40
Due between 1 year and 3 years	10	7	10	7
Due between 3 years and 5 years	2	3	2	3
Due after 5 years	45	42	45	42
	119	111	119	111
Other credit commitments				
Undrawn formal standby facilities, credit lines and other commitments to lend at call	7,016	8,408	6,887	8,382

Capital commitments

The Group and Bank had future capital expenditure which had been contracted for but not provided for at 30 September 2018 of £1m (2017: £1m).

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

5.1 Contingent liabilities and commitments (continued)

Operating lease commitments

	Group 2018 £m	Group 2017 £m	Bank 2018 £m	Bank 2017 £m
Leases as lessor				
Future minimum lease payments under non-cancellable operating leases are:				
Within 1 year	1	1	1	1
Between 1 year and 5 years	4	4	4	4
Over 5 years	1	-	1	-
	6	5	6	5
Leases as lessee				
Future minimum lease payments under non-cancellable operating leases are:				
Within 1 year	29	30	29	30
Between 1 year and 5 years	96	100	96	100
Over 5 years	124	137	124	137
	249	267	249	267

Other contingent liabilities

Conduct risk related matters

There continues to be significant uncertainty and thus judgement is required in determining the quantum of conduct risk related liabilities with note 3.14 reflecting the Group's current position in relation to redress provisions including those for PPI. The final amount required to settle the Group's potential liabilities for these, and other conduct related matters, is materially uncertain. Contingent liabilities include those matters where redress is likely to be paid and costs incurred but the amounts cannot currently be estimated.

The Group will continue to reassess the adequacy of provisions for these matters and the assumptions underlying the calculations at each reporting date based upon experience and other relevant factors at that time.

Legal claims

The Group is named in and is defending a number of legal claims arising in the ordinary course of business. No material adverse impact on the financial position of the Group is expected to arise from the ultimate resolution of these legal actions.

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

5.2 Notes to the statement of cash flows

	Group		Bank	
	2018	2017	2018	2017
	£m	£m	£m	£m
Adjustments included in loss before tax				
Interest receivable	(1,113)	(1,075)	(1,097)	(1,055)
Interest payable	258	230	266	236
Depreciation and amortisation (note 2.4)	89	87	89	87
Loss on sale of tangible fixed assets	-	1	-	1
Derivative financial instruments fair value movements	(3)	(6)	3	(8)
Impairment losses on credit exposures (note 3.6)	41	48	41	48
Costs recharged to parent entity	(33)	-	(33)	-
Gain on disposal of Vocalink	-	(20)	-	(20)
	(761)	(735)	(731)	(711)
Changes in operating assets				
Net (increase)/decrease in:				
Balances with supervisory central banks	(31)	(1)	(31)	(1)
Due from other banks	(25)	135	32	18
Derivative financial instruments	18	284	(31)	261
Financial assets at fair value through profit or loss	117	237	117	237
Loans and advances to customers	(1,488)	(2,140)	(1,433)	(2,600)
Other assets	(14)	(12)	(13)	(13)
	(1,423)	(1,497)	(1,359)	(2,098)
Changes in operating liabilities				
Net increase/(decrease) in:				
Due to other banks	(1,053)	608	(1,053)	608
Derivative financial instruments	(16)	(223)	(16)	(210)
Financial liabilities at fair value through profit or loss	(11)	(21)	(11)	(21)
Due to customers	1,186	699	1,186	698
Provisions for liabilities and charges	(223)	(298)	(223)	(298)
Defined benefit pension obligations	(14)	(128)	(14)	(128)
Other liabilities	9	280	8	281
	(122)	917	(123)	930

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).

	Group 2018 £m	Group 2017 £m	Bank 2018 £m	Bank 2017 £m
Cash and cash equivalents				
Cash and balances with central banks (note 3.1)	6,498	6,893	6,498	6,893
Other assets	86	99	86	99
Due to other banks	(12)	(12)	(12)	(12)
Other liabilities	(30)	(28)	(30)	(28)
	6,542	6,952	6,542	6,952

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

5.3 Related party transactions

	Group		Bank	
	2018	2017	2018	2017
Amounts due from related entities	£m	£m	£m	£m
Loans				
Controlled entities of the Bank	-	-	1,119	1,097
	-	-	1,119	1,097
Other receivables				
CYBG	35	366	35	366
Controlled entities of the Bank	-	-	84	84
	35	366	119	450
Total amounts due from related entities	35	366	1,238	1,547
Interest Income on the above amounts was as follows (note 2.2):				
Controlled entities of the Bank	-	-	17	25
	-	-	17	25

Amounts due to related entities	Group		Bank	
	2018	2017	2018	2017
	£m	£m	£m	£m
Deposits				
CYBG	36	27	36	27
Controlled entities of the Bank	-	-	150	12
	36	27	186	39
Debt securities				
CYBG	1,276	782	1,276	782
Controlled entities of the Bank	-	-	1	-
	1,276	782	1,277	782
Other payables				
Controlled entities of the parent - CYBG	1	-	-	-
Controlled entities of the Bank	-	-	2,422	2,903
	1	-	2,422	2,903
Total amounts due to related entities	1,313	809	3,885	3,724
Interest Income on the above amounts was as follows (note 2.2):				
CYBG	33	26	33	26
Controlled entities of the Bank	-	-	36	42
	33	26	69	68

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

5.3. Related party transactions (continued)

Debt securities

	2018 £m	2017 £m
Subordinated debt	480	482
Medium-term notes	796	300
Total debt securities	1,276	782

Subordinated debt comprises dated, unsecured loan capital and is issued to CYBG PLC. These debts will, in the event of the winding-up of the issuer, be subordinated to the claims of the depositors and all other creditors of the issuer, other than creditors whose claims rank junior to the claims of the holders of the subordinated liabilities. The debt is employed in the general business of the Bank.

Medium-term notes comprise dated, unsecured loans and are issued to CYBG PLC. These securities will, in the event of the winding-up of the issuer, be subordinated to the claims of the depositors and all other creditors of the issuer, other than creditors whose claims rank junior to the claims of the medium-term note liabilities, including those of subordinated debt holders. The debt is employed in the general business of the Bank.

Other transactions with related entities	Group		Bank	
	2018 £m	2017 £m	2018 £m	2017 £m
Gain on debt and capital restructures				
Controlled entities of the Bank	-	-	-	-
Non-interest income received				
Controlled entities of the Bank	-	-	5	38
Administrative expenses				
Controlled entities of the Bank	-	-	-	-
	-	-	-	-

The Bank and Trustee to the pension scheme have entered into a contingent Security Arrangement, which provides additional support to the Scheme by underpinning recovery plan contributions and some additional investment risk. The security is in the form of a pre-agreed maximum level of assets, that are set aside for the benefit of the Pension Scheme in certain trigger events. These assets are held by Red Grey Square Funding LLP, an insolvency remote consolidated structured entity.

The Group incurred costs in relation to pension scheme administration. These costs, which amounted to £0.3m in the year ended 30 September 2018 (2017: £0.3m), were charged to the Group sponsored Scheme. The Group has deposits of £36m (2017: £20m) at the year end placed by the Scheme at market rates.

Pension contributions of £18m (2017: £69m) were made during the year to the Yorkshire and Clydesdale Bank Pension Scheme sponsored by the Bank (note 3.16).

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

5.3. Related party transactions (continued)

Compensation of key management personnel (KMP)

KMP comprise Directors of the Bank and members of the Leadership Team.

	2018 £m	2017 £m
Salaries and other short-term benefits	9	8
Other long-term employee benefits	-	-
Termination benefits	-	-
Equity based compensation[1]	1	1
	10	9

[1] Basis of the expense recognised in the year in accordance with IFRS 2 'Equity-based compensations', including associated employers' NIC.

Directors' emoluments

Total emoluments of all Directors for the year ended 30 September 2018 were £5m (2017: £5m).

For the year ended 30 September 2018 the total emoluments disclosed do not include the value of shares or share rights awarded under long term incentive schemes in accordance with Schedule 5 paragraph 1(3)(a) of The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008.

None of the Directors were members of the Group's defined contribution pension scheme during 2018 (2017: none). None of the Directors were members of the Group's defined benefit pension scheme during 2018 (2017: one).

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 £m	2017 £m
Aggregate remuneration	2	2
Share based awards[1]	-	1
	2	3

[1] Reflects deferred bonus and other share based awards for the year, excluding LTIP

The highest paid Director does not hold any share options, nor were they a member of any pension plan during 2018, nor 2017.

Transactions with KMP

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

	2018 £m	2017 £m
Loans and advances	2	2
Deposits	3	4

No provisions have been recognised in respect of loans provided to KMPs (2017: £Nil). There were no debts written off or forgiven during the year to 30 September 2018 (2017: £Nil). Included in the above are six (2017: three) loans totalling £2m (2017: £1m) made to Directors. In addition to the above, there are guarantees of £Nil (2017: £Nil) made to Directors and their related parties.

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

5.4. Pillar 3 disclosures

Basel III CRD IV

Pillar 3 disclosure requirements are set out in Part Eight of the CRR. The consolidated disclosures of CYBG PLC, for the 2018 financial year will be issued concurrently with the Annual Report and Accounts and will be found at www.cybg.com/investor-centre/financial-results.

5.5. Post balance sheet events

IRB accreditation

On 10 October 2018, the Group received IRB accreditation from the PRA for both its mortgage and SME portfolios. The Group continues to progress its Retail unsecured lending IRB application.

Acquisition

On 15 October 2018, the CYBG PLC acquired all the voting rights in Virgin Money by means of a scheme of arrangement under Part 26 of the UK Companies Act 2006 for a purchase consideration of £1.6bn. This comprised the fair value of approximately 541m new CYBG PLC ordinary shares in exchange for all Virgin Money shares at a ratio of 1.2125 CYBG shares for each Virgin Money share. Following completion, Virgin Money shareholders owned approximately 38% of the Combined Group (on a fully diluted basis).

The fair value of the shares issued was calculated using the market price of 286.4 pence per share, on the London Stock Exchange (LSE) at its close of business on 12 October 2018.

In seeking to address the underlying trends of scale and adaptability within the banking industry, the combination will bring together the two challenger banks to create a national competitor to the large incumbent banks. The combination will offer retail and SME customers an alternative to the status quo.

Due to the acquisition of Virgin Money taking place on 15 October 2018, there has been insufficient time to complete the fair value exercise as required by IFRS 3: 'Business Combinations'. Accordingly, the fair value of the net assets acquired and any resultant goodwill to be recognised as a result of the acquisition have not yet been determined.

Following completion, the Bank subsequently acquired all the voting rights in Virgin Money for a consideration of £1.6bn.

Guaranteed minimum payments (GMP) equalisation

On 26 October 2018 the High Court ruled on a landmark pensions case relating to the defined benefits pension schemes operated by Lloyds Banking Group. The case dealt with GMP provided by schemes which were contracted-out of the State Earnings-Related Pension Scheme (SERPS) up until 5 April 1997, with the High Court ruling concluding that the associated benefits were inherently unequal between males and females because of their different state pension retirement ages.

The High Court has confirmed that it is necessary for schemes to equalise benefits, for those pensions accrued between 17 May 1990 and 6 April 1997, to address the inherent inequality of GMP between males and females. There is no single prescribed solution in order to equalise following this judgment, and it is anticipated that significant discussion and guidance will be required as to the permissible equalisation method to be adopted in any particular case.

The Group is currently assessing the impact of this recent ruling on its defined benefit pension scheme, and will work with its key advisors to ensure compliance with the recent findings as appropriate. Due to the early stage of this assessment and the complexity involved in such an exercise, it is not possible to quantify the extent of any additional financial obligation at this time.

Notes to the consolidated financial statements (continued)
Section 6: Notes to the Bank financial statements

6.1 Bank income statement

No individual income statement is presented for the Bank, as permitted by Section 408 of the Companies Act 2006.

6.2 Bank investments in controlled entities

Accounting policy

The Bank's investments in controlled entities are valued at cost or valuation less any provision for impairment. Such investments are reviewed annually for potential evidence of impairment, or more frequently when there are indications that impairment may have occurred. Losses relating to impairment in the value of shares in controlled entities are recognised in the income statement.

	2018 £m	2017 £m
At 30 September	10	10

Wholly owned subsidiary undertakings	Nature of business	Class of share held	Proportion held	Country of incorporation	Registered office
CGF No 9 Limited	Leasing	Ordinary	100%	Scotland	30 St Vincent Place, Glasgow, G1 2HL
Clydesdale Bank Asset Finance Limited	Leasing	Ordinary	100%	Scotland	30 St Vincent Place, Glasgow, G1 2HL
Clydesdale Bank (Head Office) Nominees Limited	In liquidation	Limited by guarantee	100%	Scotland	Saltire Court, 20 Castle Terrace, Edinburgh, EH1 2DB
CYB Intermediaries Limited	Insurance intermediary	Ordinary	100%	England	20 Merrion Way, Leeds, Yorkshire, LS2 8NZ
St Vincent (Equities) Limited	Investment company	Ordinary	100%	Scotland	30 St Vincent Place, Glasgow, G1 2HL
Yorkshire Bank Home Loans Limited	Mortgage finance	Ordinary	100%	England	20 Merrion Way, Leeds, Yorkshire, LS2 8NZ
CB Nominees Limited	Dormant	Limited by guarantee	100%	Scotland	30 St Vincent Place, Glasgow, G1 2HL
CYB SSP Trustee Limited	Dormant	Ordinary	100%	England	20 Merrion Way, Leeds, Yorkshire, LS2 8NZ
YCB DC Trustee Limited	Dormant	Ordinary	100%	Scotland	30 St Vincent Place, Glasgow, G1 2HL
YCBPS Property Nominee Company Limited	Dormant	Ordinary	100%	England	20 Merrion Way, Leeds, Yorkshire, LS2 8NZ
Yorkshire and Clydesdale Bank Pension Trustee Limited	Dormant	Ordinary	100%	Scotland	30 St Vincent Place, Glasgow, G1 2HL
Yorkshire Bank PLC	Dormant	Ordinary	100%	England	20 Merrion Way, Leeds, Yorkshire, LS2 8NZ

Notes to the consolidated financial statements (continued)
Section 6: Notes to the Bank financial statements (continued)

6.2 Bank investments in controlled entities (continued)

The Bank also has an interest in the Yorkshire and Clydesdale Bank Foundation, a charitable foundation registered in Scotland as a company limited by guarantee. The Bank acts as a guarantor for £10 and is the main donor.

All subsidiaries have a financial year end of 30 September.

During the year, Craig Yr Haul Management Company Limited, 11 Tudor Hill Residential Management Company Limited, Linton Springs Residential Management Company Limited, and St Johns Place Residential Management Company Limited were disposed of for no gain or loss.

CYB Intermediaries Holdings Limited and CYB Services Limited were also liquidated during the year.

In addition to the above, the Bank also has an interest in a number of structured entities:

Other controlled entities as at 30 September 2017	Nature of business	Country of incorporation	Registered office
Clydesdale Covered Bonds No. 2 LLP	Acquisition of mortgage loans	England	20 Merrion Way Leeds, LS2 8NZ
Lanark Holdings Limited	Holding company	England	Winchester House Mail Stop 429 1 Great Winchester Street London, EC2N 2DB
Lanark Trustees Limited	Mortgages trustee	England	Winchester House Mail Stop 429 1 Great Winchester Street London, EC2N 2DB
Lanark Funding Limited	Funding company	England	Winchester House Mail Stop 429 1 Great Winchester Street London, EC2N 2DB
Lanark Master Issuer PLC	Issuer of securitised notes	England	Winchester House Mail Stop 429 1 Great Winchester Street London, EC2N 2DB
Lannraig Holdings Limited	Holding company	England	35 Great St. Helen's London, EC3A 6AP United Kingdom
Lannraig Trustees Limited	Mortgages trustee	Jersey	44 Esplanade St Helier Jersey, JE4 9WG Channel Islands
Lannraig Funding Limited	Funding company	England	35 Great St. Helen's London, EC3A 6AP United Kingdom
Lannraig Master Issuer PLC	Issuer of securitised notes	England	35 Great St. Helen's London, EC3A 6AP United Kingdom
Red Grey Square Funding LLP	Security provider	England	35 Great St. Helen's London, EC3A 6AP United Kingdom

All of the above controlled entities have a financial year end of 30 September.

Details of the Group's interests in consolidated structured entities associated with securitisation and covered bond arrangements are set out in note 3.7.

Measuring financial performance - glossary

Asset quality:

Term	Definition
Impairment charge to average customer loans **(cost of risk)**	Impairment losses on credit exposures plus credit risk adjustment on fair value loans to average customer loans (defined as loans and advances to customers, other financial assets at fair value and due from customers on acceptances).
90+ days past due **(DPD)** plus impaired assets to customer loans	Customer loans that are either impaired or where the repayment is more than 90 days overdue as a percentage of total customer loans at a given date.
Net write offs to customer loans	Net write offs, including loans at fair value, as a percentage of total customer loans at a given date.

Capital optimisation:

Term	Definition
Common Equity Tier 1 ***(CET1)*** ratio	CET1 capital divided by RWAs at a given date.
Tier 1 ratio	Tier 1 capital as a percentage of risk weighted assets.
Total capital ratio	Total capital resources divided by risk weighted assets at a given date.
Leverage ratio	This is a regulatory standard ratio proposed by the Basel III as a supplementary measure to the risk based capital requirements. It is intended to constrain the build-up of excess leverage in the banking sector and is calculated by dividing Tier 1 capital resources by a defined measure of on- and off-balance sheet items plus derivatives.
Modified leverage ratio	The Group's leverage ratio on a modified basis, excluding qualifying central bank claims from the exposure measure in accordance with the policy statement issued by the PRA in October 2017.
Loan to deposit ratio ***(LDR)***	Customer loans as a percentage of customer deposits at a given date.
Liquidity coverage ratio **(LCR)**	Measures the surplus (or deficit) of the Bank's high quality liquid assets relative to weighted net stressed cash outflows over a 30 day period. It assesses whether the Bank has sufficient liquid assets to withstand a short-term liquidity stress based on cash outflow assumptions provided by regulators.
Net stable funding ratio **(NSFR)**	The total amount of available stable funding divided by the total amount of required stable funding, expressed as a percentage. The Group monitors the NSFR based on its own interpretations of current guidance available for CRD IV NSFR reporting. Therefore, the reported NSFR may change over time with regulatory developments. Due to possible differences in interpretation of the rules, the Group's ratio may not be directly comparable with those of other financial institutions.

Measuring financial performance - glossary (continued)

Underlying adjustments to the Statutory view of performance

In arriving at an underlying basis, the effects of certain items that do not promote an understanding of historical or future trends of earnings or cash flows are removed, with management believing this presents a set of results that provide a more reflective year on year comparison. These items are:

Item	FY18	FY17	Description	Reason for exclusion from the Group's current underlying performance
Conduct charges	(544)	(592)	These are customer redress and associated costs arising from legacy products and past sales practices.	These costs are historical in nature and are not indicative of the Group's current underlying performance.
Restructuring and related expense	(38)	(67)	Restructuring of the business is currently ongoing with costs including redundancy payments, property vacation costs, associated enablement costs and non-recurring costs arising from operational transformation.	These costs are significant and are part of the Group's strategic objective in simplifying and streamlining operations and processes to enhance productivity. Consequently, this expense is not viewed as a normal ongoing operating cost to the Group.
Virgin Money transacton costs	(7)	-	Costs incurred directly relating to the transaction with Virgin Money.	These costs are significant and not indicative of the Group's underlying performance.
RBS alternative remedies package spend	(16)	-	Costs incurred, in relation to the RBS alternative remedies package, to enable strategic and inorganic growth.	These costs are part of delivering the Group's growth strategy. Consequently, this expense is not viewed as a normal ongoing operating cost to the Group.
Separation costs	(8)	(8)	Costs incurred directly relating to the Demerger.	Specific costs relating to the Demerger are historic and not indicative of the Group's current underlying performance.
Gain on disposal of VocaLink	-	20	A one-off gain recognised on the disposal of the Group's VocaLink share.	Losses or gains from one-off or infrequent transactions are not indicative of the Group's current underlying performance.
Gain on defined benefit pension scheme reforms	-	88	A one-off gain on the closure of the defined pension schedule to future accrual for the majority of members.	Losses or gains from one-off or infrequent transactions are not indicative of the Group's current underlying performance.

Main Glossary

Term	Definition
Additional Tier 1 securities ***(AT1)***	Securities that are considered additional Tier 1 capital in the context of CRD IV.
arrears	A customer is in arrears when they fail to adhere to their contractual payment obligations resulting in an outstanding loan that is unpaid or overdue.
average assets	Represents the average of assets over the year adjusted for any disposed operations.
'B'	The Group's digital application suite, offering Retail customers money management capabilities across Web, Android and Apple platforms.
Bank	Clydesdale Bank PLC.
Basel II	The capital adequacy framework issued by the Basel Committee on Banking Supervision (BCBS) in June 2006 defining how firms should calculate their regulatory capital requirements.
Basel III	Reforms issued by the BCBS in December 2010 to strengthen global capital and liquidity rules with the goal of promoting a more resilient banking sector. In Europe the new requirements were implemented by CRD IV, on a phased basis from 1 January 2014 with full implementation by 1 January 2019.
basis points ***(bps)***	One hundredth of a percent (0.01%); meaning that 100 bps is equal to 1%. This term is commonly used in describing interest rate movements.
Board	Refers to the CYBG PLC Board or the Clydesdale Bank PLC Board as appropriate.
Capped Indemnity	The indemnity from NAB in favour of CYBG in respect of certain qualifying conduct costs incurred by the Group, which is capped at the Capped Indemnity Amount, subject to the Loss Sharing Arrangement, under the terms of the Conduct Indemnity Deed.
Capped Indemnity Amount	An amount equal to £1.58 bn less any Pre Covered provision amount.
carrying value (also referred to as carrying amount)	The value of an asset or a liability in the balance sheet based on either amortised cost or fair value principles.
collateral	The assets of a borrower that are used as security against a loan facility.
collective impairment provision	Impairment assessment on a collective basis for homogeneous groups of loans that are not considered individually significant and to cover losses which have been incurred but have not yet been identified on loans subject to individual assessment.
Combined Group	CYBG PLC and its controlled entities following the acquisition of Virgin Money.
commercial paper	An unsecured promissory note issued to finance short-term credit requirements. These instruments have a specified maturity date and stipulate the face amount to be paid to the investor on that date.
Common Equity Tier 1 capital ***(CET1)***	The highest quality form of regulatory capital that comprises total shareholders' equity and related non-controlling interests, less goodwill and intangible assets and certain other regulatory adjustments.
Company	Clydesdale Bank PLC.
Conduct Indemnity Deed	The deed between NAB and CYBG PLC setting out the terms of: • the Capped Indemnity; and • certain arrangements for the treatment and management of Relevant Conduct Matters.

Main Glossary (continued)

conduct risk	The risk of treating customers unfairly and/or delivering inappropriate outcomes resulting in customer detriment, regulatory fines, compensation, redress costs and reputational damage.
counterparty	The other party that participates in a financial transaction, with every transaction requiring a counterparty in order for the transaction to complete.
covered bonds	A corporate bond with primary recourse to the institution and secondary recourse to a pool of assets that act as security for the bonds on issuer default. Covered bonds remain on the issuer's balance sheet and are a source of term funding for the Group.
CRD IV	European legislation to implement Basel III. It replaces earlier European capital requirements directives with a revised package consisting of a new CRD and a new CRR. CRD IV sets out capital and liquidity requirements for European banks and harmonises the European framework for bank supervision. See also 'Basel III'.
credit risk adjustment/credit valuation adjustment	An adjustment to the valuation of financial instruments held at fair value to reflect the creditworthiness of the counterparty.
customer deposits	Money deposited by individuals and corporate entities that are not credit institutions, and can be either interest bearing, non-interest bearing or term deposits.
CYBI	CYB Investments Limited
default	A customer is in default when either they are more than 90 DPD on a credit obligation to the Group, or are considered unlikely to pay their credit obligations in full without recourse to actions such as realisation of security (if held).
delinquency	See 'arrears'.
Demerger	The demerger of CYBG Group from NAB pursuant to which all of the issued share capital of CYBI was transferred to CYBG PLC by NAB in consideration for the issue and transfer of CYBG shares to NAB in part for the benefit of NAB (which NAB subsequently sold pursuant to the Initial Public Offering (IPO)) and in part for the benefit of NAB shareholders under a scheme of arrangement under part 5.1 of the Australian Corporations Act.
Demerger date	8 February 2016.
derivative	A financial instrument that is a contract or agreement whose value is related to the value of an underlying instrument, reference rate or index.
earnings at risk ***(EaR)***	A measure of the quantity by which net interest income might change in the event of an adverse change in interest rates.
effective interest rate	The carrying value of certain financial instruments which amortises the relevant fees over the expected life of the instrument.
encumbered assets	Assets that have been pledged as security, collateral or legally 'ring-fenced' in some other way which prevents those assets being transferred, pledged, sold or otherwise disposed.
exposure	A claim, contingent claim or position which carries a risk of financial loss.
fair value	The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal (or most advantageous) market at the measurement date under current market conditions.

Main Glossary (continued)

Financial Ombudsman Service ***(FOS)***	An independent body set up by the UK Parliament to resolve individual complaints between financial businesses and their customers.
Financial Services Compensation Scheme ***(FSCS)***	The UK's compensation fund of last resort for customers of authorised financial services firms and is funded by the financial services industry. The FSCS may pay compensation if a firm is unable, or likely to be unable, to pay claims against it. This is usually because it has stopped trading or has been declared in default.
forbearance	The term generally applied to the facilities provided or changes to facilities provided to assist borrowers, both retail and SME, who are experiencing, or are about to experience, a period of financial stress.
funding risk	A form of liquidity risk arising when the liquidity needed to fund illiquid asset positions cannot be obtained at the expected terms and when required.
Group	Clydesdale Bank PLC and its controlled entities.
hedge ineffectiveness	Represents the extent to which the income statement is impacted by changes in fair value or cash flows of hedging instruments not being fully offset by changes in fair value or cash flows of hedged items.
iB	The Group's IT digital platform, built on an open architecture framework providing integration and connectivity for our customer systems, applications and technology partners.
IFRS 9	The new financial instrument accounting standard which is applicable for accounting periods beginning on or after 1 January 2018, which the Group will adopt from 1 October 2018.
impaired loans	Loans in arrears with insufficient security to cover principal and arrears of interest revenue or where there is sufficient doubt about the ultimate collectability of principal and interest.
impairment allowances	A provision held on the balance sheet to recognise that a loan is impaired. This can be calculated at either the individual or collective level.
impairment losses	Where an asset's recoverable amount is less than its carrying value and the difference is recognised in the income statement with the carrying value of the asset reduced by creating an impairment allowance. This can be assessed at either the individual or collective level.
interest rate hedging products ***(IRHP)***	This incorporates: (i) standalone hedging products identified in the Financial Services Authority (FSA) 2012 notice; (ii) the voluntary inclusion of certain of the Group's more complex tailored business loan (TBL) products; and (iii) the Group's secondary review of all fixed-rate tailored business loans (FRTBLs) complaints which were not in scope for the FSA notice.
Internal Capital Adequacy Assessment Process ***(ICAAP)***	The Group's assessment of the levels of capital that it needs to hold through an examination of its risk profile from regulatory and economic capital viewpoints.

Main Glossary (continued)

Internal Liquidity Adequacy Assessment Process ***(ILAAP)***	The Group's assessment and management of balance sheet risks relating to funding and liquidity.
Internal Ratings-Based approach ***(IRB)***	A method of calculating credit risk capital requirements using internal, rather than supervisory, estimates of risk parameters.
investment grade	The highest possible range of credit ratings, from 'AAA' to 'BBB', as measured by external credit rating agencies.
jaws	The net difference between movements in total income and underlying costs for the period expressed as a percentage.
Level 1 fair value measurements	Financial instruments whose fair value is derived from unadjusted quoted prices for identical instruments in active markets.
Level 2 fair value measurements	Financial instruments whose fair value is derived from quoted prices for similar instruments in active markets and financial instruments valued using models where all significant inputs are observable.
Level 3 fair value measurements	Financial instruments whose fair value is derived from valuation techniques where one or more significant inputs are unobservable.
Listing Rules	Regulations applicable to any company listed on a United Kingdom stock exchange, subject to the oversight of the UK Listing Authority (UKLA). The Listing Rules set out mandatory standards for any company wishing to list its shares or securities for sale to the public.
loan to value ratio ***(LTV)***	A ratio that expresses the amount of a loan as a percentage of the value of the property on which it is secured.
Loss Share	The percentage of a provision raised or an increase in a provision which CYBG PLC will be responsible for under the Conduct Indemnity Deed. Fixed at 9.7% at the Demerger date.
Loss Sharing Arrangement	The arrangement relating to the Capped Indemnity pursuant to which CYBG PLC will be responsible for the Loss Share.
medium-term notes	Debt instruments issued by corporates, including financial institutions, across a range of maturities.
Minimum Requirement for Own Funds and Eligible Liabilities ***(MREL)***	MREL is a minimum requirement for institutions to maintain equity and eligible debt liabilities, to help ensure that when an institution fails the resolution authority can use these financial resources to absorb losses and recapitalise the continuing business. The BoE set out its approach to setting banks' MREL in November 2016.
net interest income	The amount of interest received or receivable on assets, net of interest paid or payable on liabilities.
net promoter score ***(NPS)***	This is an externally collated customer loyalty metric that measures loyalty between a provider, who in this context is the Group, and a consumer.
operational risk	The risk of loss resulting from inadequate or failed internal processes, people strategies and systems or from external events.
Overall Liquidity Adequacy Rule ***(OLAR)***	An FCA and PRA rule that firms must at all times maintain liquidity resources which are adequate both as to amount and quality, to ensure that there is no significant risk that its liabilities cannot be met as they fall due. This is included in the Group's risk appetite and subject to approval by the Board as part of the ILAAP.
pension risk	The risk that, at any point in time, the available assets to meet pension liabilities are at a value below current and future scheme obligations.
PPI redress	Includes PPI customer redress and all associated costs excluding fines.

Main Glossary (continued)

Pre Covered provision amount	The amount of any provision(s) relating to Conduct Matters raised or increased by CYBG Group between 31 March 2015 and the Demerger date in respect of which NAB has provided specific support at any time after 31 March 2015 but before the Demerger date. This was £465m at the Demerger date.
probability of default ***(PD)***	The probability that a customer will default (usually within a one-year time horizon); although the time horizon will change on 1 October 2018 in line with IFRS 9 requirements.
Regulatory capital	The capital which the Group holds, determined in accordance with rules established by the PRA.
Relevant Conduct Matters	The legacy conduct issues covered by the Capped Indemnity, including certain conduct issues relating to PPI, standalone IRHP, voluntary scope TBLs and FRTBLs and other conduct matters in the period prior to the Demerger date whether or not known at the Demerger date.
Residential mortgage-backed securities ***(RMBS)***	Securities that represent interests in groups or pools of underlying mortgages. Investors in these securities have the right to cash received from future mortgage payments (interest and principal).
retail lending	Lending to individuals rather than institutions. This includes both secured and unsecured lending such as personal loans, residential and BTL mortgages, overdrafts and credit card balances.
Ring-fencing	A new regime of rules which require banks to change the way that they are structured by separating retail banking services from investment and international banking. This is to ensure the economy and taxpayers are protected in the event of any future financial crises.
risk appetite	The level and types of risk the Group is willing to assume within the boundaries of its risk capacity to achieve its strategic objectives.
risk-weighted assets ***(RWA)***	On and off balance sheet assets of the Group are allocated a risk weighting based on the amount of capital required to support the asset.
sale and repurchase agreement ('repo')	A short-term funding agreement that allows a borrower to create a collateralised loan by selling a financial asset to a lender. As part of the agreement, the borrower commits to repurchase the security at a date in the future repaying the proceeds of the loan. For the counterparty (buying the security and agreeing to sell in the future) it is a reverse repurchase agreement or a reverse repo.
Scheme	The Group's defined benefit pension scheme, the Yorkshire and Clydesdale Bank Pension Scheme.
secured lending	Lending in which the borrower pledges some asset (e.g. property) as collateral for the lending.
securitisation	The practice of pooling similar types of contractual debt and packaging the cash flows from the financial asset into securities that can be sold to institutional investors in debt capital markets. It provides the Group with a source of secured funding than can achieve a reduction in funding costs by offering typically 'AAA' rated securities secured by the underlying financial asset.

Main Glossary (continued)

SME lending	Lending to non-retail customers, including overdrafts, asset and lease financing, term lending, bill acceptances, foreign currency loans, international and trade finance, securitisation and specialised finance.
specific impairment provision	A specific provision relates to a specific loan, and represents the estimated shortfall between the carrying value of the asset and the estimated future cash flows, including the estimated realisable value of securities after meeting securities realisation costs.
standardised approach	In relation to credit risk, a method for calculating credit risk capital requirements using External Credit Assessment Institutions (ECAI) ratings and supervisory risk weights. In relation to operational risk, a method of calculating the operational capital requirement by the application of a supervisory defined percentage charge to the gross income of eight specified business lines.
stress testing	The term used to describe techniques where plausible events are considered as vulnerabilities to ascertain how this will impact the own funds or liquidity which a bank holds.
structured entities (**SE**)	An entity created to accomplish a narrow well-defined objective (e.g. securitisation of financial assets). An SE may take the form of a corporation, trust, partnership or unincorporated entity. SEs are often created with legal arrangements that impose strict limits on the activities of the SE. May also be referred to as an SPV.
subordinated debt	Liabilities which rank after the claims of other creditors of the issuer in the event of insolvency or liquidation.
Term Funding Scheme (**TFS**)	Launched in 2016 by the BoE to allow banks and building societies to borrow from the BoE at rates close to base rate. This is designed to increase lending to businesses by lowering interest rates and increasing access to credit.
Tier 1 capital	A measure of a bank's financial strength defined by CRD IV. It captures CET1 capital plus other Tier 1 securities in issue, subject to deductions.
Tier 2 capital	A component of regulatory capital, including qualifying subordinated debt, eligible collective impairment allowances and other Tier 2 securities as defined by CRD IV.
unaudited/unverified	Financial information that has not been subject to validation by the Group's external auditor.
unsecured lending	Lending in which the borrower pledges no assets as collateral for the lending (such as credit cards and current account overdrafts).
value at risk ***(VaR)***	A measure of the loss that could occur on risk positions as a result of adverse movements in market risk factors (e.g. rates, prices, volatilities) over a specified time horizon and to a given level of confidence
Virgin Money	Virgin Money Holdings (UK) plc

Abbreviations

ALCO	Assets and Liability Committee
ASX	Australian Securities Exchange
AT1	Additional Tier 1
BCBS	Basel Committee on Banking Supervision
BoE	Bank of England
bps	Basis points
BTL	Buy-to-let
CAGR	Compound Annual Growth Rate
CCB	Capital Conservation Buffer
CCyB	Countercyclical Capital Buffer
CET1	Common Equity Tier 1 Capital
CIR	Cost to income ratio
CMA	Competition and Markets Authority
CPI	Consumer Prices Index
CRD	Capital Requirements Directive
CRR	Capital Requirements Regulation
DEP	Deferred Equity Plan
DPD	Days past due
DTR	Disclosure and Transparency Rules
EAD	Exposure at Default
EaR	Earnings at risk
EBA	European Banking Authority
eCRS	electronic Customer Rating System
EPS	Earnings per share
FCA	Financial Conduct Authority
FPC	Financial Policy Committee
FRC	Financial Reporting Council
FSCS	Financial Services Compensation Scheme
FTE	Full time equivalent
GHG	Greenhouse Gases
HMRC	Her Majesty's Revenue and Customs
IAS	International Accounting Standard
IASB	International Accounting Standards Board
ICAAP	Internal Capital Adequacy Assessment Process
IFRS	International Financial Reporting Standard
ILAAP	Internal Liquidity Adequacy Assessment Process
IPO	Initial Public Offering
IRB	Internal ratings-based
IRHP	Interest rate hedging products
IRRBB	Interest rate risk in the banking book
ISDA	International Swaps and Derivatives Association
LCR	Liquidity coverage ratio
LDR	Loan to deposit ratio
LGD	Loss Given Default
LIBOR	London Interbank Offered Rate
LSE	London Stock Exchange
LTIP	Long term incentive plan
LTV	Loan to value ratio
MREL	Minimum Requirement for Own Funds and Eligible Liabilities
NAB	National Australia Bank Limited
NIM	Net interest margin
NPS	Net promoter score
NSFR	Net stable funding ratio
OLAR	Overall liquidity adequacy rule
PBT	Profit before tax
PCA	Personal current accounts
PD	Probability of Default
PPI	Payment protection insurance
PRA	Prudential Regulation Authority
RAS	Risk Appetite Statement
RMBS	Residential mortgage-backed securities
RMF	Risk Management Framework
RoTE	Return on Tangible Equity
RPI	Retail Price Index
RWA	Risk-weighted assets
SIP	Share Incentive Plan
SME	Small or medium sized enterprises
SRB	Systemic Risk Buffer
TCC	Transactional Credit Committee
TFS	Term Funding Scheme
TNAV	Tangible net asset value
TSA	Transitional Service Agreements
TSR	Total Shareholder Return
VaR	Value at risk

Other information

Country by Country Reporting ('CBCR')

The Capital Requirements (Country-by-Country Reporting) Regulations 2013 came into effect on 1 January 2014 and place certain reporting obligations on financial institutions that are within the scope of the European Union's CRD IV. The purpose of the Regulations is to provide clarity on the source of the Group's income and the locations of its operations.

The vast majority of entities that are consolidated within the Group's financial statements are UK registered entities. The activities of the Group are described in the Strategic Report.

	2018 UK
Average FTE employees (number)	5,769
Total operating income (£m)	1,011
Loss before tax (£m)	(276)
Corporation tax paid (£m)	-
Public subsidies received (£m)	-
Return on assets (%)	(0.56)%

The only other non-UK registered entity of the Group is a Trustee company that is part of the Group's securitisation vehicles (Lanark and Lannraig). Lannraig Trustees Limited is registered in Jersey. This entity plays a part in the overall securitisation process by having the beneficial interest in certain mortgage assets assigned to it. This entity has no assets or liabilities recognised in its financial statements with the securitisation activity taking place in other UK registered entities of the structures. This entity does not undertake any external economic activity and has no employees. The results of this entity as well as those of the entire Lanark and Lannraig securitisation structures are consolidated in the financial statements of the Group.

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Forward-looking statements

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