Annual report & consolidated financial statements

Clydesdale Bank PLC

For the year ended 30 September 2020

Company Number: SC001111

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Overview

Clydesdale Bank PLC (‘the Bank’), together with its subsidiary undertakings (which together comprise ‘the Group’), operate under the Clydesdale Bank, Yorkshire Bank, B and Virgin Money brands. It offers a range of banking services for both retail and business customers through retail branches, lounges, business banking centres, direct and online banking, and brokers. It is the main operating subsidiary of its immediate parent, Virgin Money UK PLC. The results referred to in this annual report and accounts relate to the 12 months up to 30 September 2020.

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 200.

Officers and professional advisers

Chairman	David Bennett
Senior Independent Non-Executive Director	Tim Wade
Independent Non-Executive Directors	Paul Coby Geeta Gopalan Darren Pope
Non-Executive Director	Amy Stirling
Executive Director	David Duffy
Group Company Secretary	Lorna McMillan
Group General Counsel	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 2020.

Principal activities

The Group operates a full service UK-focused retail and commercial banking business under the brand names 'Clydesdale Bank', 'Yorkshire Bank', 'B' and 'Virgin Money' across its core regional markets (Scotland, North East England, North West England, Yorkshire and the Humber) and selected national markets. The bank is a strong, low risk bank 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	**2020 £m**	2019 £m
Customer loans	**72,443**	72,971
Other financial assets	**15,608**	16,391
Other non-financial assets	**2,256**	1,739
Total assets	**90,307**	91,101
Customer deposits	**(67,511)**	(63,787)
Wholesale funding	**(14,224)**	(18,497)
Other liabilities	**(3,582)**	(3,676)
Total liabilities	**(85,317)**	(85,960)
Ordinary shareholders' equity	**(4,318)**	(4,469)
Additional Tier 1 (AT1) equity	**(672)**	(672)
Equity	**(4,990)**	(5,141)
Total liabilities and equity	**(90,307)**	(91,101)

Summary income statement – underlying and statutory basis[(1)] for the year ended 30 September	**2020 £m**	2019 £m
Net interest income	**1,352**	1,413
Non-interest income	**187**	196
Total operating income	**1,539**	1,609
Total operating and administrative expenses	**(914)**	(942)
Operating profit before impairment losses	**625**	667
Impairment losses on credit exposures	**(501)**	(147)
Underlying profit on ordinary activities before tax	**124**	520
Integration and transformation costs	**(139)**	(149)
Acquisition accounting unwinds	**(113)**	(87)
Legacy conduct	**(26)**	(433)
Other items	**(19)**	(33)
Statutory loss on ordinary activities before tax	**(173)**	(182)
Tax (expense)/credit	**(18)**	58
Statutory loss attributable to equity holders	**(191)**	(124)

(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 193.

Strategic report (continued)

Business review (continued)

2020 has been a uniquely challenging year for the banking industry and our business, and this is reflected in our financial performance for the year. We have been primarily focused on supporting our customers, colleagues and communities, while at the same time ensuring the stability of the Group. Despite the challenges, we did continue to execute on some key integration milestones, while delaying delivery of some of our strategic, transformation activity. Importantly, we have also taken a prudent approach to our credit impairment provisioning for what is likely to be a severe economic shock with an expected rise in specific credit losses in the period to come.

Balance sheet impacted by the pandemic

The COVID-19 pandemic has had very different impacts across our various lending segments, demonstrating the value of a diverse portfolio. Total customer lending was down 0.7% in the year to £72.4bn primarily due to a reduction in the mortgage book as we maintained our discipline in a competitive market in the first half, with demand in the second half reducing substantially owing to the pandemic restrictions. This was partly offset by increased balances in Business with £1.2bn of incremental lending under the government-guaranteed lending Bounce Back Loan Scheme (BBLS), Coronavirus Business Interruption Loan Scheme (CBILS), Coronavirus Large Business Interruption Loan Scheme (CLBILS) and growth in Personal from a strong first half performance and resilience of the balance transfer credit card portfolio in the second half. Total customer deposits increased 6.8% to £67.5bn reflecting both consumer savings behaviour under lockdown and businesses depositing government-guaranteed lending proceeds for liquidity.

Pre-provision operating profit impacted by income headwinds

Base rate reductions had an impact during the year with Net Interest Income reducing 4% year-on-year. Non-interest income was also down 5% in the year largely due to lower activity-based fees and the impact of the 'high cost of credit review' in our Personal division. Total operating income was therefore down 4% on 2019 at £1,539m. Operating costs of £914m were 3% lower on the prior year, despite absorbing £14m of COVID-19 related costs. The challenging income environment resulted in a 6% year-on-year reduction in pre-provision profit.

Significant impairment provisions drive a statutory loss

The Group assessed its International Financial Reporting Standard (IFRS) 9 impairment provisions by applying deliberately conservative economic assumptions and scenario weightings, coupled with expert judgement credit risk overlays, to increase the Group's on balance sheet provisions to £735m. This has led to the Group recognising £501m of impairment charges inclusive of write-offs in the year. This sizeable provision charge primarily explains the 76% year-on-year reduction in underlying profit to £124m (2019: £520m). After exceptional items of £297m, including £139m of integration and transformation costs and £113m of acquisition accounting unwind, the Group recorded a statutory loss after tax of £191m.

Robust capital, liquidity and funding position

Importantly though, the Group's balance sheet remains robust as we enter a period of economic stress with a transitional common equity tier 1 (CET1) ratio of 14.4%. The Group therefore retains a significant CET1 management buffer in excess of its Capital Requirements Directive IV (CRD IV) minimum CET1 requirement of 9.5%.

Funding and liquidity

The Group's liquidity surplus continues to comfortably exceed our regulatory minimum and internal risk appetite, with a Liquidity Coverage Ratio (LCR) of 140% as at 30 September 2020 (2019: 152%). Net stable funding ratio (NSFR) was 131% at 30 September 2020 (2019: 128%).

Conclusion

2020 has been a difficult year for all, but we are happy with the way our colleagues have risen to the challenge of supporting our customers and communities, while ensuring the stability of the bank. Our prudent provisioning approach means we have robust coverage levels going into a period of economic stress. In the medium term, the Group believes that, assuming no significant further deterioration in expectations for the economic outlook or change in interest rates, the Group has a clear path to delivering double digit statutory returns on tangible equity over time. The improvement in returns will be built on: optimising our balance sheet mix; ensuring we continue to reduce our cost base to reflect the future operating environment and our ambition to be the UK's leading digital bank; and delivering a more efficient capital base over time.

Strategic report (continued)

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 and Accounts of Virgin Money UK PLC. The business is managed within the Virgin Money UK PLC Group and the results are consistent with the Group's status as a fully integrated and wholly-owned subsidiary of the Virgin Money UK PLC 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.

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 193:

2020 income statement	**Statutory results £m**	**Integration and transformation costs £m**	**Acquisition accounting unwinds £m**	**Legacy conduct £m**	**Other £m**	**Underlying basis £m**
Net interest income	**1,284**	**-**	**68**	**-**	**-**	**1,352**
Non-interest income	**151**	**-**	**28**	**-**	**8**	**187**
Total operating income	**1,435**	**-**	**96**	**-**	**8**	**1,539**
Total operating and administrative expenses before impairment losses	**(1,101)**	**139**	**11**	**26**	**11**	**(914)**
Operating profit before impairment losses	**334**	**139**	**107**	**26**	**19**	**625**
Impairment losses on credit exposures	**(507)**	**-**	**6**	**-**	**-**	**(501)**
(Loss)/profit on ordinary activities before tax	**(173)**	**139**	**113**	**26**	**19**	**124**

2019 income statement	Statutory results £m	Integration and transformation costs £m	Acquisition accounting unwinds £m	Legacy conduct £m	Other £m	Underlying basis £m
Net interest income	1,516	-	(23)	-	(80)	1,413
Non-interest income	257	-	-	-	(61)	196
Total operating income	1,773	-	(23)	-	(141)	1,609
Total operating and administrative expenses before impairment losses	(1,703)	149	5	433	174	(942)
Operating profit before impairment losses	70	149	(18)	433	33	667
Impairment losses on credit exposures	(252)	-	105	-	-	(147)
(Loss)/profit on ordinary activities before tax	(182)	149	87	433	33	520

Strategic report (continued)

Principal risks and mitigating actions

The Group's principal risks could result in events or circumstances that might threaten the Group's business model, future performance, solvency, liquidity and reputation. The principal risk categories remain similar to those outlined in the Annual Report and Accounts 2019, with changes relating to: the identification of model risk as a principal risk and; the recognition of climate risk as a cross-cutting risk which manifests through the existing principal risk framework.

An overview of the Group's principal risks and mitigating actions is set out below:

Principal risks	Key mitigating actions	COVID-19 impacts and actions
Credit risk is the risk of loss of principal or interest stemming from a borrower's failure to meet contractual obligations to the Group in accordance with their agreed terms. Credit risk manifests at both a portfolio and transactional level.	• The Group applies detailed lending policies and standards which outline the approach to lending, underwriting, concentration limits and product terms. • Credit risk is managed through risk appetite and risk limits reflected in approved credit policy. • Ongoing monitoring and approval of individual transactions, regular asset quality reviews and independent oversight of credit decisions and portfolios. • Portfolio monitoring techniques cover such areas as product, industry, geographical concentrations and delinquency trends. • Stress test scenarios are regularly prepared to assess the adequacy of the Group's impairment provision and the impact on risk-weighted assets (RWAs) and capital.	**Impacts:** • Although the impacts on the Group's retail and business credit portfolios are yet to fully manifest, it is clear that credit risk remains heightened, with levels of defaults expected to increase over time, particularly once government support schemes come to an end. **Actions:** • The Group has participated in all regulatory and government support schemes with a priority focus on supporting its existing customers through COVID-19. Capital repayment holidays, interest free overdrafts (for retail customers) and extensions of credit, as well as other flexible supporting measures, continue to be provided and monitored. • Policies, risk appetite, credit decisioning and supporting frameworks have been rebased, reviewed and updated to reflect the changing environment and risk profiles.
Financial risk includes capital risk, funding risk, liquidity risk, market risk and pension risk, all of which have the ability to impact the financial performance of the Group, if managed improperly.	• Funding and liquidity risk is managed in accordance with Board-approved standards, including the annual internal liquidity adequacy assessment process (ILAAP) and strategic and contingency funding plans. • The Group completes an annual internal capital adequacy assessment process (ICAAP), formally assessing the impact of severe, yet plausible, stress events to ensure that the appropriate level and type of capital underpins the strength of the balance sheet in both normal and stressed conditions. • Board-approved risk appetite measures ensure funding and liquidity levels are monitored and managed in accordance with regulatory requirements and in support of the Group's strategy. • Market risks (interest rate and foreign exchange risks) are monitored and managed in line with established policies and allocation of capital.	**Impacts:** • Changing trends in customers' use of deposits, particularly amongst businesses, and the impacts of loan payment holidays across mortgage, credit cards and unsecured loan portfolios, have affected capital, liquidity and funding forecasting. • The possibility of low or even negative interest rates. **Actions:** • Additional monitoring and controls over capital, funding and liquidity risks resulting from COVID-19 have been put in place. The Group has early visibility of movements in RWA or potential impacts to capital from higher credit losses and stands ready to take a range of management actions. • The introduction of the Bank of England's (BoE) Term Funding Scheme with additional incentives for SMEs (TFSME) provides an alternative source of funding to wholesale markets and is included in the Group's funding plans.

Strategic report (continued)

Principal risks and mitigating actions (continued)

Principal risks	Key mitigating actions	COVID-19 impacts and actions
Model risk is the potential for adverse consequences from decisions based on incorrect or misused model outputs and reports.	• The Group has a Model Risk Policy framework in place to manage and mitigate model risk, which encompasses the end-to-end model life cycle. • The Model Risk Policy standard defines roles and responsibilities in terms of model risk management. • A suitably qualified Independent Model Validation function conducts model validations prior to model implementation, both when a model is changed and on a periodic basis.	**Impacts:** • The uncertain economic environment has affected all model components including input data, default markers, outputs, model accuracy and performance. • The rapid application of COVID-19 model adjustments has increased the risk that particular implementations contain errors or unexpected outcomes. **Actions:** • Model Risk Oversight remain actively engaged with model owners, carrying out pre-emptive model assessments to recognise and address key model risks and help validate COVID-19 driven adjustments or recalibrations. Further oversight is provided by the Model Governance Committee.
Regulatory and compliance risk is the risk of failing to comply with relevant laws and regulatory requirements, not keeping regulators informed of relevant issues, not responding effectively to information requests (IRs), not meeting regulatory deadlines or obstructing the regulator.	• Clearly defined regulatory and compliance policy statements and standards are in place, supporting both regulatory and customer expectations. • There is ongoing proactive and coordinated engagement with key regulators. • Formal monitoring of compliance is managed through focused oversight, regular reporting to the Board Risk Committee and ongoing dialogue with regulators.	**Impacts:** • The Group has deployed multiple new policies and processes to implement government, regulatory and central bank COVID-19 support measures. • Additional regulatory and compliance risks are associated with adherence to both COVID-19 specific regulatory guidance and with existing regulation. **Actions:** • Additional risk assessments, governance processes and assurance activities have been deployed across the Group to ensure compliance with existing regulation and COVID-19 specific regulatory guidance.
Conduct risk is the risk of undertaking business in a way that is contrary to the interests of customers, resulting in inappropriate customer outcomes or detriment, regulatory censure, redress costs and/or reputational damage.	• The Group has an overarching conduct risk framework, with clearly defined policy statements and standards. • Ongoing reporting and development of conduct risk appetite measures to the Executive Risk Committee and the Board. • The Group continually assess evolving conduct regulations, customer expectations, and product and proposition development. • A risk-based assurance framework is in place which monitors compliance with regulation and assesses customer outcomes.	**Impacts:** • Decisions are being made at pace, in order to protect and support customers and there is the potential of failing to achieve good customer outcomes in this environment and in the future as relief schemes come to an end. Furthermore, there is an increased risk of failure to recognise and appropriately manage financial difficulties or vulnerabilities. **Actions:** • Additional monitoring and controls are in place to mitigate conduct risks arising from the execution of new policies and processes deployed in response to COVID-19.

Strategic report (continued)

Principal risks and mitigating actions (continued)

Principal risks	Key mitigating actions	COVID-19 impacts and actions
Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.	• The Group has an established operational risk framework to identify, manage and mitigate operational risks. • Internal and external loss events are categorised using Basel II risk categories to ensure consistent assessment, monitoring and reporting of risks and events, including themes and remediation action required to prevent reoccurrence. • The Group undertakes regular, forward-looking scenario analysis to gain insight into the stresses the business could be subject to in the event of operational risk events materialising. • A framework is in place to ensure risks from individual changes are managed effectively, in line with the Group's risk appetite, with appropriate second-line oversight.	**Impacts:** • Increased remote working, the implementation of new processes and pressure on customer support areas arising from changing customer needs all have the potential to increase the Group's operational risk profile, which could lead to increased errors or delays and subsequent loss. **Actions:** • The Group has undertaken ongoing risk assessments for changes to processes and controls made in response to COVID-19, including remote working. Policy exceptions are tracked and additional controls implemented.
Technology risk is the risk of loss resulting from inadequate or failed information technology processes. Technology risk includes cyber security, IT resilience, information security, data privacy and payment risk.	• The Group has a data management framework governing the creation, storage, distribution, usage and retirement of data. • The payment risk framework outlines key scheme rules, regulations and compliance requirements to ensure that payment risk is managed within appetite. • The Board-approved security strategy focuses on the management of cyber risk, exposure and manipulation of confidential data and identity and access management. • These risks are managed by a number of controls that align to the industry recognised National Institute of Standards and Technology Framework. • IT resilience is addressed by a programme of continuous monitoring over the currency of technology estate and disaster recovery. Furthermore, critical end-to-end business recovery and contingency plans are maintained and tested.	**Impacts:** • There is an increased risk of cyber attacks, due to phishing emails which use a COVID-19 theme and breaches could have legal, regulatory or privacy implications. • Reliance on the availability of digital banking and remote network access has increased, with solutions implemented to address system constraints and safeguard our connections. **Actions:** • Additional fraud monitoring is in place and temporary process changes are being continually risk assessed. There continues to be enhanced focus on supplier service level agreements and contingency plans. • A significant amount of work has been undertaken to enable and improve home working conditions. System monitoring, incident management and escalation processes are in place with regular oversight performed.

Strategic report (continued)

Principal risks and mitigating actions (continued)

Principal risks	Key mitigating actions	COVID-19 impacts and actions
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. This includes money laundering, counter terrorist financing, sanctions, fraud and bribery and corruption.	• The Group has an established and evolving framework providing transparency and structure against which to develop and maintain consistency of approach to identify, manage and mitigate financial crime risk. • The Group continues to monitor existing, new and emerging risks and threats as a result of new laws and regulations, industry trends and economic and environment factors. • The Group operates a framework of risk-based systems and controls to minimise the extent to which its products and services can be used to commit or be subject to financial crime. Regular investments are made into the maintenance of these systems and ensure compliance. • Regular oversight of financial crime controls is undertaken to ensure they remain effective and in line with Board-approved risk appetite.	**Impacts:** • New policies and processes implemented in response to government, regulatory and central bank relief measures introduce additional fraud and financial crime risks. Support measures have been deployed at speed and there has been an enforced relaxation of certain controls. There is a risk that criminals may take advantage of customer and organisational vulnerabilities created by COVID-19. **Actions:** • Additional risk assessment, governance processes and assurance activity has been deployed across the Group to ensure the ongoing balance between customer impacts and support and maintaining fraud loss within risk appetite.
Strategic and enterprise risk is the risk of significant loss of earnings or damage arising from decisions or actions that impact the long-term interests of the Group's stakeholders or from an inability to adapt to external developments, including potential execution risk as a result of transformation activity.	• Strategic and enterprise risk is addressed through the Board-approved five year Strategic and Financial Plan, refreshed during the year to incorporate and address the impacts of COVID-19. • The Group considers strategic and enterprise risk as part of ongoing risk reporting and the management of identified strategic risks is allocated to members of the Group's Leadership Team by the CEO. • The Group continues to develop and embed its sustainability agenda in managing environmental, climate, social and governance related risks. • Regular oversight activity with workstreams focused solely on the execution risk of delivering transformation, placing customers' interest at the centre of all aspects of change.	**Impacts:** • COVID-19 has increased the pace of change and unpredictability within the external environment, including in relation to economic conditions, regulation, and culture. There is a risk that the Strategic and Financial Plan does not adequately reflect these changes, or that the Group responds ineffectively to the cultural and societal changes it has brought about. **Actions:** • The Strategic and Financial Plan has been refreshed to respond to the COVID-19 impacts experienced as well as those predicted. • The Risk Management Framework (RMF) has been refreshed in line with the new strategy and current risk environment, to ensure it remains fit for purpose and the Group's Risk Appetite Statement (RAS) takes into account the risk profile impacts of the initiatives being proposed.

Strategic report (continued)

Principal risks and mitigating actions (continued)

Principal risks	Key mitigating actions	COVID-19 impacts and actions
People risk is the risk of not having sufficiently skilled and motivated colleagues, who are clear on their responsibilities and accountabilities and 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 Group's cultural framework has a clearly defined Purpose, with Values and Behaviours that form the foundation of the performance management framework. • The quality and continuity of the Group's leadership is reviewed and assessed through succession planning and talent management activity.	**Impacts:** • There is an increased risk of colleague illness and absence, in addition to longer-term well-being risks, such as mental health impacts, which may arise from the tighter restrictions introduced to curb the spread of COVID-19. These factors could also increase pressure and reduce skills availability in key areas. **Actions:** • The Group follows government advice with colleagues working from home where possible, and social distancing and additional cleaning measures in place to support key workers based in offices and branches. Vulnerable colleagues are being given additional support from our healthcare provider.

Operational resilience

Operational resilience underpins the Group's ten principal risks. It is defined as the ability of the Group to protect and sustain its most critical functions and underlying assets, while adapting to expected or unexpected operational stress or disruption, and having the capacity to recover from issues as and when they arise. Further information can be found on page 101.

Climate risk

Climate risk is not a standalone principal risk but manifests through existing principal risk types. The Group is exposed to physical, transition and reputation risks arising from climate change. Further information can be found on page 99.

Emerging risks

The Group considers an emerging risk to be any risk which has a material unknown and unpredictable component, with the potential to significantly impact the future performance of the Group. The Group's emerging risks are continually reassessed and reviewed through a horizon scanning process, with escalation and reporting to the Board. The horizon scanning process fully considers all relevant internal and external factors, and is designed to capture those risks which are current but have not yet fully crystallised, as well as those which are expected to crystallise in future periods.

Emerging risks are allocated a status based on their expected impact (from low to very high) and time to fully crystallise (from >12 months to 3+ years), in line with the definitions outlined in the RMF and are subject to regular review across senior governance forums.

Technology and cyber risk has been added as an emerging risk reflecting the increasing reliance on digital solutions across the Group. Technology risks which are known and already crystallising are addressed separately, within the existing technology risk framework. Competition is no longer an emerging risk. The assessment of competition risks arising in the normal course of business is incorporated within the strategic and enterprise principal risk framework. Climate risk has been retained as an emerging risk to capture the inherently unknown and unpredictable elements.

Strategic report (continued)

Emerging risks (continued)

Emerging risks	Description	Mitigating actions
Geopolitical and macroeconomic environment	The economic impacts of COVID-19 have yet to fully crystallise. Although the duration and depth of the downturn is uncertain, risks to credit and margin performance are expected, with significant disruption to both supply and demand already occurring. Increasing unemployment could impact customers' ability to repay their lending. The efficacy of monetary and fiscal policy, and the speed and ability with which the UK can return to normal operating conditions, will determine the overall economic impact for the UK and the Group. Uncertainty remains over the future relationship between the UK and the EU and whether trade deal negotiations can be completed ahead of the transition year end date of 31 December 2020. There is an increased possibility of a second Scottish independence referendum, driven by a greater visibility of policy differences through the COVID-19 response and ongoing Brexit negotiations.	• The Group continues to monitor economic and political developments, in light of the ongoing uncertainty, considering potential consequences for its customers, products and operating model, including its sources of funding. • The Group actively monitors its credit portfolios and undertakes robust internal stress testing to identify sectors that may come under stress as a result of an economic slowdown in the UK.
Climate risk	There is significant uncertainty around the time horizon over which climate risks will materialise as well as the exact way in which they will occur. Stakeholder expectations and regulatory attention could develop at pace, impacting the lending activities of the Group. Sudden shifts in sentiment, if not in line with the lending practices of the Group at that time, could lead to increased scrutiny and reputational damage.	• The Group continues to consider climate change in its RMF, in line with its plan to align to regulatory expectations. Climate risks are also considered by the Board in its review and challenge of the Strategic and Financial Plan and the Group's Sustainability Strategy.
Regulatory and governmental change	The suite of government support measures, introduced in reaction to the economic pressures created by COVID-19, are complex and nuanced. Any sudden or unexpected change to the rules and regulations governing the measures could create material disruption, requiring large-scale prioritisation decisions in a fast-paced environment. The longevity of temporary changes (e.g. cancellation of the 2020 Annual Cyclical Scenario (ACS), or the possible requirement for lasting changes, is unknown and may impact firms in the medium term. Beyond COVID-19, there is continued evolution of the regulatory landscape, and the requirement to respond to on-going prudential and conduct driven initiatives.	• The Group continues to monitor emerging regulatory initiatives to identify potential impacts on its business model and ensure it is well placed to respond with effective regulatory change management. • The Group continues to work with regulators to ensure it meets all regulatory obligations, with identified implications of upcoming regulatory activity incorporated into the strategic planning cycle. • The Group has put multiple new policies in place to help ensure COVID-19 related government, regulatory and Group customer support arrangements are deployed correctly.

Strategic report (continued)

Emerging risks (continued)

Emerging risks	Description	Mitigating actions
Technology and cyber risk	The Group continues to operate in a highly competitive environment, with growth across a number of digital-only providers, and emerging signs of participation from large technology companies. These longer-term technological changes, coupled with the short-term operational challenges caused by COVID-19, are impacting the way in which customers access and use our products and services. This increases demand on systems and people, and our requirement to be flexible and responsive in a fast-paced, ever-changing environment. Emerging risks around Cloud technology and Big Data are increasing, and the fast-moving global cyber risk challenges, for example those driven by large nation states, continue to impact the security and protection of our customer data. The resilience of systems security, payment and overall technology solutions is a heightened focus of the regulator.	• The potential impacts from new technologies, and from the changing ways in which customers use the Group's services, are continuously risk assessed, with action pre-emptively taken to safeguard the end-to-end resilience of critical processes. • The Group continues to invest in the security and resilience of its infrastructure, in order to improve services and minimise the risk of disruption to customers. • The Group has resilient continuity frameworks in place to support activities in an open banking, digitally reliant market.

Outlook

Over the next 12 months the Group will continue to support Virgin Money UK PLC, the Group's ultimate parent, in delivering its targets and executing its strategy.

The Strategic report was approved by the Board of Directors on 24 November 2020 and was signed on its behalf by:

David Duffy

Chief Executive Officer

Clydesdale Bank PLC

Risk report

Effective risk management is critical to realising the Group's strategy of pioneering growth, with delighted customers and colleagues, while operating with super straightforward efficiency, discipline and sustainability. The safety and soundness of the Group is aligned to Our Purpose and is a fundamental requirement to enable our customers and stakeholders to be "happier about money".

Risk culture

Risk culture is focused on the Group's understanding of the risks it takes, which is key to enabling our strategy to disrupt the status quo.

Personal accountability is at the heart of the Group's risk culture. This is enabled through the risk management accountability model and formal delegation framework which support colleagues to make risk-based decisions. Colleagues are recruited with the core skills, abilities and attitude required to fulfil their role. They are provided with training and development to ensure they maintain and develop the required levels of competence. This supports colleagues in making risk-based decisions and judgements.

Culture is shaped by many aspects including Purpose, Values and Behaviours that set a 'Tone from the Top'; the Group's and Regulatory Codes of Conduct; operating principles; policy statements and standards; the risk management operating model; and an approved articulation of risk appetite that aligns to, and supports, strategic objectives.

The Group strives to instil a culture that enables colleagues to meet the requirements of all relevant rules, regulations, laws, codes and policies and to build constructive regulatory relationships.

The Group promote an environment of effective challenge in which decision making processes stimulate a range of views. Transparency and open dialogue are encouraged, to enable colleagues to raise concerns when they feel uncomfortable about actions, practices or behaviours.

The Group is customer-centric and values open and honest feedback from its customers. This feedback allows colleagues to rectify problems, learn from them and consistently create products and services that meet customer needs in alignment with Purpose. The Board and senior management are responsible for setting and overseeing the Group's risk culture through their actions, words and oversight activities, and for ensuring any identified areas of weakness are addressed.

The Board Risk Committee continually assesses risk culture and Internal Audit provides an independent view of risk culture to the Board Audit Committee through a risk and control-related management awareness assessment assigned to the majority of audits.

Risk strategy

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

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

Risk report (continued)

Risk appetite

Risk appetite is defined as the level and types of risk the Group is willing to assume within the boundaries of its risk capacity, to achieve its strategic objectives. The RAS articulates the Group's risk appetite to stakeholders and provides a view on the risk-taking activities the Board is comfortable with, guiding decision-makers in their strategic and business decisions.

The Risk Appetite Framework sets out the mandatory governance requirements for the creation, management and oversight of the RAS.

The RAS conveys the balance required between risk-taking and the commercial and reputational implications of doing so, promoting good customer outcomes and protecting the Group from excessive exposure. The RAS includes qualitative and quantitative limits which inform strategies, targets, policies, procedures and other controls that collectively ensure the Group remains within the Board's approved appetite.

The Group's RAS is prepared by the Group Chief Risk Officer with consideration of the strategic objectives and business model, as well as the environment in which the Group operates. Information on performance against relevant RAS settings, breaches and trends is reported to the Executive Committee and Board.

Risk governance and oversight

The Group has a structured risk governance framework to support the Board of Directors' aim of achieving long-term and sustainable growth through the Group's Purpose of 'Making you happier about money'. This includes a number of committees with a specific risk management focus, although all committees consider risk matters in accordance with the Group's RMF. 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. Oversight of the risk governance structure is facilitated by the Board.

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 and adhered to by all colleagues when carrying out their day-to day activities;
- decisions are made with proactive consideration of the potential risk and impact on customers;
- business areas must self-identify and report management issues, which are captured centrally, showing good levels of risk awareness, management remediation, and promoting a strong risk culture; and
- regular control assessments are undertaken to confirm the effectiveness of the control environment, based on control monitoring and testing, 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 management framework

The Group identifies and manages risk in line with the RMF, which is the totality of systems, structures, policies, processes and people that identifies, measures, evaluates, controls, mitigates, monitors, and reports all internal and external sources of material risk. The RMF aligns to Our Purpose by establishing an overarching framework for the identification, measurement, management and reporting of risk in a clear and transparent way.

Risk report (continued)

Risk policies and procedures

The policy framework is a key component of the Group's RMF, providing structure and governance for the consistent and 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.

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.

Stress testing

Stress testing is an important and widely recognised risk management tool, used to assess the vulnerability of financial institutions and identify risks under adverse economic scenarios. The Group uses stress testing in strategic, capital and liquidity planning, and to inform risk appetite, risk mitigation and contingency planning.

The Group undertakes stress testing using specific idiosyncratic scenarios and following the Basel Committee principles which utilise, where appropriate, scenarios provided by the BoE.

The Board and senior management are actively involved in the stress testing process, reviewing, challenging and approving all aspects of stress testing, from the consideration of scenarios to be tested, to the outcomes and mitigating actions. The involvement of the Board and senior management is considered essential for the effective operation of stress testing and the manner in which the results 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.

The BoE's 2020 ACS was cancelled as a result of COVID-19, to free up operational capacity and to help lenders to continue to meet the needs of UK households and businesses.

The Group will take part in its inaugural BoE concurrent stress test in 2021 and a significant amount of work has been undertaken to ensure preparedness for all requirements.

Principal and emerging risk categories

In line with the UK Corporate Governance Code requirements, the Board has performed a robust assessment of the Group's principal and emerging risks, including those that could result in events or circumstances that might threaten the Group's business model, future performance, solvency or liquidity and reputation. In deciding on the classification of principal risks, the Board considered the potential impact and probability of the related events and circumstances and the timescale over which they may occur. In assessing emerging risks, the Board considered what procedures are in place to identify emerging risks and how they are being managed or mitigated.

The Group's principal and emerging risks are disclosed on pages 5-11 of the strategic report.

COVID-19 impacts on principal risks

COVID-19 is impacting individuals, businesses and communities and has increased the Group's risk profile. The measures introduced to support the economy create new operational, conduct, enforceability and financial risks for the Group. These risks are being managed and will be monitored over time. The most material impacts are disclosed in the Strategic report, with further information available in the individual principal risk sections of the Risk report.

Risk report (continued)

CREDIT RISK

Whilst 2020 has undoubtedly been a difficult year, the shape and credit quality of our lending portfolio meant we were well positioned to face the economic challenges brought about by COVID-19. We started the year with a well-diversified portfolio, with 82% of our lending portfolio from a low LTV mortgage book, 11% from a business lending portfolio in solidly performing sectors, and the remaining 7% from a high quality personal lending portfolio, and this mix remained largely constant through the year. We adhered to our principles of managing our lending portfolio with a controlled risk appetite and prudent approach to underwriting with additional changes to our underwriting criteria introduced in response to the economic events.

The emergence of COVID-19 towards the end of the first half of the year and the resulting lockdown inevitably put pressure on all businesses and individuals, however the additional support available in the form of government-backed lending and payment holidays has undoubtedly eased the immediate pressures. Nevertheless, our assessment of the economic environment is cautious given the risks to the downside which remain and we have applied prudent macroeconomic forecasts and conservative weightings to those forecasts which has caused us to reassess the likelihood of future loss in our lending portfolio and resulted in us increasing our provision for future expected credit losses (ECLs), both at the half year and year end. Accordingly, we have recorded an underlying impairment charge of £501m in the year to 30 September 2020, an increase of £353m from the prior year charge of £148m. We have kept this position under close watch throughout the year and updated our view on a quarterly basis.

A key indicator of the underlying quality of the lending portfolio is the movement in staging over time and the levels of arrears in the portfolios. Arrears levels have remained largely stable across all portfolios as government interventions and payment holiday support has been deployed. Whist we have seen a deterioration in staging with 81% of the Group's lending portfolio now in stage 1 at 30 September 2020 (2019: 93%), this is principally due to probability of default (PD) migration rather than arrears, with the level of the portfolio < 30 days past due (DPD) remaining stable at 98.5% (2019: 98.6%). Stage 3 balances have similarly remained stable. In summary, whilst an element of migrations to stage 2 reflect a level of financial difficulty for certain customers, stage migrations in the year have generally been reflective of more negative macroeconomic forecasts rather than a deterioration in the underlying quality of our book. Furthermore, a significant proportion of customers who have taken advantage of the COVID-19 payment holidays available have already resumed their normal payment patterns and we will continue to closely monitor these customers going forward.

In setting our provision for expected future credit losses at the year end, we have adopted prudent macroeconomic forecasts and weightings and deployed these within our credit models. Where it has not been possible to fully quantify new or emerging risks in modelled outcomes, or we have assessed limitations in our models, expert judgement has been applied to determine an appropriate level of additional post model adjustments (PMAs); the level of PMA's is inevitably higher this year at £186m (2019: £49m) due largely to the impact of COVID-19 variables which, given the unprecedented nature of the economic shock, could not be fully incorporated into the latest models. In combination, these factors ensure the Group has suitably provided against expected future losses, with a provision of £735m at 30 September 2020 (2019: £362m). This increased level of provision results in overall coverage of 1.02% (2019: 0.50%), which we consider to be balanced and appropriate for our portfolio at the present time.

Notwithstanding the level of prudence we have exercised in measuring ECL's this year, and the recent announcement regarding positive progress in the development of a COVID-19 vaccine, the economic outlook remains challenging. We will continue to monitor and assess the quality of our credit portfolios as we navigate through these difficult times.

The Credit risk report which now follows has been structured into the sections below in order to further explain our considerations

- **Managing risk within our portfolios**: addresses the various frameworks, policies, approaches and mitigations deployed to manage and oversee credit risk;
- **Measuring credit risk within our portfolios**: covers the Group's approach to ECL methodologies and calculations as well as the approach to credit estimates and judgements, including PMAs;
- **Portfolio performance**: summarises the key credit performance measures and influencing factors set out at Group level, supported by commentary on each of the three divisions: Mortgages, Personal, and Business; and
- **Supporting our customers in times of need**: informs the various support mechanisms the Group has deployed to support customers.

A range of technical tables and analysis is also included.

CREDIT RISK (continued)

Group credit highlights

		30 Sep 2020 (audited) £m	30 Sep 2019 (audited) £m
Underlying impairment charge on credit exposures		**501**	148
Impairment provisions:	Modelled	**496**	266
	PMA	**186**	49
	Individually assessed	**53**	47
		735	362

Managing risk within our credit portfolios

Risk appetite

The Group controls its levels of credit risk by placing limits on the amount of risk it is willing to take in order to achieve its strategic 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 the independent oversight of credit decisions and portfolios.

The COVID-19 pandemic continues to present significant risks to the Group's credit portfolios. However, the Group remains focused on supporting customers and colleagues through the exceptional challenges that have crystallised over the past few months. The FY2021 RAS will continue to consider the impact of COVID-19, remaining agile, focused and responsive, to ensure we are addressing new and developing risks in a safe and controlled manner.

Measurement

The Group uses a range of statistical models, supported by both internal and external data, to measure credit risk exposures. These models underpin the internal ratings-based (IRB) approval for the mortgage and business portfolios and the standardised approach for the personal portfolios. Further information on the measurement and calculation of ECL and the Group's approach to the impairment of financial assets can be found on page 20.

The Group's portfolios are subject to regular stress testing. Stress test scenarios are regularly prepared to assess the adequacy of the Group's impairment provision and the impact on RWAs and capital. 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 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 (LGD) is stressed based on a range of factors, including property price movements.

Mitigation

The Group maintains a dynamic approach to credit management and takes necessary steps if individual issues are identified or if credit performance has, or is expected to, deteriorate due to borrower, economic or sector-specific weaknesses.

The mitigation of credit risk within the Group is achieved through approval and monitoring of individual transactions and asset quality, analysis of the performance of the various credit risk portfolios, and 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 (CRM) is also supported, in part, by obtaining collateral, and corporate and guarantees where appropriate.

Risk report (continued)

CREDIT RISK (continued)

Managing risk within our credit portfolios (continued)

Other mitigating measures are described below:

Credit assessment and mitigation

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.

The Group uses a variety of lending criteria when assessing applications for mortgage and personal 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 of the borrower under stressed scenarios 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 loan to value (LTV) less than 95%. The Group has maximum percentage LTV limits which depend upon the loan size. Product types such as Buy-To-Let and residential interest-only mortgages are controlled by transactional limits covering both LTV and value.

For business customers, 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 business 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 while 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.

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 strategy and policy

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. Significant credit risk strategies and policies are reviewed and approved annually by the Credit Risk Committee. For complex credit products and services, the Chief Credit Officer and Credit Risk Committee provide a policy framework which identifies, quantifies and mitigates risks including, but not limited to, those that have arisen as a result of the impacts of COVID-19. These policies and frameworks are delegated to, and disseminated under, the guidance and control of the Board and senior management, with appropriate oversight through governance committees.

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 regularly undertaken by Internal Audit.

Portfolio oversight

The Group's credit portfolios, and the key benchmarks, behaviours and characteristics by which those portfolios are managed, are regularly reviewed. This entails the production and analysis of regular portfolio monitoring reports for review by senior management.

Risk report (continued)

CREDIT RISK (continued)

Managing risk within our credit portfolios (continued)

Controls over rating systems

The Group has a Model Risk Oversight team that sets common minimum standards. The standards are designed to ensure risk models and associated rating systems are developed consistently and are of sufficient quality to support business decisions and meet regulatory requirements. The Group performs an annual self-assessment of its ratings systems to ensure ongoing Capital Requirements Regulation (CRR) compliance supported by all three lines of defence.

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

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 customer's 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, 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.

Collateral

Collateral held as security and other credit enhancements can be summarised as follows:

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 Business 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). All commercial property collateral is subject to an independent, professional valuation when taken and thereafter subject to periodic review in accordance with policy requirements.

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 provides asset-backed lending in the form of asset and receivables finance. Security for these exposures is held in the form of direct recourse to the underlying asset financed.

Further detail on collateral can be found on pages 34-36.

Risk report (continued)

CREDIT RISK (continued)

Managing risk within our credit portfolios (continued)

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: The Credit Risk Committee 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 and 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 counterparty, by product, by geographical region and by industry sector. In addition, single name exposure limits exist to control exposures to a single 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 and the Chief Credit Officer. Any exposure which continues or is expected to continue beyond 30 days will also be submitted to the Transactional Credit Committee with proposals to correct the exposure within an agreed period, not to exceed 12 months.

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 (EBA) for financial 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.

CREDIT RISK (continued)

Measuring risk within our credit portfolios

The Group adopts two approaches to the measurement of credit risk:

Individually assessed approach

A charge is taken to the consolidated income statement when an individually assessed provision has been recognised or a direct write-off has been applied to an asset balance

Collectively assessed approach

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 and to calculate the level of ECL. This is supplemented by management judgement in the form of PMAs where necessary.

At each reporting date, the Group assesses financial assets measured at amortised cost, as well as loan commitments and financial guarantees not measured at fair value through profit or loss (FVTPL), for impairment. The impairment loss allowance is calculated using an ECL methodology and reflects: (i) an unbiased and probability weighted amount; (ii) the time value of money which discounts the impairment loss; and (iii) reasonable and supportable information that is available without undue cost or effort about past events, current conditions and forecasts of future economic conditions.

The calculated ECL is determined using the following classifications:

Classification	ECL calculation period	Description
Stage 1	12 months	A loan that is not credit-impaired on initial recognition and has not experienced a significant increase in credit risk (SICR).
Stage 2	Lifetime	If a SICR has occurred since initial recognition, the loan is moved to stage 2 but is not yet deemed to be credit-impaired.
Stage 3	Lifetime	If the loan is credit-impaired it is moved to stage 3.

In addition to the above stages, purchased or originated credit-impaired (POCI) financial assets are those which are assessed as being credit-impaired upon initial recognition. Once a financial asset is classified as POCI, it remains there until derecognition irrespective of its credit quality. POCI financial assets are included within those financial assets in Stage 3 with corresponding values disclosed by way of footnote to the relevant tables. The Group regards the date of acquisition as the origination date for purchased portfolios.

A Stage 2 ECL is required where a SICR has been identified, such as a deterioration in PD since origination, subject to the 30 DPD backstop; with Stage 3 required where there is credit impairment subject to the 90 DPD backstop.

ECL methodology is based upon the combination of PD, LGD and exposure at default (EAD) estimates that consider a range of factors that impact on credit risk and the level of impairment loss provisioning. The Group uses reasonable and supportable forecasts of future economic conditions in estimating the ECL allowance. The methodology and assumptions used in the ECL calculation are reviewed regularly and updated as necessary.

ECLs under IFRS 9 use economic forecasts, models and judgement to provide a forward-looking assessment of the required provisions. PMAs have been used to address known limitations in the Group's models or data. Due to the current severe economic conditions, government and Group interventions to support customers, and uncertainty arising from COVID-19, the Group has not relied upon modelled outcomes alone. Following detailed analysis, expert credit judgement has been applied, resulting in additional PMAs to ensure the ECL calculation reflects the full set of plausible circumstances including data limitations, customer support measures, rapidly changing customer behaviours and the emerging nature of COVID-19 risks.

Further detail on the accounting policy applied to ECLs can be found in note 3.2 to the financial statements.

Risk report (continued)

CREDIT RISK (continued)

Portfolio performance

How our portfolios have performed

Credit risk exposures are classified into mortgage, personal and business portfolios. 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 Business lending, a single large exposure policy is in place and forms part of the risk appetite measures that are monitored and reported on a monthly basis. The overall composition and quality of the credit portfolio is monitored and regularly 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 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.

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**	
	2020	2019	**2020**	2019
	£m	£m	**£m**	£m
Loans and advances to customers (note 3.1)	**72,428**	73,093	**71,436**	32,389
Cash and balances with central banks (note 3.4)	**9,107**	10,296	**9,107**	6,621
Due from other banks	**927**	1,018	**174**	225
Due from related entities	**11**	18	**1,163**	2,476
Financial instruments at fair value through other comprehensive income (note 3.7)	**5,080**	4,328	**5,080**	2,350
Derivative financial assets (note 3.6)	**318**	366	**134**	442
Other financial assets at fair value (note 3.5)	**191**	261	**191**	254
	88,062	89,380	**87,285**	44,757
Financial guarantees (note 5.1)	**95**	113	**95**	113
Other credit commitments (note 5.1)	**16,775**	15,158	**16,714**	6,677
Maximum credit risk exposure	**104,932**	104,651	**104,094**	51,547

All Treasury-related financial assets are classed as Stage 1 financial assets under IFRS 9.

Included within cash and balances with central banks is £7.2bn of cash is held with the BoE (2019: £8.4bn). Due from other banks is all with senior investment grade counterparties. Financial instruments at fair value through other comprehensive income (FVOCI) and the credit rating of counterparties are discussed in note 3.7.

CREDIT RISK (continued)

Portfolio performance (continued)

Concentration of lending assets

The following audited tables show the levels of concentration of the Group's loans and advances.

	Group		Bank	
	2020	2019	**2020**	2019
	£m	£m	**£m**	£m
Property - mortgage	**58,652**	60,391	**57,746**	23,693
Agriculture, forestry, fishing and mining	**1,634**	1,494	**1,635**	1,495
Instalment loans to individuals and other personal	**5,550**	5,280	**5,550**	1,406
Manufacturing	**884**	793	**833**	758
Wholesale and retail	**961**	766	**962**	767
Property - construction	**337**	165	**337**	165
Financial, investment and insurance	**97**	104	**97**	104
Government and public authorities	**19**	30	**18**	30
Other commercial and industrial	**4,789**	4,221	**4,747**	4,195
Gross loans and advances to customers[1]	**72,923**	73,244	**71,925**	32,613

(1) The Group has a portfolio of fair valued business loans of £190m (2019: £253m) loans and advances to customers (note 3.1) which are classified separately as financial assets at FVTPL on the balance sheet. At 30 September 2020 the most significant concentrations of exposure were in agriculture, forestry, fishing and mining (29%), real estate (28%), health and social work (18%),and government and public authorities (9%).

	Group		Bank	
Contingent liabilities and related commitments (audited)	**2020**	2019	**2020**	2019
	£m	£m	**£m**	£m
Property - mortgage	**3,088**	2,642	**3,027**	1,394
Agriculture, forestry, fishing and mining	**375**	302	**375**	302
Instalment loans to individuals and other personal lending (including credit cards)	**9,674**	9,069	**9,674**	1,789
Manufacturing	**692**	582	**692**	582
Wholesale and retail	**563**	472	**563**	472
Property - construction	**136**	118	**136**	118
Financial, investment and insurance	**173**	103	**173**	150
Government and public authorities	**348**	350	**348**	350
Other commercial and industrial	**1,821**	1,633	**1,821**	1,633
	16,870	15,271	**16,809**	6,790

Risk report (continued)

CREDIT RISK (continued)

Portfolio performance (continued)

Key credit metrics

	30 Sep 2020 (audited) £m	30 Sep 2019 (audited) £m
IMPAIRMENT PROVISIONS HELD ON CREDIT EXPOSURES		
Mortgage lending	**131**	40
Personal lending	**301**	175
Business lending	**303**	147
	735	362
UNDERLYING IMPAIRMENT CHARGE ON CREDIT EXPOSURES		
Mortgage lending	**95**	4
Personal lending	**223**	119
Business lending	**183**	25
	501	148
ASSET QUALITY MEASURES:		
Underlying impairment charge(1) to average customer loans (cost of risk)	**0.68%**	0.21%
Stage 3 assets to customer loans	**1.19%**	1.09%
Total provision to customer loans(2)	**1.02%**	0.50%
Stage 3 provision to Stage 3 loans (including POCI)	**15.62%**	14.32%

(1) Inclusive of gains/losses on assets held at fair value and elements of fraud loss but excludes the acquisition accounting impact on impairment losses shown on page 124.

(2) This includes the government-backed portfolio of Bounce Back Loans (BBLs), Coronavirus Business Interruption Loans (CBILs) and Coronavirus Large Business Interruption Loans (CLBILs)

Group credit performance

Total loans and advances to customers decreased by £0.3bn in the year, reflecting the Group's focus on supporting existing customers, muted demand for new borrowing and the impact of changing customer behaviours as lending was paid down more rapidly. Mortgage lending decreased by £1.7bn, offset by a £1.1bn increase in Business lending and a £0.3bn increase in personal lending.

The Group's impairment provision increased by £373m to £735m during the year, primarily due to the Group's assessment of the impact of COVID-19 on future credit losses. This assessment adopts multiple forward-looking, macroeconomic scenarios with higher probability weights applied to a worsening economic outlook. In addition, PMAs have been applied where required.

The Group's underlying impairment charge has increased from £148m to £501m during the year mainly due to the use of revised economic scenarios in credit impairment models and the application of judgement based PMAs to reflect emerging COVID-19 risks. Increases are most evident in the personal and business portfolios, reflecting their heightened sensitivity to significant deterioration in unemployment and GDP forecasts.

As at 30 September 2020 the Group's cost of risk was 68bps (30 September 2019: 21bps), further reflecting the pessimistic economic outlook.

Underlying credit portfolio performance remains stable, as evidenced by the proportion of Stage 3 loans to total customer loans of 1.19% (2019: 1.09%). There has been no material deterioration in asset quality measures, arrears and default levels remain low, and forbearance levels remain static. This is due to a combination of customer support measures, controlled risk appetite and a continued focus on responsible lending decisions. Customer support measures include participating in government-backed loan schemes and offering payment holidays, augmented by other temporary fiscal stimulus such as furlough and HMRC payment deferrals. Further commentary on the types of customer support provided can be found in the divisional commentary on pages 24-28.

The proportion of total provisions to total customer loans has increased to 1.02% (30 September 2019: 0.50%) reflecting the expectation that additional losses will emerge as the level of COVID-19 support subsides and the economy hardens.

CREDIT RISK (continued)

Mortgage credit performance

	30 Sep 2020	30 Sep 2019
Gross loans and advances	**£58.7bn**	£60.4bn
Impairment charge	**£95m**	£4m
Cost of risk	**16bps**	1bps
Provision to customer loan ratio	**23bps/£131m**	7bps/£40m
% Loans in Stage 2	**13.9%**	3.0%
% Loans in Stage 3	**0.9%**	0.8%
% Forborne	**1.08%**	0.98%
90+ DPD	**0.43%**	0.32%
Indexed LTV of mortgage portfolios	**57.3%**	57.2%

Portfolio and impairment (pages 22, 37-38)

The Group's mortgage lending has reduced from £60.4bn to £58.7bn in the year to 30 September 2020, reflective of underlying contraction in the portfolio. This aligns with the divisional strategy to maintain disciplined pricing in a competitive environment and reflects the effect of lockdown on the UK housing market, particularly in the second half of the financial year. Demand for new mortgage lending was muted and the Group focused on providing much needed support for existing customers.

The impairment provision has increased by £91m to £131m as at 30 September 2020. This gives rise to a provision to customer loan coverage ratio of 23bps, an increase of 16bps from 2019. Consistent with the other portfolios, this reflects the adoption of a prudent approach to setting impairment provisions in expectation of future economic deterioration and heightened credit losses due to the impact of COVID-19.

The mortgage portfolio continues to evidence strong underlying credit quality, with no material deterioration in asset quality measures. This is supported by prudent risk appetite setting, robust credit underwriting disciplines and a continued focus on responsible lending.

It remains unclear how the residential property market and mortgage customers will react post COVID-19, and the extent to which house prices could be impacted. This could affect customers' ability to pay and the level of security provided, which is a significant factor in limiting losses. Regional and social differences may begin to emerge as the UK recovers from the impact of COVID-19 with certain households potentially disproportionately affected. This level of granular detail cannot be fully reflected within the macroeconomic forecasts and models and requires a detailed level of judgement and expertise to estimate the potential impact on ECL.

The impairment charge has increased by £91m to £95m in the year to 30 September 2020. £29m of this increase relates to the adoption of more conservative forward-looking macroeconomic scenarios with higher probability weights applied to a worsening economic outlook. Further analysis, with appropriate expert judgement, determined that PMAs should also be applied to address impacts on calculation inputs or model sensitivities. This resulted in a further £62m increase in ECL, £43m of which relates to the longer-term implications for customers who have taken a payment holiday. Analysis indicates that a proportion of these customers are expected to experience difficulty in returning to their contractual repayment profile leading to a level of forbearance, delinquency or potentially default. Further PMAs have also been raised to address the risk of high house prices relative to income, heightened sensitivity for buy-to-let customers and for certain customers with a high indebtedness index.

IFRS 9 staging (pages 37-44)

Despite the application of more negative economic forecasts and additional PMAs, 85.2% of mortgage lending remains classed as Stage 1 (2019: 96.2%). The reduction during the year reflects the expected COVID-19 impact on customers. This has led to a corresponding increase of 10.9% in Stage 2 to 13.9% (2019: 3.0%). Stage migrations reflect updated macroeconomic forecasts, triggering a more negative outlook and increasing the volume of mortgage customer accounts exhibiting SICR. The migration to Stage 2 also recognises, through PMAs, that some customers with payment holidays will have experienced a SICR.

Risk report (continued)

CREDIT RISK (continued)

Mortgage credit performance (continued)

Mortgage IFRS 9 PDs are driven by underlying internal credit scores adjusted for forward-looking macroeconomics. Of the Stage 2 mortgage balances, 87% are as a result of PD deterioration influenced by revised macroeconomic forecasts. The changes in PD grades observed at 30 September 2020 do not reflect any deterioration in credit scores but rather the migration to more conservative macroeconomic forecasts. While there has been a reduction from 92% (2019) to 81% of assets classed as 'Strong', the proportion of assets classed as 'Good' has increased to 14% (2019: 5%), with the result that over 95% of the mortgage portfolio still remains 'Good' or better.

The proportion of mortgages classified as Stage 3 remains modest and stable at 0.9% (2019:0.8%).

Asset quality, collateral and loan to value (pages 34-35)

The mortgage portfolio remains very well secured with 83% of mortgages, by loan value, having an indexed LTV less than 75%, with an average portfolio LTV of 57.3% (2019: 57.2%). The proportion of the portfolio over 90% LTV has remained stable at 1.9% (2019: 2.1%) and the proportion over 80% LTV has increased only slightly to 11.1% as at 30 September 2020 (30 September 2019: 10.7%).

90+ DPD arrears as at September 2020 of 0.43% (2019: 0.32%) remains low and less than the market average of 0.8%. Mild deterioration in arrears was observed prior to COVID-19, in line with industry experience. Further deterioration in delinquency has occurred due to COVID-19 as customers have moved through arrears however a moratorium on repossessions has prevented action being taken resulting in a small number of loans being in arrears longer than would typically be expected under normal circumstances. The underlying arrears for the year continues to evidence a stable portfolio, with improving bureau scores and reduced customer indebtedness, accepting that payment holidays will have benefitted customers and there will be challenges ahead.

Payment holidays (page 29)

20% of mortgage customers , by balance, applied for and were granted a payment holiday. Of the payment holidays which have matured by 30 September 2020, 98% of customers have resumed payment in line with previously contracted terms with only 2% requiring further support or having moved into arrears. Only 4% of customers, by balance, have an active payment holiday in force at 30 September 2020. The Group will continue to support customers in line with their needs and revised regulatory guidance.

Forbearance (pages 30-32)

A key indicator of underlying mortgage portfolio health is the level of forbearance granted. As at 30 September 2020, forbearance totalled £636m (5,621 customers), an increase from the 30 September 2019 position of £589m (5,061 customers). This represents 1.08% of total mortgage balances (2019: 0.98%). Forbearance remains an important metric, reflecting the volume and value of concessions granted to customers on a non-commercial basis. The increase in forbearance is driven by additional volumes of tailored arrangements. The majority of customers benefitting from these arrangements are expected to return to fully performing status when the temporary support arrangements expire. Payment holidays granted in line with regulation have not been classified as forbearance.

Risk report (continued)

CREDIT RISK (continued)

Personal credit performance

	30 Sep 2020			30 Sep 2019		
	Credit cards	**Loans and overdrafts**	**Total personal**	Credit cards	Loans and overdrafts	Total personal
Gross loans and advances	**£4.5bn**	**£1.1bn**	**£5.6bn**	£4.2bn	£1.1bn	£5.3bn
Impairment charge	**£153m**	**£70m**	**£223m**	£102m	£17m	£119m
Cost of risk	**355bps**	**721bps**	**423bps**	287bps	192bps	269bps
Provision to customer loan ratio	**537bps/ £222m**	**824bps/ £79m**	**591bps/ £301m**	342bps/ £145m	322bps/ £30m	339bps/ £175m
% Loans in Stage 2	**11.6%**	**28.0%**	**14.8%**	8.9%	4.4%	8.0%
% Loans in Stage 3	**1.2%**	**1.4%**	**1.2%**	1.3%	1.4%	1.3%
% Forborne	**0.63%**	**0.88%**	**0.67%**	0.53%	1.10%	0.70%
90+ DPD	**0.38%**	**0.52%**	**0.41%**	0.54%	0.67%	0.57%

Portfolio and impairment (pages 22,37-38)

Of the £5.6bn total personal lending, the majority is credit cards at £4.5bn, with the balance comprising personal loans and overdrafts. The modest year-on-year growth in the portfolio reflects the changed environment, more muted demand for credit and customers' prudent action in response to COVID-19, paying down lending where they have been able to do so. Arrears levels remain stable as customers continue to behave responsibly and benefit from the various forms of government support, including payment holidays. Most customers who have sought a payment holiday have now reverted to normal terms. Further detail is provided on page 29.

The impairment provision has increased by £126m to £301m as at 30 September 2020, driving an increase in the provision coverage ratio of 252bps to 591bps. £36m of the increase results from the modelled application of more negative macroeconomic forecasts, with the remaining increase due to additional PMAs. £23m of the PMAs reflect the longer-term implications for customers who have taken a payment holiday. Analysis indicates that a proportion of these customers are expected to experience difficultly in returning to the contractual repayment profile leading to a level of forbearance, delinquency and potentially default currently masked by support measures. £17m relates to an assumption that the sale or future recovery value of unsecured written-off debt will potentially reduce and result in an adjustment being required to loss given default assumptions in the ECL calculation, and £14m relates to the assumption that improvements in customer risk profiles through bureau data inputs are temporary and therefore not reflective of the longer-term expectations. The majority of the residual PMA increase is to address a lack of sensitivity in the modelled outcome, particularly for the personal loan portfolio.

Cost of risk for the year of 423bps (2019: 269bps) is reflective of this higher allowance.

IFRS 9 staging (pages 37-44)

The adoption of more negative economic forecasts and additional PMAs has driven movement from Stage 1 to Stage 2, with Stage 2 increasing by 6.7% to 14.8% (2019: 8.1%) requiring additional allowance for lifetime loss. 84% of the portfolio remains in Stage 1.

Portfolio PD is most sensitive to the rate of unemployment, which is forecast to peak at c10%. The increased forecast assumption results in a deterioration in PD, influencing the migration of customer loans into Stage 2. Of the Stage 2 Personal balances, 77% are as a result of PD deterioration influenced by revised macroeconomic forecasts (2019: 41%). Stage 3 personal lending remains modest and stable at 1.2% (2019: 1.3%).

Asset quality

Asset quality has been assisted by the credit strategies deployed during the year to control and, where determined, tighten origination controls. The total credit cards arrears balance of 1.4% is supported by payment holidays and prudent customer behaviours (2019: 1.7%). The majority of payment holidays have now matured, and customers have returned to normal payment terms. New lending continues to focus on segments with lower levels of economic volatility with portfolio level exposures to non-homeowners, lower age demographics and self-employed remaining low.

Lending performance also remains strong with 90+DPD measures at a cyclical low point of 0.41% (2019: 0.57%).

CREDIT RISK (continued)

Personal credit performance (continued)

Payment holidays (page 29)

5% of credit card customers were granted a payment holiday. Where those holidays have matured, 92% of customers have reverted to repay in line with previously contracted terms and 8% have either sought additional support or fallen into arrears. Of the 11% of personal loan customers granted a payment holiday, 95% of those which have matured have reverted to normal terms with 5% seeking further support or in arrears. 1% of credit cards customers and 3% of personal loan customers had an active payment holiday arrangement in place at 30 September 2020. The Group will continue to support customers in line with their needs and revised regulatory guidance.

Forbearance (pages 30-32)

Limited forbearance is exercised in relation to personal loans and overdrafts, with a modest reduction to £8.4m (0.88% of the personal lending portfolio) from £11.5m (1.10%) at 30 September 2019. As at 30 September 2020, credit cards forbearance totalled £27m (6,309 customers), an increase from the 30 September 2019 position of £24m (5,522 customers). This represents 0.63% of total credit cards balances (2019: 0.53%). The increase in credit cards forbearance is driven by additional volumes of payment arrangements. The level of impairment coverage on forborne loans has increased to 47.2% from 41.3% at 30 September 2019 reflecting a more prudent approach to ECL. Payment holidays granted in line with regulation have not been classified as forbearance.

Business credit performance

	30 Sep 2020	30 Sep 2019
Gross Loans and advances	**£8.7bn**(1)	£7.6bn
Impairment charge	**£183m**	£25m
Cost of risk	**212bps**	30bps
Provision to customer loan ratio/£(2)	**391bps/£303m**	193bps/£147m
% Loans in Stage 2	**44.2%**	30.2%
% Loans in Stage 3	**3.2%**	3.6%
% Forborne	**5.9%**	6.38%
90+ DPD	**0.27%**	0.47%

(1) Inclusive of government-backed loan schemes.
(2) Coverage ratio excludes government-backed loan schemes.

Portfolio and impairment (pages 22,37-38)

Business lending has increased by £1.1bn during the year to £8.7bn as at 30 September 2020 (2019: £7.6bn). This includes lending under government-backed loan schemes, which contributed to £1.2bn of portfolio growth in the year. Further information can be found on p29.

There has been no significant deterioration in underlying asset quality measures. The Group entered the pandemic with a defensively positioned portfolio biased away from sectors expected to experience disruption such as Hospitality and Retail, towards sectors expected to be resilient, such as Agriculture and Health & Social Care.

The impairment provision has increased by £156m to £303m as at 30 September, due to the expectation of greater pressures on the portfolio in 2021 from COVID-19 and Brexit. The impairment charge for the year to 30 September 2020 was £183m giving a cost of risk of 212bps.

The resultant coverage ratio of provisions to customer loans of 391bps increased by 198bps from 2019, reflective of the composition of the Group's generally sub-investment grade SME portfolio. Historically selective risk appetite choices have limited exposures to more sensitive sectors such as Hospitality, Retail, Travel, Construction and Commercial Real Estate. Even in the absence of increased default or arrears experience, the prudent economic forecasts applied caused PDs across the business portfolio to worsen with the accompanying increase in coverage reflective of the impact of COVID-19 through increased PDs including further migrations from 12-month to lifetime loss coverage.

Risk report (continued)

CREDIT RISK (continued)

Business credit performance (continued)

The Group does not hold any level of PMA for Business lending as at 30 September 2020. The policies and frameworks in place to identify business customers experiencing financial difficulty are operating effectively, meaning internal rating systems respond appropriately as levels of customer difficulty heighten. The overall level of modelled provision for business loans is assessed as sufficient in the context of the portfolio shape and strength, and considering the extensive number of sector and segment reviews undertaken in recent months. Regular customer and portfolio level analysis is completed to ensure early identification of business customers likely to experience financial difficulty. This enables prompt relationship manager engagement with customers and appropriate early support interventions.

IFRS 9 staging (pages 37-44)

The application of the revised, more negatively biased, forecast economic scenarios has resulted in heightened portfolio stage migration with 44.2% of balances in Stage 2 (2019: 30.2%). This reflects the Group's prudent assumptions and the early adoption of the EBA requirements to retain forborne assets in Stage 2 for a minimum of two years. Business migration to Stage 2 can result from a range of triggers. Since 30 September 2019, there has been a notable shift with economic forecasts weighing more heavily and 75% of balances in Stage 2 now associated with a deterioration in PD as a result of forward-looking economic forecasts, most notably GDP. As at 30 September 2019, deterioration was more typically associated with discrete internal ratings downgrades and only 2% of Stage 2 migrations were a consequence of forward looking economic indicators. Business loans in Stage 3 remain modest and stable at 3.2% (2019: 3.6%).

The PDs for business lending combine both internal ratings information and forward-looking economic forecasts. These economic forecasts, which include double-digit GDP falls in 2020 and a relatively weak recovery, are the material drivers of the PD and stage migrations across the year. The deteriorations in PD and staging have not been driven to any material extent by observed evidence of impairment through either internal downgrades or the emergence of arrears or defaults. While the proportion of assets classed as 'Strong' has reduced to 11% (2019: 32%), assets classed as 'Good' have increased to 73% (2019: 62%), and over 84% of the business portfolio still remain 'Good' or better.

Asset quality

Asset quality is notably influenced by the support provided to customers, including government-backed loan schemes, and the Group's prudent risk appetite and risk frameworks which seek to ensure early identification of customers in difficulty. The early identification and escalation of customers evidencing deteriorating positions ensures the Group is intervening early and providing appropriate types of support to changing customer circumstances.

Arrears measures are stable to improving, with 90+ DPD of 0.27% as at 30 September 2020 (2019: 0.47%). During the year, the proportion of business customer accounts classed as categorised (watch, default and impaired), by value, has increased from 8.13% to 8.61% of the total business book. The Group has clear strategies in place to work with each customer and the marginal increase reflects the lack of significant increase in the proportion of customers evidencing financial distress.

Payment holidays (page 29)

23% of eligible customers took advantage of a repayment holiday and, of those which have matured, 98% have returned to regular payment by 30 September 2020. Only 1% of business customer balances, equating to £108m, have an active payment holiday in force at 30 September 2020. Of the initial population granted a holiday, 2% have sought further support or have fallen into arrears. The Group will continue to support customers in line with their needs and revised regulatory guidance.

Forbearance (pages 33-34)

Business portfolio forbearance has increased from £509m (368 customers) at 30 September 2019 to £539m (368 customers) at 30 September 2020. Forbearance remains an important metric, reflecting the volume and value of concessions granted to customers on a non-commercial basis. Moves in forbearance reflect the proportion of business customers requiring support on non-standard terms and evidencing financial difficulty. As a percentage of the business portfolio, forborne balances have reduced to 5.92% (2019: 6.38%) while impairment coverage, in line with actions taken on expected credit losses, has increased to 14.3% (2019: 10.87%). The majority of forbearance arrangements relate to term extensions allowing customers a longer term to repay their obligations in full than initially contracted. Payment holidays granted in line with regulation have not been classified as forbearance.

CREDIT RISK (continued)

Supporting our customers in times of need

During the year, the Group participated in the various UK Government backed loan schemes for businesses, in addition to offering payment holidays to mortgage, personal and business customers.

Government backed loan schemes

The following loan schemes were introduced by the government in April and May 2020, with changes made to their operation announced in September 2020:

- BBLs: loans of between £2,000 and £50,000 are available under this scheme with a fixed rate of lending available for up to ten years with no repayments due in the first year. Changes to the scheme included customers applying to pay interest only for six-months (up to a maximum of three applications) with the additional potential for a six-month payment holiday for both capital and interest payments (this can only be requested where the customer has already made six repayments of principal). The government guarantees 100% of the lending.
- CBILs: loans of over £50,000 to a maximum of £5m are available under this scheme. They attract a variable rate of lending with no arrangement fees or interest paid by the borrower in the first 12 months. The government pays the fees and interest and guarantee 80% of the lending. The maximum loan term is six years.
- CLBILs: loans of over £50.000, up to a maximum of £200m (in aggregate) are available under this scheme with a variable rate of lending and terms of between three months and three years. The government guarantee 80% of the lending.

The Group has the following lending under these schemes:

(Unaudited)	**No. of customers**	**Balance (£m)**	**Average loan size (£m)**	**% of total Business lending**
BBLs	28,077	807	0.03	9%
CBILs	907	334	0.37	3%
CLBILs	3	20	6.59	Immaterial

The deadline for applications for loans under the schemes is 31 January 2021.

Payment holidays

The Group continues to actively support customers through COVID-19, offering payment holidays where appropriate, although the level of new requests has reduced significantly since the peak in April 2020. Following the announcement of further national COVID-19 restrictions at the end of October 2020, the Group will continue to align with all applicable Financial Conduct Authority (FCA) guidance in respect of payment holidays and anticipates extending their availability to impacted customers requesting a payment holiday prior to the 31 January 2021 deadline.

(Audited)	**Payment holidays granted to date**		**Payment holidays currently in force at end September 2020**		**Of matured payment holidays**	
	Total balances £m	**% of Total balances**	**Total balances £m**	**% of Total balances**	**% Resumed repayment**	**% Further treatment / arrears**
Mortgages	11,908	20%	2,525	**4%**	98%	2%
Credit cards	219	5%	31	**1%**	92%	8%
Personal	103	11%	26	**3%**	95%	5%
Business	2,072	23%	108	**1%**	98%	2%

Supporting our customers in times of need (continued)

Forbearance

The Group makes every effort to treat customers fairly and aligns its forbearance practices to that principle. While forbearance alone is not necessarily an indicator of impaired status, it is a trigger for a 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.

As a consequence of the Group's decision to early adopt the EBA probationary rules relative to forbearance, exposures classified as forborne and performing at the date forbearance is 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, which are non-performing when customers were granted forbearance, cannot exit non-performing status for a minimum of 12 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). Forbearance frameworks are reviewed on a regular basis to ensure the operational processes remain appropriate and, where required, system changes are made to enhance forbearance data capture.

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.

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.

Customers who requested COVID-19 related support, including payment holidays; and who were not the subject of any wider SICR triggers or who were otherwise assessed as having the ability in the medium term to be viable and meet our risk appetite criteria, were not considered to have been granted forbearance.

Where the Group has identified customers for whom additional borrowing would require remedial action to return them to be within our risk appetite over the medium-term, or customers who were showing signs of financial stress before the COVID-19 crisis, such customers are considered to have been granted forbearance with exposures categorised as Stage 2 and subject to a lifetime ECL assessment.

Mortgage and personal forbearance

The Group utilises various forbearance measures for mortgage and personal 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)

Mortgage and personal forbearance (continued)

Help is provided through specialist teams such as 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 following tables summarise the level of forbearance in respect of the Group's mortgage and credit card portfolios at each balance sheet date. All balances subject to forbearance are classed as either Stage 2 or Stage 3 for ECL purposes:

Group (audited) As at 30 September 2020	**Total loans and advances subject to forbearance measures**			**Impairment allowance on loans and advances subject to forbearance measures**	
	Number of loans	**Gross carrying amount £m**	**% of total portfolio**	**Impairment allowance £m**	**Coverage %**
Mortgages					
Formal arrangements	1,194	145	0.25	7.2	4.94
Temporary arrangements	792	100	0.17	5.2	5.21
Payment arrangement	1,475	141	0.24	2.8	1.96
Payment holiday	1,454	157	0.26	2.3	1.45
Interest only conversion	379	64	0.11	0.4	0.58
Term extension	163	13	0.02	0.1	0.89
Other	28	3	0.01	-	1.13
Legal	136	13	0.02	1.0	7.87
Total mortgage forbearance	5,621	636	1.08	19.0	2.98

Personal - Credit Cards	**Number of loans**	**Gross carrying amount £m**	**% of total portfolio**	**Impairment allowance £m**	**Coverage %**
Payment arrangement	6,309	27	0.63	12.5	47.23
Total cards forbearance	6,309	27	0.63	12.5	47.23

Risk report (continued)

CREDIT RISK (continued)

Mortgage and personal forbearance (continued)

Group (audited) As at 30 September 2019	Total loans and advances subject to forbearance measures			Impairment allowance on loans and advances subject to forbearance measures	
	Number of loans	Gross carrying amount £m	% of total portfolio	Impairment allowance £m	Coverage %
Mortgages					
Formal arrangements	1,352	157	0.26	4.4	2.83
Temporary arrangements	913	119	0.20	3.1	2.62
Payment arrangement	1,118	113	0.19	1.6	1.41
Payment holiday	981	114	0.19	0.7	0.58
Interest only conversion	358	54	0.09	0.3	0.57
Term extension	174	16	0.03	0.1	0.64
Other	35	3	0.00	-	0.50
Legal	130	13	0.02	0.3	2.46
Total mortgage forbearance	5,061	589	0.98	10.5	1.79

	Number of loans	Gross carrying amount £m	% of total portfolio	Impairment allowance £m	Coverage %
Personal - Credit Cards					
Payment arrangement	5,522	24	0.53	9.5	41.30
Total cards forbearance	5,522	24	0.53	9.5	41.30

The increase in Mortgage forbearance is primarily driven by payment arrangements, typically where an account is in arrears and the agreement to adjust payments gives a path to clear the overdue amounts, and short term payment holidays with the vast majority returning to fully performing status at the end of the agreed term.

When all other avenues of resolution including forbearance have been explored, the Group will take steps to repossess and sell underlying collateral. In the 12-month period to 30 September 2020, there were 57 repossessions of which 21 were voluntary (12 months to 30 September 2019 : 66 including 14 voluntary).

The increase in credit cards forbearance is the result of payment arrangements being extended to customers where COVID-19 payment holidays were not deemed to be a suitable solution.

Other Personal lending forbearance

The Group currently exercises limited forbearance strategies in relation to current accounts and personal loans. The Group has assessed the total loan balances subject to forbearance on other types of personal lending to be £8.4m as at 30 September 2020 (30 September 2019: £11.5m), representing 0.88% of the personal lending portfolio (30 September 2019: 1.10%).

Impairment provisions on forborne balances totalled £3.4m as at 30 September 2020 (30 September 2019: £3.6m) providing overall coverage of 40.59% (30 September 2019: 31.58%).

Risk report (continued)

CREDIT RISK (continued)

Business forbearance

Forbearance is considered to exist for business customers where one or more concessions are granted on a non-commercial basis. The Group reports business 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 business 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. All balances subject to forbearance are classed as either Stage 2 or Stage 3 for ECL purposes.

Group (audited) As at 30 September 2020	**Total loans and advances subject to forbearance measures**			**Impairment allowance on loans and advances subject to forbearance measures**	
	Number of customers	**Gross carrying amount £m**	**% of total portfolio**	**Impairment allowance £m**	**Coverage %**
Term extension	199	211	2.31	27.5	13.05
Deferral of contracted capital repayments	92	115	1.26	23.1	20.08
Reduction in contracted interest rate	2	1	0.01	0.1	6.75
Alternative forms of payment	1	-	-	-	64.36
Debt forgiveness	2	4	0.05	0.2	4.66
Refinancing	15	6	0.07	1.8	29.37
Covenant breach/reset/waiver	57	202	2.22	24.4	12.10
Total business forbearance	368	539	5.92	77.1	14.30

Group (audited) As at 30 September 2019	Total loans and advances subject to forbearance measures			Impairment allowance on loans and advances subject to forbearance measures	
	Number of customers	Gross carrying amount £m	% of total portfolio	Impairment allowance £m	Coverage %
Term extension	187	153	1.93	14.9	9.70
Deferral of contracted capital repayments	98	134	1.68	15.0	11.16
Reduction in contracted interest rate	3	1	0.02	-	3.37
Alternative forms of payment	2	7	0.08	0.4	5.37
Debt forgiveness	2	4	0.05	-	1.06
Refinancing	16	10	0.12	1.5	15.03
Covenant breach/reset/waiver	60	200	2.50	23.6	11.82
Total business forbearance	368	509	6.38	55.4	10.87

CREDIT RISK (continued)

Business forbearance (continued)

The number of business customers granted forbearance as at 30 September 2020 remained at 368, with the associated gross carrying value increasing by £30m (6%). Customers within the forbearance portfolio have received £23m of COVID-19 related support loans: £17m CBIL and £6m BBL. In addition, business customers have been supported with 63 Capital Repayment Holidays (CRH) accounting for £147m of the exposure, with two customers (£29m exposure) being granted a second CRH. There are only seven newly forborne connections (£1.7m exposure) where the impact of COVID-19 is the primary driver of trading deterioration.

The table incudes a portfolio of financial assets at fair value. The gross value of fair value loans subject to forbearance as at 30 September 2020 is £7m (30 September 2019: £8m), representing 0.08% of the total business portfolio (30 September 2019: 0.11%). The credit risk adjustment on these amounts totalled £0.7m (30 September 2019: £0.6m), a coverage of 9.77% (30 September 2019: 6.94%).

The contractual amount outstanding on loans and advances that were written off during the reporting year or still subject to enforcement activity was £4.1m.

Collateral

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;
- 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.

Mortgage lending by average LTV

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

September 2020	**Stage 1**			**Stage 2**			**Stage 3**[2]			**Total**		
LTV[1]	**Loans £m**	**%**	**ECL £m**	**Loans £m**	**%**	**ECL £m**	**Loans £m**	**%**	**ECL £m**	**Loans £m**	**%**	**ECL £m**
Less than 50%	18,495	37%	2	2,705	33%	6	214	41%	4	21,414	37%	12
50% to 75%	23,215	46%	5	3,754	46%	40	192	37%	6	27,161	46%	51
76% to 80%	2,896	6%	1	641	8%	12	33	7%	2	3,570	6%	15
81% to 85%	2,336	5%	2	437	6%	12	21	4%	2	2,794	5%	16
86% to 90%	2,131	4%	2	428	5%	15	19	4%	2	2,578	4%	19
91% to 95%	798	2%	1	170	2%	8	9	2%	1	977	2%	10
96% to 100%	56	0%	0	21	0%	1	6	1%	1	83	0%	2
Greater than 100%	43	0%	1	10	0%	1	22	4%	4	75	0%	6
	49,970	100%	**14**	**8,166**	100%	**95**	**516**	100%	**22**	**58,652**	100%	**131**

CREDIT RISK (continued)

Mortgage lending by average LTV (continued)

September 2019	Stage 1			Stage 2			Stage 3[2]			Total		
LTV[1]	Loans £m	%	ECL £m	Loans £m	%	ECL £m	Loans £m	%	ECL £m	Loans £m	%	ECL £m
Less than 50%	21,644	37%	1	682	38%	1	195	42%	3	22,521	37%	5
50% to 75%	26,778	46%	2	816	45%	4	177	38%	8	27,771	46%	14
76% to 80%	3,518	6%	1	117	7%	1	23	5%	2	3,658	6%	4
81% to 85%	2,635	5%	1	75	4%	1	22	5%	3	2,732	5%	5
86% to 90%	2,382	4%	1	73	4%	1	12	3%	2	2,467	4%	4
91% to 95%	1,016	2%	-	29	2%	1	9	2%	2	1,054	2%	3
96% to 100%	79	0%	-	5	0%	-	7	1%	1	91	0%	1
Greater than 100%	68	0%	-	8	0%	-	21	4%	4	97	0%	4
	58,120	100%	6	1,805	100%	9	466	100%	25	60,391	100%	40

(1) LTV of the mortgage portfolio is defined as mortgage portfolio weighted by balance. Currently the Clydesdale Bank PLC portfolio is indexed using the MIAC Acadametrics indices at a given date, while the Virgin Money Holdings (UK) PLC portfolio is indexed using the Markit indices. The Group view is a combined summary of the two portfolios.

(2) Stage 3 includes £86m of purchased or originated credit impaired (POCI) gross loans and advances (2019: £101m).

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 CRM and after Credit Conversion Factors (CCFs) 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.

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 CRM and after CCFs 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 this is disclosed elsewhere in this section.

Group (audited) 2020 Exposure classes	**Cash £m**	**Guarantees £m**	**Netting £m**	**Debt Securities £m**	**Other physical collateral £m**	**Receivables £m**	**Total £m**	**Exposure £m**
Corporates	8	926	76	-	487	648	2,145	2,359
Total IRB approach	8	926	76	-	487	648	2,145	2,359
Central governments or	5,410	-	-	-	-	-	5,410	7,420
Regional governments or	-	-	155	-	-	-	155	155
Financial institutions	-	-	-	295	-	-	295	360
Corporates	-	170	-	-	-	-	170	170
Exposures in default	-	1	-	-	-	-	1	1
Total Standardised approach	**5,410**	**171**	**155**	**295**	**-**	**-**	**6,031**	**8,106**
Total	**5,418**	**1,097**	**231**	**295**	**487**	**648**	**8,176**	**10,465**

Risk report (continued)

CREDIT RISK (continued)

Group (audited) 2019 Exposure classes	Cash £m	Guarantees £m	Netting £m	Debt Securities £m	Total £m	Exposure £m
Corporates	12	-	69	-	81	203
Total IRB approach	12	-	69	-	81	203
Central governments or central banks	3,809	-	-	-	3,809	5,695
Regional governments or local authorities	-	-	110	-	110	110
Institutions	-	-	-	304	304	360
Corporates	4	6	-	-	10	10
Secured by mortgages on residential real estate	-	-	-	-	-	2
Secured by mortgages on commercial real estate	-	-	-	-	-	1
Exposures in default	-	-	-	-	-	-
Total Standardised approach	3,813	6	110	304	4,233	6,178
Total	3,825	6	179	304	4,314	6,381

The increase in cash collateral held and corresponding exposure is due to movements within the liquid asset portfolio and similar transactions outstanding at 30 September 2020 (including Term Funding Scheme (TFS) drawings), reflected within central governments or central banks. The debt securities collateral held continues to be in relation to a repo where UK Gilts were placed as security.

Lending backed by government guarantees in response to COVID-19 can be seen within the Guarantee column.

Following PRA approval during the year, the Group moved to recognise Asset Finance and Invoice Finance collateral, being other physical collateral and receivables respectively, as being eligible collateral from a CRM perspective in relation to the Foundation internal ratings-based (FIRB) approach.

Corporates is the largest sector utilising other risk mitigation techniques, with all five 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)

Credit quality of loans and advances as at 30 September 2020 (audited)

The following tables highlight the distribution of the Group's gross loans and advances, ECL and coverage by IFRS 9 stage allocation**.**

Gross Loans and advances[1] ECL and coverage

At 30 September 2020			***Personal***									
	Mortgages		***Cards***		***Loans & Overdrafts***		***Combined***		**Business[2]**		**Total**	
	£m	**%**	***£m***	***%***	***£m***	***%***	***£m***	***%***	**£m**	**%**	**£m**	**%**
Gross loans and advances [1]												
Stage 1	49,970	85.2%	3,893	87.2%	767	70.6%	*4,660*	*84.0%*	4,589	52.6%	59,219	81.2%
Stage 2 < 30 DPD	*7,976*	*13.6%*	*512*	*11.4%*	*298*	*27.4%*	*810*	*14.6%*	*3,843*	*44.1%*	*12,629*	17.3%
Stage 2 > 30 DPD	*190*	*0.3%*	*7*	*0.2%*	*6*	*0.6%*	*13*	*0.2%*	*10*	*0.1%*	*213*	0.3%
Stage 2 - total	8,166	13.9%	519	11.6%	304	28.0%	*823*	*14.8%*	3,853	44.2%	12,842	17.6%
Stage 3 (Inc POCI)[3]	516	0.9%	52	1.2%	15	1.4%	*67*	*1.2%*	279	3.2%	862	1.2%
	58,652	**100.0%**	**4,464**	**100.0%**	**1,086**	**100.0%**	***5,550***	***100.0%***	**8,721**	**100.0%**	**72,923**	**100.0%**
ECLs												
Stage 1	14	10.7%	48	21.6%	22	27.8%	*70*	*23.3%*	52	17.1%	136	18.5%
Stage 2 < 30 DPD	*84*	*64.1%*	*141*	*63.5%*	*44*	*55.7%*	*185*	*61.4%*	*176*	*58.1%*	*445*	60.6%
Stage 2 > 30 DPD	*11*	*8.4%*	*6*	*2.7%*	*3*	*3.8%*	*9*	*3.0%*	*-*	*0.0%*	*20*	2.7%
Stage 2 - total	95	72.5%	147	66.2%	47	59.5%	194	64.4%	176	58.1%	465	63.3%
Stage 3 (Inc POCI) [3]	22	16.8%	27	12.2%	10	12.7%	*37*	*12.3%*	75	24.8%	134	18.2%
	131	**100.0%**	**222**	**100.0%**	**79**	**100.0%**	***301***	***100.0%***	**303**	**100.0%**	**735**	**100.0%**
Coverage												
Stage 1	0.03%		1.34%		3.22%		*1.64%*		1.42%		0.24%	
Stage 2 < 30 DPD	*1.06%*		*29.73%*		*16.67%*		*25.03%*		*4.60%*		*3.56%*	
Stage 2 > 30 DPD	*5.98%*		*76.86%*		*74.28%*		*75.83%*		*5.12%*		*9.73%*	
Stage 2 - total	1.17%		30.40%		17.64%		*25.81%*		4.61%		3.66%	
Stage 3 (Inc POCI) [3]	4.31%		57.48%		79.43%		*62.05%*		26.77%		15.74%	
	0.23%		**5.37%**		**8.24%**		***5.91%***		**3.91%**		**1.03%**	

(1) Excludes loans designated at FVTPL, balances due from customers on acceptances, accrued interest and deferred and unamortised fee income.
(2) Business coverage has been adjusted to exclude government-backed loans
(3) Stage 3 includes POCI for gross loans and advances of £86m for Mortgages and £4m Personal; and ECL of £Nil for Mortgages and (£2m) for Personal.

Risk report (continued)

CREDIT RISK (continued)

Gross Loans and advances[1] ECL and coverage (continued)

At 30 September 2019			Personal									
	Mortgages		*Cards*		*Loans & Overdrafts*		*Combined*		Business		Total	
	£m	%	£m	%	£m	%	*£m*	*%*	£m	%	£m	%
Gross loans and advances[1]												
Stage 1	58,120	96.2%	3,806	89.8%	981	94.2%	*4,787*	*90.7%*	5,016	66.2%	67,923	92.7%
Stage 2 < 30 DPD	*1,637*	*2.7%*	*353*	*8.3%*	*39*	*3.7%*	*392*	*7.4%*	*2,280*	*30.1%*	*4,309*	5.9%
Stage 2 > 30 DPD	*168*	*0.3%*	*25*	*0.6%*	*7*	*0.7%*	*32*	*0.6%*	*5*	*0.1%*	*205*	0.3%
Stage 2 - total	1,805	3.0%	378	8.9%	46	4.4%	*424*	*8.0%*	2,285	30.2%	4,514	6.2%
Stage 3 (Inc POCI)[2]	466	0.8%	54	1.3%	15	1.4%	*69*	*1.3%*	272	3.6%	807	1.1%
	60,391	100.0%	4,238	100.0%	1,042	100.0%	*5,280*	*100.0%*	7,573	100.0%	73,244	100.0%
ECLs												
Stage 1	6	15.0%	42	29.0%	11	36.7%	*53*	*30.3%*	20	13.6%	79	21.8%
Stage 2 < 30 DPD	*5*	*12.5%*	*65*	*44.8%*	*6*	*20.0%*	*71*	*40.6%*	*72*	*49.0%*	*148*	40.9%
Stage 2 > 30 DPD	*4*	*10.0%*	*12*	*8.3%*	*4*	*13.3%*	*16*	*9.1%*	*-*	*0.0%*	*20*	5.5%
Stage 2 - total	9	22.5%	77	53.1%	10	33.3%	87	49.7%	72	49.0%	168	46.4%
Stage 3 (Inc POCI)[2]	25	62.5%	26	17.9%	9	30.0%	*35*	*20.0%*	55	37.4%	115	31.8%
	40	100.0%	145	100.0%	30	100.0%	*175*	*100.0%*	147	100.0%	362	100.0%
Coverage												
Stage 1	0.01%		1.11%		1.30%		*1.11%*		0.40%		0.12%	
Stage 2 < 30 DPD	*0.29%*		*18.49%*		*15.55%*		*18.22%*		*3.13%*		*3.41%*	
Stage 2 > 30 DPD	*2.26%*		*46.91%*		*67.99%*		*51.18%*		*2.27%*		*9.68%*	
Stage 2 - total	0.47%		20.35%		23.16%		*20.64%*		31.30%		3.69%	
Stage 3 (Inc POCI)[2]	5.36%		48.15%		67.90%		*50.72%*		19.99%		14.25%	
	0.07%		3.42%		3.22%		*3.39%*		1.93%		0.50%	

(1) Excludes loans designated at FVTPL, balances due from customers on acceptances, accrued interest and deferred and unamortised fee income.
(2) Stage 3 includes POCI for gross loans and advances of £103m for Mortgages and £8m Personal; and ECL of (£1m) for Mortgages and (£2m) for Personal.

Risk report (continued)

CREDIT RISK (continued)

Stage 2 balances

There can be a number of reasons that require a financial asset to be subject to a Stage 2 lifetime ECL calculation other than reaching the 30 DPD backstop. The following table highlights the relevant trigger point leading to a financial asset that is not >30 DPD being in Stage 2:

At 30 September 2020			**Personal**									
	Mortgages		***Cards***		***Loans & Overdrafts***		***Combined***		**Business**		**Total**	
	£m	**%**	**£m**	**%**	**£m**	**%**	***£m***	**%**	**£m**	**%**	**£m**	**%**
PD deterioration	7,085	87%	342	66%	293	96%	*635*	77%	2,881	75%	10,601	82%
Forbearance	*174*	*2%*	*14*	*3%*	*3*	*1%*	*17*	*2%*	*353*	*9%*	544	*4%*
AFD or Watch List(1)	*13*	*0%*	*-*	*0%*	*-*	*0%*	*-*	*0%*	*586*	*15%*	599	*5%*
> 30 DPD	190	2%	7	1%	6	2%	*13*	2%	10	0%	213	2%
Other(2)	704	9%	156	30%	2	1%	*158*	19%	23	1%	885	7%
	8,166	**100%**	**519**	**100%**	**304**	**100%**	***823***	**100%**	**3,853**	**100%**	**12,842**	**100%**
ECLs												
PD deterioration	65	68%	86	59%	42	89%	*128*	66%	103	58%	296	64%
Forbearance	3	3%	*5*	*3%*	*2*	*5%*	*7*	*4%*	*31*	*18%*	41	*9%*
AFD or Watch List(1)	-	0%	*-*	*0%*	*-*	*0%*	*-*	*0%*	*37*	*21%*	37	*8%*
>30 DPD	11	12%	6	4%	3	6%	*9*	5%	-	0%	20	4%
Other(2)	16	17%	50	34%	-	0%	*50*	25%	5	3%	71	15%
	95	**100%**	**147**	**100%**	**47**	**100%**	***194***	**100%**	**176**	**100%**	**465**	**100%**

At 30 September 2019			Personal									
	Mortgages		*Cards*		*Loans & Overdrafts*		*Combined*		Business		Total	
	£m	%	£m	%	£m	%	*£m*	%	£m	%	£m	%
PD deterioration	809	45%	137	36%	35	76%	*172*	41%	1,512	66%	2,493	55%
Forbearance	*214*	*12%*	*6*	*2%*	*3*	*7%*	*9*	*2%*	*292*	*13%*	515	*11%*
AFD or Watch List(1)	*13*	*1%*	*-*	*0%*	*-*	*0%*	*-*	*0%*	*446*	*20%*	459	*10%*
>30 DPD	168	9%	25	7%	7	15%	*32*	8%	5	0%	205	5%
Other(2)	601	33%	210	55%	1	2%	*211*	49%	30	1%	842	19%
	1,805	100%	378	100%	46	100%	*424*	100%	2,285	100%	4,514	100%
ECLs												
PD deterioration	3	33%	25	32%	5	50%	*30*	35%	33	46%	66	39%
Forbearance	*1*	*11%*	*1*	*1%*	*1*	*10%*	*2*	*2%*	*17*	*24%*	20	*12%*
AFD or Watch List(1)	*-*	*0%*	*-*	*0%*	*-*	*0%*	*-*	*0%*	*19*	*26%*	19	*11%*
> 30 DPD	4	45%	12	16%	4	40%	*16*	18%	-	0%	20	12%
Other(2)	1	11%	39	51%	-	0%	*39*	45%	3	4%	43	26%
	9	100%	77	100%	10	100%	*87*	100%	72	100%	168	100%

(1) Approaching Financial Difficulty (AFD) and Watch markers are early warning indicators of customers who may be approaching financial difficulties. If these indicators are not reversed they may lead to a requirement for more proactive management by the Group.

(2) Other includes eCRS (internal rating scale) changes as well as a number of smaller value drivers.

Risk report (continued)

CREDIT RISK (continued)

Credit risk exposure, by internal PD rating, by IFRS 9 stage allocation (audited)

The distribution of the Group's credit exposures by internal PD rating is analysed below:

As at 30 September 2020		**Stage 1 £m**	**Stage 2 £m**	**Stage 3[(1)] £m**	**Total £m**
Mortgages	**PD Range**				
Strong	0 - 0.74	44,038	3,785	-	47,823
Good	0.75 - 2.49	5,246	2,879	-	8,125
Satisfactory	2.50 - 99.99	686	1,502	-	2,188
Default	100	-	-	516	516
Total		49,970	8,166	516	58,652
Personal					
Strong	0 - 2.49	4,144	183	-	4,327
Good	2.50 - 9.99	500	478	-	978
Satisfactory	10.00 - 99.99	16	162	-	178
Default	100	-	-	67	67
Total		4,660	823	67	5,550
Business					
Strong	0 - 0.74	791	150	-	941
Good	0.75 - 9.99	3,674	2,733	-	6,407
Satisfactory	10.00 - 99.99	124	970	-	1,094
Default	100	-	-	279	279
Total		4,589	3,853	279	8,721

(1) Stage 3 includes £90m of POCI, £86m Mortgages, £4m Cards.

As at 30 September 2019		Stage 1 £m	Stage 2 £m	Stage 3[(1)] £m	Total £m
Mortgages	**PD Range**				
Strong	0 - 0.74	55,057	833	-	55,890
Good	0.75 - 2.49	2,648	455	-	3,103
Satisfactory	2.50 - 99.99	415	517	-	932
Default	100	-	-	466	466
Total		58,120	1,805	466	60,391
Personal					
Strong	0 - 2.49	4,197	50	0	4,247
Good	2.50 - 9.99	553	231	0	784
Satisfactory	10.00 - 99.99	37	143	0	180
Default	100	0	0	69	69
Total		4,787	424	69	5,280
Business					
Strong	0 - 0.74	2,225	175	0	2,400
Good	0.75 - 9.99	2,789	1,938	0	4,727
Satisfactory	10.00 - 99.99	2	172	0	174
Default	100	-	-	272	272
Total		5,016	2,285	272	7,573

(1) Stage 3 includes £111m of POCI, £103m Mortgages, £8m Cards.

Risk report (continued)

CREDIT RISK (continued)

Reconciliation of movement in gross balances and impairment loss allowance

The following tables explain the changes in the loss allowance and gross carrying value of the portfolios between 30 September 2019 and 30 September 2020. Values are calculated using the individual customer account balances, and the stage allocation is taken as at the end of each month. The monthly position of each account is aggregated to report a net closing position for the year, thereby incorporating all movements an account has made during the year.

	Stage 1		Stage 2		Stage 3[1]			
September 2020	**Gross Loans £m**	**ECL £m**	**Gross Loans £m**	**ECL £m**	**Gross Loans £m**	**ECL £m**	**Total Gross Loans £m**	**Total Provisions £m**
Opening balance at 1 October 2019	67,923	79	4,514	168	807	115	73,244	362
Transfers from Stage 1 to Stage 2	(14,970)	(81)	9,511	436	-	-	(5,459)	355
Transfers from Stage 2 to Stage 1	5,032	37	(2,813)	(190)	-	-	2,219	(153)
Transfers to Stage 3	(102)	(1)	(328)	(84)	384	129	(46)	44
Transfers from Stage 3	44	-	76	9	(93)	(18)	27	(9)
Changes to model methodology	24	(8)	(24)	(6)	-	-	-	(14)
New assets originated or purchased	18,380	96	1,349	90	150	15	19,879	201
Repayments and other movements	(3,454)	67	2,304	150	40	(49)	(1,110)	167
Repaid or derecognised	(13,658)	(53)	(1,747)	(108)	(267)	(63)	(15,672)	(224)
Write offs	-	-	-	-	(159)	(159)	(159)	(158)
Cash recoveries	-	-	-	-	-	25	-	25
Individually assessed impairment charge	-	-	-	-	-	139	-	139
Closing balance at 30 September 2020	**59,219**	**136**	**12,842**	**465**	**862**	**134**	**72,923**	**735**

(1) Stage 3 includes POCI for gross loans and advances of £86m for Mortgages and £4m Personal; and ECL of £Nil for Mortgages and (£2m) for Personal

MORTGAGES								
Opening balance at 1 October 2019	58,120	6	1,805	9	466	25	60,391	40
Transfers from Stage 1 to Stage 2	(10,390)	(10)	4,976	75	-	-	(5,414)	65
Transfers from Stage 2 to Stage 1	3,525	3	(1,260)	(17)	-	-	2,265	(14)
Transfers to Stage 3	(63)	-	(69)	(6)	86	13	(46)	7
Transfers from Stage 3	38	-	24	3	(34)	(6)	28	(3)
Changes to model methodology	-	-	-	-	-	-	-	-
New assets originated or purchased	6,981	1	16	-	3	-	7,000	1
Repayments and other movements	(2,018)	15	2,784	32	32	(6)	798	41
Repaid or derecognised	(6,223)	(1)	(110)	(1)	(34)	(4)	(6,367)	(6)
Write offs	-	-	-	-	(3)	(3)	(3)	(3)
Cash recoveries	-	-	-	-	-	-	-	-
Individually assessed impairment charge	-	-	-	-	-	3	-	3
Closing balance at 30 September 2020	**49,970**	**14**	**8,166**	**95**	**516**	**22**	**58,652**	**131**

Risk report (continued)

CREDIT RISK (continued)

Reconciliation of movement in gross balances and impairment loss allowance (continued)

September 2020 PERSONAL	Stage 1 Gross Loans £m	Stage 1 ECL £m	Stage 2 Gross Loans £m	Stage 2 ECL £m	Stage 3 Gross Loans £m	Stage 3 ECL £m	Total Gross Loans £m	Total Provisions £m
Opening balance at 1 October 2019	4,787	53	424	87	69	35	5,280	175
Transfers from Stage 1 to Stage 2	(1,326)	(47)	1,356	270	-	-	30	223
Transfers from Stage 2 to Stage 1	723	29	(768)	(151)	-	-	(45)	(122)
Transfers to Stage 3	(23)	(1)	(110)	(65)	135	96	2	30
Transfers from Stage 3	2	-	3	2	(6)	(5)	(1)	(3)
Changes to model methodology	24	(8)	(24)	(6)	-	-	-	(14)
New assets originated or purchased	1,621	26	5	1	1	-	1,627	27
Repayments and other movements	(925)	23	(45)	62	36	(52)	(934)	33
Repaid or derecognised	(223)	(5)	(18)	(6)	(40)	(36)	(281)	(47)
Write offs	-	-	-	-	(128)	(128)	(128)	(128)
Cash recoveries	-	-	-	-	-	23	-	23
Individually assessed impairment charge	-	-	-	-	-	104	-	104
Closing balance at 30 September 2020	**4,660**	**70**	**823**	**194**	**67**	**37**	**5,550**	**301**
BUSINESS								
Opening balance at 1 October 2019	5,016	20	2,285	72	272	55	7,573	147
Transfers from Stage 1 to Stage 2	(3,254)	(24)	3,179	91	-	-	(75)	67
Transfers from Stage 2 to Stage 1	784	5	(785)	(22)	-	-	(1)	(17)
Transfers to Stage 3	(16)	-	(149)	(13)	163	20	(2)	7
Transfers from Stage 3	4	-	49	4	(53)	(7)	-	(3)
Changes to model methodology	-	-	-	-	-	-	-	-
New assets originated or purchased	9,778	69	1,328	89	146	15	11,252	173
Repayments and other movements	(511)	29	(435)	56	(28)	9	(974)	94
Repaid or derecognised	(7,212)	(47)	(1,619)	(101)	(193)	(23)	(9,024)	(171)
Write offs	-	-	-	-	(28)	(28)	(28)	(28)
Cash recoveries	-	-	-	-	-	2	-	2
Individually assessed impairment charge	-	-	-	-	-	32	-	32
Closing balance at 30 September 2020	**4,589**	**52**	**3,853**	**176**	**279**	**75**	**8,721**	**303**

Risk report (continued)

CREDIT RISK (continued)

Reconciliation of movement in gross balances and impairment loss allowance (continued)

	Stage 1		Stage 2		Stage 3[1]			
September 2019	Gross Loans £m	ECL £m	Gross Loans £m	ECL £m	Gross Loans £m	ECL £m	Total Gross Loans £m	Total Provisions £m
Opening balance at 1 October 2018	29,454	53	2,897	86	564	85	32,915	224
Transfers from Stage 1 to Stage 2	(6,552)	(60)	6,570	257	-	-	18	197
Transfers from Stage 2 to Stage 1	3,619	17	(3,650)	(98)	-	-	(31)	(81)
Transfers to Stage 3	(153)	(2)	(496)	(82)	650	125	1	41
Transfers from Stage 3	41	-	128	6	(175)	(18)	(6)	(12)
Changes to model methodology	(1,752)	(5)	(32)	(6)	-	-	(1,784)	(11)
New assets originated or purchased	57,236	152	1,004	65	46	7	58,286	224
Repayments and other movements	(984)	(23)	(268)	17	92	(12)	(1,160)	(18)
Repaid or derecognised	(12,986)	(53)	(1,639)	(77)	(233)	(15)	(14,858)	(145)
Write offs	-	-	-	-	(137)	(199)	(137)	(199)
Cash recoveries	-	-	-	-	-	28	-	28
Individually assessed impairment charge	-	-	-	-	-	114	-	114
Closing balance at 30 September 2019	67,923	79	4,514	168	807	115	73,244	362

(1) Stage 3 includes POCI for gross loans and advances of £103m for Mortgages and £8m Personal; and ECL of (£1m) for Mortgages and (£2m) for Personal.

MORTGAGES								
Opening balance at 1 October 2018	23,572	3	689	3	279	23	24,540	29
Transfers from Stage 1 to Stage 2	(3,851)	(4)	3,835	22	-	-	(16)	18
Transfers from Stage 2 to Stage 1	2,393	1	(2,401)	(9)	-	-	(8)	(8)
Transfers to Stage 3	(92)	(1)	(185)	(4)	276	11	(1)	6
Transfers from Stage 3	29	-	72	1	(105)	(4)	(4)	(3)
Changes to model methodology	-	-	-	-	-	-	-	-
New assets originated or purchased.	44,730	8	3	-	138	-	44,871	8
Repayments and other movements	(2,412)	-	(48)	(3)	(31)	(1)	(2,491)	(4)
Repaid or derecognised	(6,249)	(1)	(160)	(1)	(83)	(2)	(6,492)	(4)
Write offs	-	-	-	-	(8)	(3)	(8)	(3)
Cash recoveries	-	-	-	-	-	-	-	-
Individually assessed impairment charge	-	-	-	-	-	1	-	1
Closing balance at 30 September 2019	58,120	6	1,805	9	466	25	60,391	40

Risk report (continued)

CREDIT RISK (continued)

Reconciliation of movement in gross balances and impairment loss allowance (continued)

September 2019	Stage 1 Gross Loans £m	Stage 1 ECL £m	Stage 2 Gross Loans £m	Stage 2 ECL £m	Stage 3 Gross Loans £m	Stage 3 ECL £m	Total Gross Loans £m	Total Provisions £m
PERSONAL								
Opening balance at 1 October 2018	1,143	15	38	12	22	18	1,203	45
Transfers from Stage 1 to Stage 2	(931)	(48)	970	194	-	-	39	146
Transfers from Stage 2 to Stage 1	403	12	(422)	(70)	-	-	(19)	(58)
Transfers to Stage 3	(28)	(1)	(95)	(56)	125	91	2	34
Transfers from Stage 3	3	-	2	1	(7)	(6)	(2)	(5)
Changes to model methodology	32	(1)	(32)	(6)	-	-	-	(7)
New assets originated or purchased	4,429	85	2	-	1	1	4,432	86
Repayments and other movements	(20)	(5)	(24)	17	36	(4)	(8)	8
Repaid or derecognised	(244)	(4)	(15)	(5)	(8)	(6)	(267)	(15)
Write offs	-	-	-	-	(100)	(165)	(100)	(165)
Cash recoveries	-	-	-	-	-	27	-	27
Individually assessed impairment charge	-	-	-	-	-	79	-	79
Closing balance at 30 September 2019	4,787	53	424	87	69	35	5,280	175
BUSINESS								
Opening balance at 1 October 2018	4,739	35	2,170	71	263	44	7,172	150
Transfers from Stage 1 to Stage 2	(1,770)	(8)	1,765	41	-	-	(5)	33
Transfers from Stage 2 to Stage 1	823	4	(827)	(19)	-	-	(4)	(15)
Transfers to Stage 3	(33)	-	(216)	(22)	249	23	-	1
Transfers from Stage 3	9	-	54	4	(63)	(8)	-	(4)
Changes to model methodology	(1,784)	(4)	-	-	-	-	(1,784)	(4)
New assets originated or purchased	8,077	59	999	65	44	6	9,120	130
Repayments and other movements	1,448	(18)	(196)	3	(50)	(7)	1,202	(22)
Repaid or derecognised	(6,493)	(48)	(1,464)	(71)	(142)	(7)	(8,099)	(126)
Write offs	-	-	-	-	(29)	(31)	(29)	(31)
Cash recoveries	-	-	-	-	-	1	-	1
Individually assessed impairment charge	-	-	-	-	-	34	-	34
Closing balance at 30 September 2019	5,016	20	2,285	72	272	55	7,573	147

Transfer from Stage 1 to Stage 2 (non-credit impaired)
A lifetime ECL calculation is required where an asset has been assessed as experiencing a SICR, as determined by the Group's staging criteria. The non-credit impaired movements are classed as Stage 2.

Transfer from Stage 2 to Stage 1
A 12-month ECL calculation is required where an asset, that had previously been classed as Stage 2, reverts back to the conditions observed at the initial credit assessment.

Risk report (continued)

CREDIT RISK (continued)

Reconciliation of movement in gross balances and impairment loss allowance (continued)

Transfer to Stage 3
A lifetime ECL calculation is required where an asset has been assessed as experiencing a SICR, as determined by the Group's staging criteria. The credit impaired movements are classed as Stage 3.

Transfer from Stage 3
Where an asset, that had previously been classed at Stage 3, has either; (i) reverted back to the conditions observed at the initial credit assessment where a 12-month ECL should be calculated, or (ii) no longer meets the criteria for Stage 3 but does meet the criteria for Stage 2, it is transferred to that category.

Changes in model methodology
ECL value changes resulting from a change to an underlying model methodology.

New assets originated or purchased
The balance and ECL calculated on newly opened or originated assets. Assets where the term has ended, and a new facility has been provided are reported as new assets.

Repayments and other movements
Movements due to customer repayment and other minor movements not captured under any other category.

Repaid or derecognised (excluding write-offs)
ECL impact from customer repayment or derecognition of all or part of an asset, other than that resulting from a write-off.

Write-offs
ECL impact due to the reduction of all, or part, of an asset balance due to a write-off approved by the Group. ECL release may appear higher than the asset balance on some occasions as a result of the initial ECL lifetime being released, in addition to the individually assessed provision applied for the asset balance write-off.

Cash recoveries
ECL impact of payments received on assets that had previously been written off.

Individually assessed impairment charge
The income statement charge where an individually assessed provision has been recognised or a direct write-off has been applied to an asset balance and reported separately from the Stage 3 provision.

Scenarios, weightings and macroeconomic assumptions

The Group's allowance for ECL's at 30 September 2020 was £735m (30 September 2019: £362m).

Macroeconomic assumptions
A range of future macro-economic conditions is used in the scenarios over the five-year forecast period, reflecting the best estimate of future conditions under each scenario. The Group has identified the following key macroeconomic conditions as the most significant inputs for IFRS 9 modelling purposes: UK GDP growth, inflation, house prices, base rates, and unemployment rates. These are assessed and reviewed on a quarterly basis to ensure appropriateness and relevance to the ECL calculation. The output of the models is then supplemented by PMAs when it is considered that not all the risks identified in a product segment have been accurately reflected within the models.

The shock to the economy as a result of COVID-19 has been faster and more severe than any in history. This has put increased emphasis on the IFRS 9 models and the impact of the forward-looking multiple macroeconomic scenarios on ECLs. As a result, the Group has reassessed the possible IFRS 9 scenarios to select appropriate scenarios and weightings. The scenario weightings are considered and debated by an internal review panel and then recommended and approved for use in the IFRS 9 models by the Asset and Liability Committee (ALCO).

Risk report (continued)

CREDIT RISK (continued)

Scenarios, weightings and macroeconomic assumptions (continued)

The three scenarios selected, together with the weightings applied, have been updated to reflect the current economic environment:

Scenario	2020 (%)	2019 (%)
Upside	5	20
Base	50	60
Downside	45	20

The 'Upside' scenario has been reduced to a 5% weighting as it is considered to be overly optimistic in the current economic environment and the medium-term outlook. The decrease in the level of weighting applied to the 'Base' scenario is reflective of the severity of the impact of COVID-19 on the UK economy and the subsequent view that a larger share of the weightings should be focused on the downside scenario.

Upside (5%)

This reflects the unprecedented collapse of GDP (20% year-on-year, based on Q2 of the calendar year). The resultant effect is a predicted annual reduction of 10.8% in 2020. Public sector borrowing is expected to exceed 14% of GDP in the fiscal year 2020/21, lifting public debt to c. 110% of GDP in the near term before falling back to stabilise at c. 97% (the pre-crisis long run forecast was c. 80%).

Base (50%)

Growth in GDP is limited to an average of just 0.5% per annum for the next five years, which translates into around 4% lower than in the upside scenario by the end of the forecast period. Unemployment peaks at 8.8% and recovers slowly while property prices, and in particular commercial property prices, suffer sharp falls and only recover to pre-crisis levels towards the end of the scenario.

Downside (45%)

Demand shock from lockdown is compounded by financial crisis, with the slow pace of lifting lockdown restrictions weighing on sentiment, as investment decisions are delayed. The size of the deficit leads to the re-introduction of austerity measures, with output declining by c. 24% peak to trough and unemployment surging to 12%.

Within each portfolio, the following are the macroeconomic inputs which are more sensitive to change and therefore more likely to drive the move from Stage 1 to Stage 2 under a stress scenario:

- Business: GDP, Unemployment and Base Rate
- Personal: Unemployment and Inflation
- Mortgages: Unemployment, House Price Index (HPI) and Base Rate

Five-year simple averages and graphical illustrations for the most sensitive inputs of unemployment, GDP and HPI are:

	Unemployment %	GDP %	HPI %
At 30 September 2020			
Upside	**4.4**	**1.3**	**1.7**
Base	**6.5**	**0.5**	**(1.6)**
Downside	**7.4**	**(0.4)**	**(6.2)**
At 30 September 2019			
Upside	3.4	2.7	5.8
Base	3.8	1.8	2.9
Downside	5.8	0.2	(4.6)

The full range of the key macro-economic assumptions is included in the table on page 49.

CREDIT RISK (continued)

The use of estimates, judgements and sensitivity analysis

The following are the main areas where estimates and judgements are applied to the ECL calculation:

The use of estimates
Asset lifetimes
The calculation of the ECL allowance is dependent on the expected life of the Group's portfolios. The Group assumes the remaining contract term as the maximum period to consider credit losses wherever possible. For the Group's credit card and overdraft portfolios, behavioural factors such as observed retention rates and other portfolio level assumptions are taken into consideration in determining the estimated asset life.

Economic scenarios
The calculation of the Group's impairment provision is sensitive to changes in the chosen weightings as highlighted above. The effect on the closing modelled provision of each portfolio as a result of applying a 100% weighting to each of the selected scenarios is shown below:

30 September 2020

	Probability Weighted[(1)] **£m**	**Upside £m**	**Base £m**	**Downside £m**
Mortgages	**46**	**7**	**28**	**76**
Personal of which:	**190**	**162**	**183**	**204**
- Cards	**165**	**139**	**158**	**179**
- Personal loans and overdrafts	**25**	**23**	**25**	**25**
Business	**260**	**156**	**214**	**324**
Total	**496**	**325**	**425**	**604**

30 September 2019

	Probability Weighted £m	Upside £m	Base £m	Downside £m
Mortgages	16	14	14	25
Personal of which:	156	150	153	172
- Cards	131	125	128	146
- Personal loans and overdrafts	25	25	25	26
Business	94	75	88	134
Total	266	239	255	331

(1) In addition to the modelled provison shown in the table, the Group holds £186m relative to PMAs (2019: £49m) and £53m of individually assessed provision (2019: £47m).

One of the criteria for moving an exposure between stages is the PD which incorporates macroeconomic factors. As a result, the stage allocation will be different in each scenario and so the probability-weighted ECL cannot be recalculated using the scenario ECL provided and the scenario weightings.

Certain asset classes are less sensitive to specific macroeconomic factors, showing lower relative levels of sensitivity. To ensure appropriate levels of ECL, the relative lack of sensitivity is compensated for through the application of PMAs, further detail of which can be found on page 48.

Risk report (continued)

CREDIT RISK (continued)

The use of judgement

Significant increase in credit risk
Considerable judgement is required in determining the point at which a SICR has occurred, as this is the point at which a 12-month ECL is replaced by a lifetime ECL. The Group has developed a series of triggers that indicate where a SICR has occurred when assessing exposures for the risk of default occurring at each reporting date compared to the risk at origination. There is no single factor that influences this decision, rather a combination of different criteria that enables the Group to make an assessment based on the quantitative and qualitative information available. This includes the impact of forward-looking macroeconomic factors but excludes the existence of any collateral implications.

Indicators of a SICR include deterioration of the residual lifetime PD by set thresholds which are unique to each product portfolio, non-default forbearance programmes, and watch list status. The Group adopts the backstop position that a SICR will have taken place when the financial asset reaches 30 DPD. Customers who requested COVID-19 related support, including payment holidays, and who were not the subject of any wider SICR triggers or who were otherwise assessed as having the ability in the medium term to be viable and meet our risk appetite criteria, were not considered to have been granted forbearance or to have a SICR.

The Group does not have a set absolute threshold by which the PD would have to increase by in establishing that a SICR has occurred, and has established an approach with the required SICR threshold trigger varying on a portfolio basis according to the origination PD.

The table below illustrates this with reference to the Group's business and credit card portfolios:

		Origination PD	**SICR Trigger**
Business	Low origination PD	0.04%	0.23%
	High origination PD	10.09%	13.20%
Credit Card	Low origination PD	1.00%	23.86%
	High origination PD	11.00%	28.11%

Changes to the overall SICR thresholds can also impact staging, driving accounts into higher stages with the resultant impact on the ECL allowance:

	2020 (£m)	2019 (£m)
A 10% movement in the mortgage portfolio from Stage 1 to Stage 2	+18	+7
A 10% movement in the credit card portfolio from Stage 1 to Stage 2	+56	+ 52
A 10% movement in the business portfolio from Stage 1 to Stage 2	+11	+ 13
A PD stress which increases PDs upwards by 20% for all portfolios	+151	+ 54

Definition of default
The PD of a credit exposure is a key input to the measurement of the ECL allowance. Default occurs when there is evidence that a customer is experiencing significant financial difficulty which is likely to affect the ability to repay amounts due. The Group utilises the 90 DPD backstop for default purposes.

CREDIT RISK (continued)

The use of judgement (continued)

PMAs

The ECL provision is further impacted by judgements in the form of PMAs, which are judgements that increase the collectively assessed modelled output where the Group considers that not all of the known or potential future risks identified in a particular product segment have been accurately reflected within the models.

At 30 September 2020, £186m of PMAs (2019: £49m) are included within the balance sheet ECL provision of £735m (2019: £362m) and categorised as:

	2020	2019
	£m	£m
Mortgages	**75**	14
Personal	**111**	19
Business	**-**	16
Total	**186**	49

PMAs account for 57% of the mortgage ECL provision of £131m (2019: 35% of £40m) and 37% of the personal ECL provision of £301m (2019: 7% of £175m). The Group does not hold PMAs in relation to the Business portfolio. PMAs are assigned between Stages 1 and 2. PMAs are discussed in more detail in the divisional commentary on pages 24-28.

The key macroeconomic factors used in the scenarios and their weighted averages are[1]:

Scenario	Group weighting	Economic measure[1]	2020	2021	2022	2023	2024
		Base rate	0.2%	0.1%	0.1%	0.2%	0.4%
		Unemployment	5.5%	5.1%	3.9%	3.7%	3.6%
Upside	5%	GDP	(10.8%)	10.2%	3.5%	1.9%	1.8%
		Inflation	0.7%	1.2%	1.7%	1.8%	1.7%
		HPI	(4.2%)	(1.8%)	6.7%	4.0%	3.8%
		Base rate	0.2%	0.1%	0.1%	0.2%	0.3%
		Unemployment	6.1%	7.8%	6.3%	6.3%	6.0%
Base	50%	GDP	(14.0%)	7.9%	4.6%	2.1%	1.8%
		Inflation	(0.6%)	(0.2%)	2.0%	2.3%	1.2%
		HPI	(7.3%)	(8.5%)	1.5%	1.9%	4.1%
		Base rate	0.2%	(0.5%)	(0.5%)	(0.3%)	(0.3%)
		Unemployment	6.7%	10.0%	7.2%	6.8%	6.5%
Downside	45%	GDP	(16.9%)	5.0%	5.7%	2.0%	1.9%
		Inflation	(0.2%)	(1.4%)	1.0%	2.4%	0.8%
		HPI	(11.2%)	(15.6%)	(6.7%)	(2.2%)	4.8%
		Base rate	0.2%	(0.2%)	(0.2%)	(0.1%)	0.0%
		Unemployment	6.3%	8.6%	6.6%	6.4%	6.1%
Weighted average		GDP	(15.1%)	6.7%	5.1%	2.1%	1.9%
		Inflation	(0.4%)	(0.7%)	1.5%	2.3%	1.1%
		HPI	(8.9%)	(11.4%)	(1.9%)	0.2%	4.4%

(1) Economic assumptions are on a calendar year basis unless otherwise stated.

CREDIT RISK (continued)

Other credit risks

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

Offsetting of financial assets and liabilities

The Group reduces exposure to credit risk through central clearing for eligible derivatives and daily posting of cash collateral on such transactions as detailed in note 3.6 to the financial statements. The amounts offset on the balance sheet, as shown below, represent derivatives and variation margin collateral with central clearing houses which meet the criteria for offsetting under IAS 32. The table excludes financial instruments not subject to offset and that are only subject to collateral arrangements (e.g. loans and advances).

The Group enters into derivatives with various counterparties which are governed by industry-standard master netting agreements. The Group holds and provides collateral in respect of derivatives transactions covered by these agreements. The right to offset balances under these master netting agreements only arises in the event of non-payment or default and, as a result, these arrangements do not qualify for offsetting under IAS 32.

The 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

2020 (audited)				**Net amounts not offset in the balance sheet**		
	Gross Amounts	**Gross amounts offset in the balance sheet[1]**	**Net amounts presented on balance sheet[1]**	**Subject to master netting agreements instruments**	**Cash collateral pledged/ received**	**Net Amount**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**
Assets						
Derivative financial instruments[2]	423	(105)	318	(127)	(12)	179
Liabilities						
Derivative financial instruments[2]	1,063	(813)	250	(127)	(83)	40
Securities sold under repurchase agreement	-	-	-	-	-	-

Group

2019 (audited)				Net amounts not offset in the balance sheet		
	Gross Amounts	Gross amounts offset in the balance sheet[1]	Net amounts presented on balance sheet[1]	Subject to master netting agreements instruments	Cash collateral pledged/ received	Net Amount
	£m	£m	£m	£m	£m	£m
Assets						
Derivative financial instruments[2]	478	(112)	366	(70)	(8)	288
Liabilities						
Derivative financial instruments[2]	739	(466)	273	(70)	(190)	13
Securities sold under repurchase agreement	1,554	-	1,554	(1,554)	-	-

(1) Cash collateral amounts are limited to the net balance sheet exposure in order to exclude any over collateralisation. In addition to cash collateral, the Group holds securities collateral in respect of derivative transactions subject to master netting agreements of £522m (2019: £57m), which is not recognised on the balance sheet.

(2) Derivative financial instruments comprise both trading and hedging derivative assets and liabilities.

Risk report (continued)

CREDIT RISK (continued)

Offsetting of financial assets and liabilities (continued)

Bank

2020 (audited)

				Net amounts not offset in the balance sheet		
	Gross Amounts	**Gross amounts offset in the balance sheet[1]**	**Net amounts presented on balance sheet[1]**	**Subject to master netting agreements instruments**	**Cash Collateral Pledged/ Received**	**Net Amount**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**
Assets						
Derivative financial instruments[2]	239	(105)	134	(67)	(12)	55
Liabilities						
Derivative financial instruments[2]	1,063	(813)	250	(67)	(143)	40
Securities sold under repurchase agreement	-	-	-	-	-	-

Bank

2019 (audited)

				Net amounts not offset in the balance sheet		
	Gross Amounts	Gross amounts offset in the balance sheet [1]	Net amounts presented on balance sheet [1]	Subject to master netting agreements instruments	Cash Collateral Pledged/ Received	Net Amount
	£m	£m	£m	£m	£m	£m
Assets						
Derivative financial instruments[2]	554	(112)	442	(87)	(302)	53
Liabilities						
Derivative financial instruments[2]	757	(465)	292	(87)	(180)	25
Securities sold under repurchase agreement	1,554	-	1,554	(1,554)	-	-

(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)

FINANCIAL RISK

Financial risk covers several categories of risk which impact the manner in which the Group can support its customers in a safe and sound manner. They include capital risk, funding risk, liquidity risk, market risk, and pension risk. During the year, model risk was removed as a sub-category of financial risk and promoted to principal risk status.

CET1	Loan to deposit ratio (LDR)	LCR
14.4%	107%	140%

Risk appetite

The primary objective for the management of financial risks is to control the risk profile within approved risk limits, to maintain the confidence of the Group's customers and other stakeholders. Financial risks are also managed to protect current and future earnings from the impact of market volatility. The Group applies a prudent approach to financial risks in order to safeguard the ongoing strength and resilience of the balance sheet. These activities are all undertaken in a manner consistent with the Group's obligations under ring-fencing legislation and prudential rules.

Financial risk appetite is approved by the Board, with authority delegated to ALCO for subsequent implementation and monitoring. The Board has established a range of capital risk appetite measures including CET1, leverage and minimum holdings of capital. Measures for funding and liquidity risks consider the structure of the balance sheet, the Group's overall funding profile and compliance with the Overall Liquidity Adequacy Rule (OLAR). Board-approved risk appetite covers both regulatory and internal liquidity requirements and the need to maintain access to liquidity resources sufficient to accommodate outflows of funds in a range of stress scenarios over a one-month and three-month period.

The Group's participation in wholesale markets, along with its use of financial instruments, is to fund its banking activities and 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.

The Group's pension risk appetite is a component of the Group-wide RAS framework for the management of balance sheet risks and is considered in the context of potential capital impacts as a result of volatility in the Scheme's valuations.

Capital risk

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

Exposures

Capital risk exposures arise when the Group has insufficient capital resources to support its business activities or to meet regulatory capital requirements under normal operating conditions or stressed scenarios.

Measurement

The Group manages capital in accordance with prudential rules issued by the Prudential Regulation Authority (PRA) and the FCA, which are implemented through the CRD IV CRR regulatory framework. Pillar 1 capital requirements for the year ended 30 September 2020 are calculated in respect of credit risk, operational risk, market risk, counterparty credit risk and credit valuation adjustments. The capital requirements for retail mortgages are calculated using an advanced internal ratings based (AIRB) approach while the business portfolios use a FIRB approach. In March 2020, the Group received approval to move the specialised lending portfolio from the standardised approach to a slotting IRB basis. All other requirements are calculated using the standardised approach.

The Group obtained IRB accreditation for certain portfolios in October 2018 and the PRA has since released a final policy statement outlining its approach to implementing definition of default in line with EBA guidelines. Further to this, there are recommended changes to both PD and LGD model components relating directly to the calculation of risk-weighted capital requirements. In July 2020, the PRA announced their timeline to evaluate the approach of UK banks to the change in the definition of default calculation. Implementation for residential mortgage portfolios is expected to be in 2021 and by 1 January 2022 for all other exposure classes, subject to PRA approval.

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

The Group IRB framework looks at the customer and business PD along with loss severity (EAD and LGD). The outputs are used in the calculation of RWA, EL and IFRS 9 ECL. The IRB parameters and rating assessments are actively embedded in the following day-to-day processes:

- Credit approval – IRB models and parameters are used to assess the customer risk and IRB outputs are used to inform cut-off models that drive the lending decisions;
- Pricing – IRB outputs and estimates are used in the assessment of new products and portfolio pricing reviews;
- Risk appetite – IRB parameters are included in the assessment of models and are analysed to inform the Group's risk capacity and appetite; and
- Asset quality – IRB parameters are monitored to understand the product and segment performance of the Group's portfolios.

Regulatory capital developments

The regulatory landscape for capital is subject to a number of changes which leads to uncertainty on eventual outcomes.

Reconciling capital requirements and macroprudential buffers

On 6 July 2020, the PRA published policy statement 15/20, which updates the Pillar 2A capital framework to take account of the additional resilience associated with higher macroprudential buffer requirements in a standard risk environment. The PRA will make changes to Pillar 2A, where applicable, on or before 16 December 2020.

Capital Requirements Directive V (CRD V) and Capital Requirements Regulation II (CRR II)

On 16 July 2020, Her Majesty's Treasury (HMT) issued a consultation on aspects of CRD V that must be implemented before the end of the transition period for the UK leaving the EU. Items being consulted on include macro-prudential tools (O-SII buffer, Systemic Risk Buffer), holding companies and equal pay framework and enforcement. On 15 October 2020, HMT published a summary of responses to the consultation and laid draft legislation in Parliament.

On 31 July 2020, the PRA issued CP12/20 'CRD V' which set out proposed changes to the PRA's rules, supervisory statements and statements of policy to meet the objectives of CRD V. This consultation was focused on Pillar 2, remuneration, intermediate parent undertakings, governance, and third-country branch reporting.

On 20 October 2020, the PRA issued CP17/20 'CRD V: Further implementation'. This consultation is focused on: the approval and supervision of holding companies; measures to enhance supervisory requirements for interest rate risk in the banking book (IRRBB); revisions to the capital buffers framework; amendments to the definition of the maximum distributable amount that constrains a firm's distributions when it uses its capital buffers; and clarifying the quality of capital required to meet Pillar 2. It also covers CRR measures in respect of the process through which variable capital requirements may be applied to firms' real estate exposures, and the methods that may be used for prudential consolidation.

Based on the CRD V and CRR II requirements published in the EU Official Journal and the subsequent HMT/PRA releases, the Group does not anticipate a material impact on capital ratios.

FINANCIAL RISK (continued)

Capital risk (continued)

Basel III revisions

The Basel Committee published its final reforms to the Basel III framework in December 2017. The amendments include changes to the standardised approaches to credit and operational risks and the introduction of a new RWA output floor. The reforms are subject to a transition period from 2023 to 2028.

IRB approach to UK mortgage risk weights

In September 2020, the PRA issued Consultation Paper 14/20 'Internal Ratings Based UK mortgage risk weights: Managing deficiencies in model risk capture'. The proposals help address the PRA's view of prudential risks from "inappropriately low" IRB UK mortgage risk weights with the aim of:

- reducing the difference in standardised approach and IRB mortgage risk weights for current UK mortgages;
- placing a limit on future divergence; and
- reducing the variability of mortgage risk weights between those firms on the IRB approach for given levels of mortgage LTVs.

Key proposals from this are the introduction of the following floors:

- an individual mortgage risk weight of at least 7%; and
- an exposure-weighted average risk weight of at least 10% for an IRB UK mortgage portfolio as a whole.

Following consultation, the PRA's final policy is expected to take effect from 1 January 2022.

COVID-19 regulatory capital developments

There have been a number of regulatory capital developments in the UK and Europe in response to COVID-19. Key items relevant to the Group are set out below.

Government backed loan schemes

During the year, the Group participated in the various government backed loan schemes for businesses, in addition to offering payment holidays to both business and retail customers. These schemes have had a number of different impacts on the Group's financial risk profile which are discussed throughout this section. Further details are provided in the Credit risk section.

Revised timelines

In order to provide operational capacity for banks to respond to the immediate financial stability priorities resulting from the impact of COVID-19, both the PRA and Basel communicated revised timelines across key regulatory initiatives. The implementation of the Basel III revisions has been delayed by one year to 1 January 2023, and includes revisions to: the standardised approach to credit risk; IRB approach; operational risk framework, market risk framework; Pillar 3 disclosures and the introduction of output floors.

In addition, the PRA advised that the proposals in Consultation Paper 21/19 'Credit risk: Probability of Default and Loss Given Default estimation' will be delayed by one year to 1 January 2022 and the hybrid IRB models will also be delayed until the same date.

On 26 March 2020, the PRA wrote to the Chief Executive Officers of UK banks setting out guidance in respect of:

- consistent and robust IFRS 9 accounting and the regulatory definition of default;
- the treatment of borrowers who breach covenants due to COVID-19; and
- the regulatory capital treatment of IFRS 9.

The PRA has subsequently provided a number of updates to banks in this regard as the COVID-19 situation evolves.

Risk report (continued)

FINANCIAL RISK (continued)

Capital risk (continued)

CRR 'Quick Fix' Package

On 24 June 2020, the European Parliament adopted regulation to facilitate lending to households and businesses in the EU in light of COVID-19. This package, known as the 'CRR Quick Fix', came into force on 27 June 2020 and made a number of beneficial amendments to the CRR that apply to the Group, such as IFRS 9 transitional arrangements and SME supporting factors.

On 14 October 2020, the EBA published its final draft Regulatory Technical Standards (RTS) specifying the prudential treatment of software assets. The RTS replaces the current upfront full deduction with a simple approach based on a prudential amortisation of software assets calibrated over a period of maximum three years. The RTS will become effective on the day following its publication in the Official Journal of the European Union.

Mitigation

The Group's capital risk policy standard provides the framework for the management of capital 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 regulatory 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: growing income; cutting costs; raising new equity via, for example, a rights issue; reducing or cancelling distributions on capital instruments; and raising 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 lending strategy.

Capital optimisation remains a key strategic priority of the Group. Work is progressing to ensure that the approach to models and IRB portfolios supports the overall strategy and delivers robust outcomes for the management of risks.

Monitoring

The capital plan is approved by the Board on an annual basis. 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 of the impact on capital ratios, risk appetite and the future outlook.

FINANCIAL RISK (continued)

Capital risk (continued)

Capital position

The Group's capital position as at 30 September 2020 is summarised below:

Regulatory capital (unaudited)[1]	2020 £m	2019 £m
Statutory total equity	**4,990**	5,141
CET1 capital: regulatory adjustments[2]		
AT1 capital instruments	**(672)**	(672)
Defined benefit pension fund assets	**(470)**	(257)
Prudent valuation adjustment	**(6)**	(5)
Intangible assets	**(477)**	(501)
Goodwill	**(11)**	(11)
Deferred tax asset relying on future profitability	**(215)**	(250)
Cash flow hedge reserve	**80**	25
Excess expected losses	**-**	(88)
Forseeable distributions	**(21)**	(20)
IFRS 9 transitional adjustments	**310**	100
Total regulatory adjustments to CET1	**(1,482)**	(1,679)
Total CET1 capital	**3,508**	3,462
AT1 capital		
AT1 capital instruments	**672**	672
Total AT1 capital	**672**	672
Total Tier 1 capital	**4,180**	4,134
Tier 2 capital		
Subordinated debt	**749**	723
Total Tier 2 capital	**749**	723
Total regulatory capital	**4,929**	4,857

(1) This table shows the capital position on a CRD IV 'fully loaded' basis and transitional IFRS 9 basis.
(2) A number of regulatory adjustments to CET1 capital are required under CRD IV regulatory capital rules.

Risk report (continued)

FINANCIAL RISK (continued)

Capital risk (continued)

Regulatory capital flow of funds (unaudited)[1]	**CRD IV 2020 £m**	CRD IV 2019 £m
CET1 capital[2]		
CET1 capital at 1 October	**3,462**	2,148
Share capital: ordinary share new issuance	**-**	1,779
Retained earnings and other reserves (including special purpose entities)	**(152)**	(186)
Prudent valuation adjustment	**(1)**	(2)
Intangible assets	**24**	(89)
Goodwill	**-**	(11)
Deferred tax asset relying on future profitability	**35**	(58)
Defined benefit pension fund assets	**(213)**	(119)
Cash flow hedge reserve	**55**	(12)
Excess expected losses	**88**	(88)
IFRS 9 transitional relief	**210**	100
Total CET1 capital	**3,508**	3,462
AT1 capital		
AT1 capital at 1 October	**672**	425
Share capital issued: AT1 Capital issued	**-**	247
Total AT1 capital	**672**	672
Total Tier 1 capital	**4,180**	4,134
Tier 2 capital		
Tier 2 capital at 1 October	**723**	629
Credit risk adjustments[3]	**-**	(152)
Other movements	**-**	(1)
Capital instruments issued: subordinated debt	**472**	247
Capital instruments purchased: subordinated debt	**(446)**	-
Total Tier 2 capital	**749**	723
Total capital	**4,929**	4,857

(1) The table shows the capital position on a CRD IV 'fully loaded' basis and transitional IFRS 9 basis.
(2) CET1 capital is comprised of shares issued and related share premium, retained earnings and other reserves less specified regulatory adjustments.
(3) The transition to IFRS 9 reporting has removed the requirement for Tier 2 credit risk adjustments.

The Group’s CET1 capital increased by £46m in the year, primarily driven by the loss for the year of £191m and AT1 distributions of £59m, offset by regulatory adjustments for expected losses and transitional relief of £298m.

During the year, there were also increases in Tier 2 capital. The Group issued an additional £475m of Tier 2 capital in September 2020 in the form of Fixed Rate Reset Callable Tier 2 Notes due 2030. In addition, the Group purchased £445m of the Fixed Reset Callable Subordinated Tier 2 Notes due 2026 during the year. The balances do not agree directly to the regulatory capital flow of funds statement above due to differences between the accounting and regulatory carrying values.

FINANCIAL RISK (continued)

Capital risk (continued)

Minimum Pillar 1 capital requirements (unaudited)	**2020**	2019
	£m	£m
Credit risk	**1,718**	1,685
Operational risk	**205**	209
Counterparty risk	**14**	15
Credit valuation adjustment	**14**	15
Pillar 1 regulatory capital requirements	**1,951**	1,924

RWA movements (unaudited)

	12 months to 30 September 2020					12 months to 30 September 2019[1]				
RWA flow statement[1]	**IRB RWA £m**	**STD RWA £m**	**Other RWA £m**	**Total £m**	**Capital required £m**	IRB RWA £m	STD RWA £m	Other RWA £m	Total £m	Capital required £m
RWA at 1 October	**15,104**	**5,938**	**3,004**	**24,046**	**1,924**	-	18,103	2,014	20,117	1,610
Asset size	**(48)**	**197**	**-**	**149**	**12**	183	517	12	712	57
Asset quality	**462**	**(88)**	**-**	**374**	**30**	484	(61)	-	423	34
Model updates[2]	**149**	**-**	**-**	**149**	**12**	(396)	-	-	(396)	(32)
Methodology and policy	**(287)**	**(48)**	**-**	**(335)**	**(27)**	250	-	-	250	20
Acquisitions and disposals	**-**	**-**	**-**	**-**	**-**	4,330	2,870	960	8,160	653
IRB accreditation	**457**	**(473)**	**-**	**(16)**	**(1)**	10,247	(15,592)	-	(5,345)	(428)
Other[3]	**8**	**92**	**(83)**	**17**	**1**	6	101	18	125	10
RWA at 30 September	**15,845**	**5,618**	**2,921**	**24,384**	**1,951**	15,104	5,938	3,004	24,046	1,924

(1) The comparative has been restated in line with current year presentation following a change in flow logic.
(2) Model updates include the mortgage quarterly PD calibrations.
(3) Other includes operational risk, CVA and counterparty credit risk.

Methodology and policy

Movements are driven by a number of differing impacts, the most material of which are the SME Supporting Factor changes, which were implemented by the CRR Quick Fix package and took effect from 27 June 2020, resulting in a £695m reduction in RWA.

The other material change is the inclusion of a new mortgage LGD model, approved by the regulator and deployed into the heritage Virgin Money rating system in March 2020. This resulted in an uplift of £511m in RWA due to increased risk sensitivity and improved downturn estimation.

Of the remaining reduction of £151m, £94m relates to the recognition of eligible collateral in relation to the asset finance and invoice finance portfolios, following approval by the PRA; and a further £68m reduction due to a change in the credit conversion factor applied to personal current accounts and business credit cards.

IRB accreditation

Movements were driven by PRA approval received in March 2020 to move the specialised lending portfolio from the standardised approach to IRB slotting, this was first reported in June 2020.

Risk report (continued)

FINANCIAL RISK (continued)

Capital risk (continued)

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

Capital requirements for calculating RWA	At 30 September 2020			At 30 September 2019		
	Capital required £m	RWA £m	Exposure £m	Capital required £m	RWA £m	Exposure £m
Corporates	**509**	**6,361**	**9,465**	501	6,258	8,587
Retail	**759**	**9,484**	**62,683**	708	8,846	64,067
Total IRB Approach	**1,268**	**15,845**	**72,148**	1,209	15,104	72,654
Central governments or central banks	**-**	**-**	**12,259**	1	9	11,660
Regional governments or local authorities	**1**	**13**	**219**	1	13	175
Public sector entities	**-**	**5**	**409**	-	5	335
Multilateral development banks	**-**	**-**	**1,268**	-	-	1,034
Financial institutions	**15**	**186**	**899**	16	206	959
Corporates	**17**	**213**	**236**	28	349	378
Retail	**327**	**4,089**	**5,453**	319	3,993	5,324
Secured by mortgages on immovable property	**12**	**144**	**433**	40	496	873
Exposures in default	**5**	**62**	**58**	5	59	55
Equity exposures	**-**	**3**	**2**	-	5	3
Items associated with particularly high risk	**-**	**-**	**-**	1	11	7
Covered bonds	**12**	**144**	**1,442**	11	141	1,415
Other items	**61**	**759**	**740**	54	651	743
Total standardised approach	**450**	**5,618**	**23,418**	476	5,938	22,961
Total credit risk	**1,718**	**21,463**	**95,566**	1,685	21,042	95,615
Operational risk	**205**	**2,567**		209	2,621	
Counterparty risk	**14**	**179**		15	191	
Credit valuation adjustment	**14**	**175**		15	192	
Total Pillar 1 regulatory capital requirements	**1,951**	**24,384**		1,924	24,046	

The exposure amounts disclosed above are post CCF and pre-credit mitigation.

Additional breakdown analysis of the IRB portfolios can be seen within the 'EU CR6 -IRB Approach – Credit risk by exposure class and PD range' table within the Group's Pillar 3 disclosures.

FINANCIAL RISK (continued)

Capital risk (continued)

Capital position and CET1 (unaudited)	2020 £m	2019 £m
RWA[1]		
Retail mortgages	**9,484**	8,845
Business lending	**6,714**	7,122
Other retail lending	**4,151**	4,042
Other lending	**320**	485
Other[2]	**794**	548
Credit risk	**21,463**	21,042
Operational risk	**2,567**	2,621
Counterparty risk	**179**	191
Credit valuation adjustment	**175**	192
Total RWA	**24,384**	24,046
Capital ratios		
CET1 ratio	**14.4%**	14.4%
Tier 1 ratio	**17.1%**	17.2%
Total capital ratio	**20.2%**	20.2%

(1) RWA are calculated under the AIRB approach for the mortgage portfolio and the FIRB approach for the business portfolio. In March 2020, the Group received approval to move the specialised lending portfolio from a standardised approach to IRB slotting, with this change first being reported in June 2020. All other portfolios are calculated under the standardised approach, via either sequential IRB implementation or Permanent Partial Use.

(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, other debtors, prepayments and deferred tax assets that are not deducted.

The below table shows a comparison of capital resources, requirements and ratios with and without the application of transitional arrangements for IFRS 9.

IFRS 9 transitional arrangements (unaudited)	30 September 2020 (£m)	
Available capital (amounts)	**IFRS 9 Transitional basis**	**IFRS 9 Fully loaded basis**
CET1 capital	**3,508**	**3,198**
Tier 1 capital	**4,180**	**3,870**
Total capital	**4,929**	**4,714**
RWA (amounts)		
Total RWA	**24,384**	**24,231**
Capital ratios		
CET1 (as a percentage of risk exposure amount)	**14.4%**	**13.2%**
Tier 1 (as a percentage of risk exposure amount)	**17.1%**	**16.0%**
Total capital (as a percentage of risk exposure amount)	**20.2%**	**19.5%**
Leverage ratio		
Leverage ratio total exposure measure	**86,475**	**86,164**
Leverage ratio	**4.8%**	**4.5%**

FINANCIAL RISK (continued)

Capital risk (continued)

The adoption of IFRS 9 by the Group on 1 October 2018 resulted in an increase in credit impairment losses due to the move from an incurred loss to an expected credit loss methodology. The CRR includes transitional arrangements which allow for the regulatory capital impact of these higher losses to be phased in over a 5-year period from adoption. The table above presents the Group's key capital metrics as reported (i.e. including transitional relief), and on a fully loaded basis (with no transitional relief).

The CRR Quick Fix amendments package, which applies from 27 June 2020, introduced changes to provide additional relief from the economic impacts of COVID-19. Under this package, relevant provisions raised from 1 January 2020 through to 2021 have a CET1 add-back percentage of 100%, reducing to 75% in 2022, 50% in 2023 and 25% in 2024.

Capital requirements

The Group measures the amount of capital it is required to hold 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 RWA the Group is currently required to hold, excluding any PRA buffer.

	As at 30 September 2020	
Minimum Requirements (unaudited)	**CET1**	**Total Capital**
Pillar 1[(1)]	4.5%	8.0%
Pillar 2A[(2)]	2.5%	4.4%
Total Capital Requirement	**7.0%**	**12.4%**
Capital conservation buffer	2.5%	2.5%
UK countercyclical capital buffer	0.0%	0.0%
Total (excluding PRA buffer)[(3)]	**9.5%**	**14.9%**

(1) The minimum amount of total capital under Pillar 1 of the regulatory framework is determined as 8% of RWA, of which at least 4.5% of RWA is required to be covered by CET1 capital.

(2) On 7 May 2020, the PRA announced that Pillar 2A capital requirements for banks would be converted from an RWA percentage to a fixed amount. This change was made on the basis that the PRA does not believe that RWA are a good approximation for the evolution of the risks captured in Pillar 2A in a stress.

(3) 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; and
- A buffer relating to the results of the BoE stress tests.

Risk report (continued)

FINANCIAL RISK (continued)

Capital risk (continued)

The Group continues to maintain a significant buffer to its CRD IV minimum CET1 requirement, with excess CET1 of 4.9%, being a buffer equivalent to £950m.

The Group's total capital Pillar 2A requirement has reduced from 5.3% at September 2019 to 4.4% at September 2020 following revisions made by the PRA during the year.

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 has implemented the provisions on capital buffers outlined in the CRD to create combined capital buffers including a Capital Conservation Buffer (CCB), a Countercyclical Capital Buffer (CCyB), a Global Systemically Important Institution (G-SII) Buffer, and a Systemic Risk Buffer (SRB) for ring-fenced banks. The Group's capital planning process considers the impact of all relevant capital buffers.

The UK CCyB is dependent upon the BoE's view of credit conditions in the economy and may be set between 0% and 2.5%. On 11 March 2020, as part of a package of measures to support the economy from the impact of COVID-19, the Financial Policy Committee (FPC) announced a reduction in the UK CCyB to 0% with immediate effect. The FPC expects to maintain the 0% rate for at least 12 months, so that any subsequent increase would not take effect until March 2022 at the earliest.

The Group does not currently meet the criteria for designation as a systemically important institution or the threshold for systemic risk, and as such is not subject to a G-SII or SRB.

Minimum requirement for own funds and eligible liabilities (MREL)

An analysis of the Group's current MREL position is provided below:

	As at	
	30 Sep 2020	30 Sep 2019
Total capital resources[(1)]	**4,929**	4,857
Eligible senior unsecured securities issued by Clydesdale Bank PLC[(2)]	**2,002**	1,550
Total MREL resources	**6,931**	6,407
Risk-weighted assets	**24,384**	24,046
MREL ratio	**28.4%**	26.6%

(1) This table shows the capital position on a CRD IV 'fully loaded' basis and transitional IFRS 9 basis.
(2) Excludes instruments with less than one year to maturity.

In June 2018, the Bank of England published its updated approach to setting a MREL. MREL is subject to phased implementation and will be fully implemented from 1 January 2022, at which time the Group's indicative MREL is expected to be two times the sum of its Pillar 1 and Pillar 2A capital requirements, subject to final regulatory guidance. During the transitional period from 1 January 2020 until 31 December 2021, the Group is subject to an interim MREL of 18% of risk-weighted assets.

During 2020, the Group issued £0.9bn of debt that contributes to its MREL (£450m senior unsecured term funding and £475m subordinated debt). Combined with previous issuances made over the last few years, the Group's MREL ratio of 28.4% comfortably exceeds its interim MREL and is in line with its expected end-state MREL.

This means future MREL issuance is focused on building a prudent management buffer over the expected end-state MREL.

FINANCIAL RISK (continued)

Capital risk (continued)

Dividend

The Board has recommended not to pay a final dividend for the financial year ended 30 September 2020.

Leverage

Leverage ratio (unaudited)	2020 £m	2019 £m
Total Tier 1 capital for the leverage ratio		
Total CET1 capital	**3,508**	3,462
AT1 capital	**672**	672
Total Tier 1	**4,180**	4,134
Exposures for the leverage ratio		
Total assets	**90,307**	91,101
Adjustment for off-balance sheet items	**2,892**	2,728
Adjustment for derivative financial instruments	**81**	(35)
Adjustment for securities financing transactions	**2,072**	1,934
Adjustment for qualifying central bank claims	**(8,088)**	-
Other adjustments	**(789)**	(986)
Leverage ratio exposure	**86,475**	94,742
CRD IV Leverage Ratio(1)	**4.8%**	4.4%
UK leverage ratio(2)	**4.9%**	4.9%
Average UK leverage ratio exposure(3)	**85,712**	n/a
Average UK leverage ratio(3)	**4.6%**	n/a

(1) IFRS 9 transitional capital arrangements have been applied to the CRD IV leverage ratio calculation as at 30 September 2020.

(2) The Group's leverage ratio on a modified basis, excluding qualifying central bank claims and loans under the UK BBLS from the exposure measure.

(3) The fully loaded average leverage exposure measure is based on the daily average of on-balance sheet items and three month-end average of off-balance sheet items. The average leverage ratio is based on the average of the month end Tier 1 capital position. Under the UK Leverage Ratio Framework, the Group was only required to start reporting average balances from December 2019.

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. The first reporting date from which the Group met this threshold was 31 December 2019 and as a result, the average UK leverage ratio exposure and average UK leverage ratio are disclosed for the first time.

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

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

- capital: Tier 1 capital defined on a CRD IV fully loaded and IFRS 9 transitional basis; 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 CRD IV leverage ratio of 4.8% (30 September 2019: 4.4%) exceeds the Basel Committee's proposed minimum of 3%, and the Group's UK leverage ratio of 4.9% (30 September 2019: 4.9%) exceeds the UK minimum ratio of 3.25%.

Following the FPC announcement on 11 March 2020 to reduce the Group's CCyB rate to 0%, the leverage ratio buffer also reduced to 0%.

FINANCIAL RISK (continued)

Funding and liquidity risk

Funding risk occurs where the Group is unable to raise or maintain funds of sufficient quantity and quality to support the delivery of the business plan or sustain lending commitments. Prudent funding risk management reduces the likelihood of liquidity risks occurring, increases the stability of funding sources, minimises concentration risks and controls future balance sheet growth.

Liquidity risk occurs when the Group is unable to meet its current and future financial obligations as they fall due or at acceptable cost, or when the Group reduces liquidity resources below internal or regulatory stress requirements.

Exposures

The Group is predominantly funded by personal and business customers. Customer funding is augmented by the Group’s ongoing wholesale funding programmes, medium-term secured funding issuance (e.g. the Group’s securitisation programme), Regulated Covered Bonds and unsecured medium-term notes. The Group also has access to the BoE TFSs.

Funding risk exposures arise from an unsustainable or undiversified funding base, for example, a reliance on short-term wholesale deposits. The risk may result in deviation from funding strategy, requiring funding to be originated rapidly at excessive cost, or require a reduction in lending growth, which are outcomes that may adversely affect customers or shareholders.

The Group’s primary liquidity risk exposure arises through the redemption of retail deposits where customers have the ability to withdraw funds with limited or no notice. Exposure also arises from the refinancing of customer and wholesale funding at maturity and the ability to fund new and existing committed lending obligations including mortgage pipeline and credit card facilities.

Measurement

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 short-and long-term view of risks under both normal and stressed conditions. The measures focus on: cash outflows and inflows under stress; concentration risks; refinancing risks; asset encumbrance; and readiness of mitigating actions.

The Group’s funding plan establishes an acceptable level of funding risk which is approved 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 financial risk policy standards. A series of metrics is used across the Group to measure risk exposures, including funding ratios, limits to concentration risk and maximum levels of encumbrance.

Liquidity risk exposures are subject to assessment under both regulatory and internal requirements. The volume and quality of the Group’s liquid asset portfolio is defined through a series of stress tests across a range of time horizons and stress conditions. The High-Quality Liquid Asset (HQLA) requirement is quantified as the outflow of funds under a series of stress scenarios less the impact of inflows from assets. Stress cash outflow assumptions have been established for individual liquidity risk drivers across idiosyncratic and market-wide stresses. Liquidity within the Group is managed in accordance with the ILAAP, which is approved by the Board.

The Treasury function is responsible for the development and execution of strategy subject to oversight from the Risk function. In relation to funding and liquidity risk, the primary management committee is the 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.

FINANCIAL RISK (continued)

Funding and liquidity risk (continued)

Monitoring

Liquidity is actively monitored by the Group. Reporting is conducted through ALCO and the Executive Risk Committee. In a stress situation or in adverse conditions, the level of monitoring and reporting is increased commensurate with the nature of the stress event, as demonstrated in response to COVID-19.

Monitoring and control processes are in place against internal and regulatory liquidity requirements. The Group monitors a range of market and internal early warning indicators on a routine basis for early signs of liquidity risk in the market or specific to the Group. These indicators cover a mixture of quantitative and qualitative measures including daily variation of customer balances, measurement against stress requirements and monitoring of the macroeconomic environment.

Mitigation

The Group holds a portfolio of 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 (SMF). 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. In addition to customer funding, wholesale funding is used to support balance sheet growth, lengthen the contractual tenor of funding and diversify funding sources. These funding programmes are a source of strength for the Group and leverage the Group's high-quality mortgage book as collateral for secured funding.

As a participant in the BoE SMF, the Group has access to funding via the TFS. Following its launch in April 2020, the Group has also been able to access additional funding from the SMEs scheme (TFSME), which was established to provide cost-effective funds to banks to support additional lending to the real economy, and incentivise lending to SMEs during a period of economic disruption caused by COVID-19.

The funding plan includes an assessment of the Group's capacity for raising funds from its primary sources, thereby mitigating funding risk. Refinancing risks are carefully managed and are subject to controls overseen by ALCO. The Group's funding plan includes embedded TFS and TFSME repayment profiles designed to manage refinancing risk.

The Group recovery 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, assesses capacity, details the action required, allocates the key tasks to individuals, provides a timeframe and defines a management committee to manage the action plan.

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

FINANCIAL RISK (continued)

Funding and liquidity risk (continued)

Sources of funding

The table below provides an overview of the Group's sources of funding as at 30 September 2020:

	2020 **£m**	2019 £m
Total assets	**90,307**	91,101
Less: other liabilities(1)	**(6,205)**	(5,777)
Funding requirement	**84,102**	85,324
Funded by:		
Customer deposits	**67,710**	64,000
Debt securities in issue	**5,933**	7,267
Due to other banks	**5,469**	8,916
of which:		
Secured loans	**5,397**	7,308
Securities sold under agreements to repurchase	**-**	1,554
Transaction balances with other banks	**15**	12
Deposits with other banks	**57**	42
Equity	**4,990**	5,141
Total funding	**84,102**	85,324

(1) Other liabilities include customer deposits at FVTPL, derivative financial instruments, due to related entities, deferred tax liabilities, provisions for liabilities and charges, amounts due to related entities and other liabilities as per the balance sheet line item.

The Group's funding objective is to prudently manage the sources and tenor of funds in order to provide a sound base from which to support sustainable customer growth. At 30 September 2020, the Group had a funding requirement of £84,102m (2019: £85,323m) with the majority being used to support loans and advances to customers.

The Group's funding mix did not materially change throughout the year and continues to be predominantly retail-funded. During the year, the Group has been active in the securitisation and senior debt markets.

Customer deposits

The majority of the Group's funding requirement was met by customer deposits of £67,710m (2019: £64,000m). Customer deposits comprise interest bearing deposits, term deposits and non-interest bearing demand deposits from a range of sources including personal and business customers. The increase of £3,710m during the year demonstrates the impact of COVID-19, as societal restrictions coupled with a fall in UK consumer confidence linked to the recessionary environment have driven increases in customer deposits within current accounts and easy access saving products.

Equity

Equity of £4,990m (30 September 2019: £5,141m) was also used to meet the Group's funding requirement. Equity comprises ordinary share capital, retained earnings, other equity investments and a number of other reserves. For full details on equity refer to note 4.1 within the consolidated financial statements.

Risk report (continued)

FINANCIAL RISK (continued)

Funding and liquidity risk (continued)

Liquid assets

The quantity and quality of the Group's liquid assets are calibrated to the Board's view of liquidity risk appetite and remain at a prudent level above regulatory requirements. The Group was compliant with all internal and regulatory liquidity metrics at both 30 September 2019 and 30 September 2020.

The LCR has been managed from 152% to 140% during the year and remains comfortably above regulatory and internal risk appetite. The management of liquidity resources throughout the year recognises the reduced risk exposure from transformation activities and increased availability of contingent funding through the BoE TFSME.

	2020 (Audited) £m	**2019 (Audited) £m**
Eligible liquidity buffer	**10,675**	11,243
Net stress outflows	**7,609**	7,409
Surplus	**3,066**	3,834
LCR	**140%**	152%

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

The volume and quality of the Group's liquid asset portfolio is considered through a series of internal stress tests across a range of time horizons and stress conditions, including most recently the Group's view of liquidity risk due to impacts of COVID-19 and the UK's withdrawal from the EU. The Group ensures a liquidity surplus is held, during normal market conditions, above the most severe of these scenarios. Stress cash outflow assumptions have been established for individual liquidity risk drivers and are approved annually by the Board as part of the ILAAP.

The key risk driver assumptions applied to the scenarios are:

Liquidity risk driver	**Internal stress assumption**
Retail funding	Severe unexpected withdrawal of retail deposits by customers arising from redemption or refinancing risk. No additional deposit inflows are assumed.
Wholesale funding	Limited opportunity to refinance wholesale contractual maturities. Full outflow of secured and unsecured funding during the refinancing period, with no reinvestment of funding.
Off-balance sheet	Cash outflows during the period of stress as a result of off-balance sheet commitments such as mortgage pipeline, undrawn credit card facilities and collateral commitments. Lending outflows, over and above contractual obligations, are honoured as the Group preserves ongoing division viability.
Intra-day	Other participants in the payment system withhold or delay payments or customers increase transactions resulting in reduced liquidity.
Liquid assets	The liquidity portfolio value is reduced, reflecting stressed market conditions.

The Group monitors the movements in its credit ratings and the related requirement to post collateral for payment systems and clearing houses. These figures are not considered material compared to the volume of unencumbered liquid assets.

As at 30 September 2020, the Group held eligible liquid assets well in excess of 100% of net stress outflows, as defined through internal risk appetite.

Risk report (continued)

FINANCIAL RISK (continued)

Funding and liquidity risk (continued)

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

Liquid asset portfolio[1]	**30 September 2020 £m**	30 September 2019 £m	Change %	**Average 2020 £m**	Average 2019 £m
Level 1					
Cash and balances with central banks	**6,255**	7,469	(16%)	**6,430**	7,266
UK Governments treasury bills and gilts	**1,232**	1,076	14%	**1,301**	870
Other debt securities	**3,262**	2,867	14%	**3,186**	2,604
Total level 1	**10,749**	11,412	(6%)	**10,917**	10,740
Level 2[2]	**29**	29	-	**33**	103
Total LCR eligible assets	**10,778**	11,441	(6%)	**10,950**	10,843

(1) Excludes encumbered assets.
(2) Includes Level 2A and Level 2B.

Before investing in any security, an assessment is completed for both the credit quality and the treatment for liquidity purposes. ALCO oversees the composition of the liquid asset portfolio.

Further information can be found in notes 3.4 (cash and balances with central banks) and 3.7 (FVOCI) of the Group's consolidated financial statements.

Cash and balances with central banks of £9,107m, as per note 3.4, include: £2,572m of assets that are encumbered to support the issuance of Scottish bank notes (excluding notes not in circulation) and to support payments systems; £220m of mandatory central bank deposits; and £61m excluded from LCR to cover operating expenses.

Financial assets at fair value through other comprehensive income of £5,080m, as per note 3.7, includes: £826m of encumbered UK Government Treasury bills and gilts, £312m of which is encumbered to support Operational Continuity in Resolution (OCIR) and £513m of which is encumbered to support structured funding programmes.

The CRR II amendments to the CRR will introduce a binding net stable funding ratio (NSFR) requirement from 28 June 2021. Based on current interpretations of European regulatory requirements and guidance, the ratio as of 30 September 2020 is 131% (2019: 128%).

Encumbered assets by asset category

The Group manages the level of asset encumbrance to ensure appropriate assets are maintained to support potential future planned and stressed funding requirements. Encumbrance limits are set in the Group RAS and calibrated to ensure that after a stress scenario is applied that increases asset encumbrance, the balance sheet can recover over an acceptable period of time. Examples of reasons for asset encumbrance include, among others, supporting the Group’s secured funding programmes to provide stable term funding to the Group, the posting of assets in respect of drawings under the TFS, use of assets as collateral for payments systems in order to support customer transactional activity, and providing security for the Group’s issuance of Scottish bank notes.

Risk report (continued)

FINANCIAL RISK (continued)

Funding and liquidity risk (continued)

Encumbered assets by asset category (audited)	Assets encumbered with non-central bank counterparties				Positioned at the central bank (including encumbered)	Other assets				
						Assets not positioned at the central bank				
30 September 2020	Covered bonds £m	Securiti-sations £m	Other £m	Total £m	£m	Readily available for encumbrance £m	Other assets capable of being encumbered £m	Cannot be encumbered £m	Total £m	Total £m
Loans and advances to customers	2,551	7,253	-	9,804	15,604	26,736	17,404	3,070	62,814	**72,618**
Cash and balances with central banks	-	-	-	-	2,994	6,113	-	-	9,107	**9,107**
Due from other banks	337	424	93	854	-	-	73	-	73	**927**
Derivative financial instruments	-	-	-	-	-	-	-	318	318	**318**
Financial instruments at fair value through other comprehensive income	-	-	826	826	-	4,254	-	-	4,254	**5,080**
Other assets	-	-	910	910	-	-	289	1,058	1,347	**2,257**
Total	**2,888**	**7,677**	**1,829**	**12,394**	**18,598**	**37,103**	**17,766**	**4,446**	**77,913**	**90,307**

	Assets encumbered with non-central bank counterparties				Positioned at the central bank (including encumbered)	Other assets				
						Assets not positioned at the central bank				
30 September 2019	Covered bonds £m	Securiti-sations £m	Other £m	Total £m	£m	Readily available for encumbrance £m	Other assets capable of being encumbered £m	Cannot be encumbered £m	Total £m	Total £m
Loans and advances to customers	2,896	8,571	-	11,467	19,929	19,933	18,587	3,430	61,879	73,346
Cash and balances with central banks	-	-	-	-	3,219	7,077	-	-	10,296	10,296
Due from other banks	156	550	171	877	-	-	131	10	141	1,018
Derivative financial instruments	-	-	-	-	-	-	-	366	366	366
Financial instruments at fair value through other comprehensive income	41	34	555	630	-	3,697	-	1	3,698	4,328
Other assets	-	-	409	409	-	-	163	1,175	1,338	1,747
Total	3,093	9,155	1,135	13,383	23,148	30,707	18,881	4,982	77,718	91,101

Risk report (continued)

FINANCIAL RISK (continued)

Funding and liquidity risk (continued)

The Group's total non-central bank asset encumbrance decreased by £989m to £12,394m as at 30 September 2020. This was primarily due to a reduction in RMBS funding offset by an increase in derivatives margin requirements. Current levels of encumbrance include the impact of use of TFSs which are subject to a repayment profile to manage refinancing risk, and the TFSME scheme launched this year.

Assets and liabilities by maturity

The following tables represent a breakdown of the Group's balance sheet, according to the contractual maturity of the assets and liabilities. 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 the Group 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 2020 (audited)	Call	3 months or less	3 to 12 months	1 to 5 years	Over 5 years	No specified maturity(1)	Total
	£m	£m	£m	£m	£m	£m	£m
Assets							
Financial assets at amortised cost							
Loans and advances to customers	**785**	**2,058**	**1,820**	**10,878**	**52,460**	**4,427**	**72,428**
Cash and balances with central banks	**7,547**	**-**	**-**	**-**	**-**	**1,560**	**9,107**
Due from other banks	**814**	**113**	**-**	**-**	**-**	**-**	**927**
Financial assets at fair value through profit or loss							
Loans and advances to customers	**-**	**7**	**17**	**61**	**105**	**-**	**190**
Derivative financial instruments	**1**	**9**	**114**	**80**	**114**	**-**	**318**
Other financial assets at fair value	**-**	**-**	**-**	**-**	**-**	**1**	**1**
Due from related entities	**2**	**9**	**-**	**-**	**-**	**-**	**11**
Financial assets at fair value through other comprehensive income	**-**	**732**	**251**	**2,318**	**1,779**	**-**	**5,080**
Other assets	**-**	**32**	**322**	**2**	**1**	**1,888**	**2,245**
Total assets	**9,149**	**2,960**	**2,524**	**13,339**	**54,459**	**7,876**	**90,307**
Liabilities							
Financial liabilities at amortised cost							
Customer deposits	**44,676**	**4,677**	**11,080**	**7,277**	**-**	**-**	**67,710**
Debt securities in issue	**-**	**372**	**1,224**	**3,042**	**1,295**	**-**	**5,933**
Due to other banks	**68**	**-**	**1,493**	**3,908**	**-**	**-**	**5,469**
Financial liabilities at fair value through profit or loss							
Customer deposits	-	-	-	-	-	-	-
Derivative financial instruments	**1**	**4**	**33**	**76**	**136**	**-**	**250**
Due to related entities	**4**	**11**	**39**	**2,359**	**409**	**-**	**2,822**
Other liabilities	**2,319**	**81**	**85**	**76**	**79**	**493**	**3,133**
Total liabilities	**47,068**	**5,145**	**13,954**	**16,738**	**1,919**	**493**	**85,317**
Off balance sheet items							
Financial guarantees	**-**	**18**	**15**	**16**	**46**	**-**	**95**
Other credit commitments	**16,775**	**-**	**-**	**-**	**-**	**-**	**16,775**
Total off-balance sheet items	**16,775**	**18**	**15**	**16**	**46**	**-**	**16,870**

1) The 'no specified maturity' within loans and advances to customers relates to credit cards.

Risk report (continued)

FINANCIAL RISK (continued)

Funding and liquidity risk (continued)

Group 2019 (audited)	Call	3 months or less	3 to 12 months	1 to 5 years	Over 5 years	No specified maturity[1]	Total
	£m	£m	£m	£m	£m	£m	£m
Assets							
Financial assets at amortised cost							
Loans and advances to customers	1,097	1,804	1,738	9,775	54,462	4,217	73,093
Cash and balances with central banks	8,722	-	-	-	-	1,574	10,296
Due from other banks	225	793	-	-	-	-	1,018
Financial assets at fair value through profit or loss							
Loans and advances to customers	-	6	26	96	125	-	253
Derivative financial instruments	-	8	34	226	98	-	366
Other financial assets at fair value	-	-	-	-	-	8	8
Due from related entities	11	7	-	-	-	-	18
Financial assets at fair value through other comprehensive income	-	125	784	1,735	1,684	-	4,328
Other assets	-	66	173	-	-	1,482	1,721
Total assets	10,055	2,809	2,755	11,832	56,369	7,281	91,101
Liabilities							
Financial liabilities at amortised cost							
Customer deposits	40,512	5,558	10,168	7,762	-	-	64,000
Debt securities in issue	-	574	1,241	4,148	1,303	-	7,267
Due to other banks	45	1,361	181	7,329	-	-	8,916
Financial liabilities at fair value through profit or loss							
Customer deposits	-	2	2	-	-	-	4
Derivative financial instruments	-	7	14	64	188	-	273
Due to related entities	4	-	19	1,020	1,272	-	2,315
Other liabilities	2,277	78	93	-	-	737	3,185
Total liabilities	42,838	7,580	11,718	20,323	2,763	737	85,960
Off balance sheet items							
Financial guarantees	-	23	24	18	48	-	113
Other credit commitments	15,158	-	-	-	-	-	15,158
Total off-balance sheet items	15,158	23	24	18	48	-	15,271

1) The ‘no specified maturity’ within loans and advances to customers relates to credit cards.

Risk report (continued)

FINANCIAL RISK (continued)

Funding and liquidity risk (continued)

Assets and liabilities by maturity (continued)

Bank 2020 (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[(1)] £m	Total £m
Assets							
Financial assets at amortised cost							
Loans and advances to customers	785	2,051	1,812	10,795	51,566	4,427	71,436
Cash and balances with central banks	7,547	-	-	-	-	1,560	9,107
Due from other banks	174	-	-	-	-	-	174
Financial assets at fair value through profit or loss							
Loans and advances to customers	-	7	17	61	105	-	190
Derivative financial instruments	1	9	37	69	18	-	134
Other financial assets at fair value	-	-	-	-	-	1	1
Due from related entities	964	10	47	-	-	142	1,163
Financial assets at fair value through other comprehensive income	-	732	251	2,318	1,779	-	5,080
Other assets	-	33	325	2	1	1,953	2,314
Total assets	9,471	2,842	2,489	13,245	53,469	8,083	89,599
Liabilities							
Financial liabilities at amortised cost							
Customer deposits	44,676	4,677	11,080	7,277	-	-	67,710
Debt securities in issue	-	-	10	598	1,244	-	1,852
Due to other banks	68	-	1,493	3,908	-	-	5,469
Financial liabilities at fair value through profit or loss							
Customer deposits	-	-	-	-	-	-	-
Derivative financial instruments	1	4	33	76	136	-	250
Due to related entities	589	187	630	3,839	1,005	5	6,255
Other liabilities	2,318	83	84	76	79	492	3,132
Total liabilities	47,652	4,951	13,330	15,774	2,464	497	84,668
Off balance sheet items							
Financial guarantees	-	18	15	16	46	-	95
Other credit commitments	16,714	-	-	-	-	-	16,714
Total off-balance sheet items	16,714	18	15	16	46	-	16,809

(1) The ‘no specified maturity’ within loans and advances to customers relates to credit cards.

Risk report (continued)

FINANCIAL RISK (continued)

Funding and liquidity risk (continued)

Assets and liabilities by maturity (continued)

Bank 2019 (audited)	Call	3 months or less	3 to 12 months	1 to 5 years	Over 5 years	No specified maturity[1]	Total
	£m	£m	£m	£m	£m	£m	£m
Assets							
Financial assets at amortised cost							
Loans and advances to customers	1,097	1,468	873	4,987	23,598	366	32,389
Cash and balances with central banks	5,050	-	-	-	-	1,571	6,621
Due from other banks	225	-	-	-	-	-	225
Financial assets at fair value through profit or loss							
Loans and advances to customers	-	6	26	96	125	-	253
Derivative financial instruments	-	8	17	269	148	-	442
Other financial assets at fair value	-	-	-	-	-	1	1
Due from related entities	2,340	21	9	-	-	106	2,476
Financial assets at fair value through other comprehensive income	-	-	537	826	987	-	2,350
Other assets	-	47	151	-	-	3,005	3,203
Total assets	8,712	1,550	1,613	6,178	24,858	5,049	47,960
Liabilities							
Financial liabilities at amortised cost							
Customer deposits	22,058	2,032	3,925	1,756	-	-	29,771
Debt securities in issue	-	-	10	-	699	-	709
Due to other banks	43	1,363	204	2,250	-	-	3,860
Financial liabilities at fair value through profit or loss							
Customer deposits	-	2	2	-	-	-	4
Derivative financial instruments	-	8	16	86	182	-	292
Due to related entities	546	293	499	2,814	1,179	5	5,336
Other liabilities	2,277	46	85	-	-	624	3,032
Total liabilities	24,924	3,744	4,741	6,906	2,060	629	43,004
Off balance sheet items							
Financial guarantees	-	23	24	18	48	-	113
Other credit commitments	6,677	-	-	-	-	-	6,677
Total off-balance sheet items	6,677	23	24	18	48	-	6,790

(1) The 'no specified maturity' within loans and advances to customers relates to credit cards.

Risk report (continued)

FINANCIAL RISK (continued)

Funding and liquidity risk (continued)

Cash flows payable under financial liabilities by contractual maturity

Group 2020 (audited)	**Call**	**3 months or less**	**3 to 12 months**	**1 to 5 years**	**Over 5 years**	**No specified maturity**	**Total**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Liabilities							
Financial liabilities at amortised cost							
Customer deposits	**44,676**	**4,720**	**11,211**	**7,423**	**-**	**-**	**68,030**
Debt securities in issue	**-**	**378**	**1,268**	**3,178**	**1,277**	**-**	**6,101**
Due to other banks	**68**	**1**	**1,507**	**3,907**	**-**	**-**	**5,483**
Financial liabilities at fair value through profit or loss							
Trading derivative liabilities	**-**	**32**	**39**	**27**	**24**	**-**	**122**
Hedging derivative liabilities							
Contractual amounts payable	**-**	**5**	**25**	**159**	**48**	**-**	**237**
Contractual amounts receivable	**-**	**-**	**-**	**(79)**	**-**	**-**	**(79)**
Due to related entities	**4**	**45**	**113**	**2,744**	**416**	**-**	**3,322**
All other financial liabilities	**2,319**	**81**	**85**	**76**	**79**	**493**	**3,133**
Total liabilities	**47,067**	**5,262**	**14,248**	**17,435**	**1,844**	**493**	**86,349**

Group 2019 (audited)	Call	3 months or less	3 to 12 months	1 to 5 years	Over 5 years	No specified maturity	Total
	£m	£m	£m	£m	£m	£m	£m
Liabilities							
Financial liabilities at amortised cost							
Customer deposits	40,512	5,590	10,321	8,014	-	-	64,437
Debt securities in issue	-	589	1,316	4,369	1,297	-	7,571
Due to other banks	45	1,375	240	7,380	-	-	9,040
Financial liabilities at fair value through profit or loss							
Customer deposits	-	2	2	-	-	-	4
Trading derivative liabilities	-	15	14	36	28	-	93
Hedging derivative liabilities							
Contractual amounts payable	-	7	36	197	619	-	859
Contractual amounts receivable	-	-	(1)	(81)	(532)	-	(614)
Due to related entities	4	-	87	1,338	1,315	-	2,744
All other financial liabilities	2,277	78	93	-	-	737	3,185
Total liabilities	42,838	7,656	12,108	21,253	2,727	737	87,319

Risk report (continued)

FINANCIAL RISK (continued)

Funding and liquidity risk (continued)

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

Bank 2020 (audited)	**Call**	**3 months or less**	**3 to 12 months**	**1 to 5 years**	**Over 5 years**	**No specified maturity**	**Total**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Liabilities							
Financial liabilities at amortised cost							
Customer deposits	**44,676**	**4,720**	**11,211**	**7,423**	**-**	**-**	**68,030**
Debt securities in issue	**-**	**1**	**36**	**739**	**1,277**	**-**	**2,053**
Due to other banks	**68**	**1**	**1,507**	**3,907**	**-**	**-**	**5,483**
Financial liabilities at fair value through profit or loss							
Trading derivative liabilities	**-**	**32**	**39**	**27**	**24**	**-**	**122**
Hedging derivative liabilities							
Contractual amounts payable	**-**	**5**	**25**	**159**	**48**	**-**	**237**
Contractual amounts receivable	**-**	**-**	**-**	**(79)**	**-**	**-**	**(79)**
Due to related entities	**546**	**423**	**1,381**	**5,922**	**1,693**	**5**	**9,970**
All other financial liabilities	**2,318**	**83**	**84**	**76**	**79**	**492**	**3,132**
Total liabilities	**47,608**	**5,265**	**14,283**	**18,174**	**3,121**	**497**	**88,948**

Bank 2019 (audited)	Call	3 months or less	3 to 12 months	1 to 5 years	Over 5 years	No specified maturity	Total
	£m	£m	£m	£m	£m	£m	£m
Liabilities							
Financial liabilities at amortised cost							
Customer deposits	22,058	2,035	3,964	1,815	-	-	29,872
Debt securities in issue	-	2	37	752	1,297	-	2,088
Due to other banks	43	1,365	216	2,260	-	-	3,884
Financial liabilities at fair value through profit or loss							
Customer deposits	-	2	2	-	-	-	4
Trading derivative liabilities	-	11	21	36	28	-	96
Hedging derivative liabilities							
Contractual amounts payable	-	8	38	186	69	-	301
Contractual amounts receivable	-	-	(1)	(81)	-	-	(82)
Due to related entities	546	148	754	3,675	1,315	5	6,443
All other financial liabilities	2,277	46	85	-	-	624	3,032
Total liabilities	24,924	3,617	5,116	8,643	2,709	629	45,638

FINANCIAL RISK (continued)

Funding and liquidity risk (continued)

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 and those associated with all future coupon payments.

The table below shows the residual maturity of the Group's debt securities in issue:

Analysis of debt securities in issue by residual maturity (unaudited):

	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	Total at 30 Sept 2020 £m	Total at 30 Sept 2019 £m
Covered bonds	**-**	**10**	**623**	**1,295**	**1,928**	1,912
Securitisation	**372**	**1,214**	**2,419**	**-**	**4,005**	5,051
Medium term notes	**-**	**-**	**-**	**-**	**-**	304
Total debt securities in issue	**372**	**1,224**	**3,042**	**1,295**	**5,933**	7,267

External credit ratings

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

	Outlook as at 30 Sept 2020(1)	As at 30 Sept 2020	30 Sept 2019
Virgin Money UK PLC			
Moody's	**Stable**	**Baa3**	Baa3
Fitch	**Negative**	**BBB+**	BBB+
Standard & Poor's	**Negative**	**BBB-**	BBB-
Clydesdale Bank PLC			
Moody's(2)	**Stable**	**Baa1**	Baa1
Fitch	**Negative**	**A-**	A-
Standard & Poor's	**Negative**	**BBB+**	BBB+

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

On 21 October 2019, Fitch and Moody's withdrew the long- and short-term ratings of Virgin Money Holdings (UK) PLC and Virgin Money PLC following completion of the Financial Services and Markets Act 2000 (FSMA) Part VII transfer.

On 12 November 2019, Moody's changed the outlook on the long-term ratings of Virgin Money UK PLC and Clydesdale Bank PLC to 'stable' from 'positive.' This followed a revision in Moody's outlook for the UK Sovereign from 'stable' to 'negative', reflecting their view that UK institutions have weakened and the UK's economic and fiscal strength is likely to be weaker going forward. Moody's adjusted the ratings outlook for 15 UK banks and building societies, including the Group.

On 1 April 2020, Fitch placed the long-term ratings of Virgin Money UK PLC and Clydesdale Bank PLC on 'rating watch negative', reflecting the downside risks resulting from the economic and financial market implications of COVID-19. On 10 July 2020, Fitch affirmed the ratings of Virgin Money UK PLC and Clydesdale Bank PLC, removed the 'rating watch negative' and changed the outlook to 'negative'. The negative outlook reflects Fitch's view that risks remain clearly tilted to the downside in the medium term but that the Group's ratings are not immediately at risk from the impact of the economic downturn, due mainly to the bank's sufficient capital buffers and sound asset quality metrics at the entry point of the crisis, and relatively large and stable deposit funding.

On 23 April 2020, Standard & Poor's changed the outlook on the long-term ratings of Virgin Money UK PLC and Clydesdale Bank PLC to 'negative' (from 'stable' and 'positive,' respectively), as part of a broader action on the European banking sector. The outlook revisions reflects Standard & Poor's view that the economic stress triggered by COVID-19 is likely to put pressure on the Group's asset quality and earnings and may delay MREL issuance.

As at 24 November 2020, there have been no other changes to the Group's long-term credit ratings or outlooks since the report date.

Risk report (continued)

FINANCIAL RISK (continued)

Market risk

Market risk is the risk of loss associated with adverse changes in the value of assets and liabilities held by the Group as a result of movements in market factors such as foreign exchange risk, interest rates (duration risk), customer behaviour (optionality risk), and the movement in rate spreads across types of assets or liabilities (basis risk and credit spread risk). The Group's balance sheet is predominantly UK based and is denominated in GBP, therefore foreign exchange risk is not a material risk for the Group.

Outlook

The BoE continues to assess the appropriateness of a negative official Bank Rate alongside other monetary policy tools that are available to support the economy and may consider using negative rates, if it is deemed to be more effective in terms of policy objectives over other tools. To be an effective policy tool the BoE recognises the need for the financial sector to be operationally ready to implement such a policy step in a way that doesn't adversely affect the safety and soundness of firms and is engaging with firms on this matter, including the Group.

This engagement is not indicative that a zero or negative policy rate will be employed, nor is the engagement asking firms to begin taking steps to ensure operational readiness. The BoE has requested information on the impact of a range of outcomes each of which would have different operational considerations and potentially different outcomes in terms of risk, margins and earnings for firms.

Exposure

The Group's principal exposure comes from structural interest rate risk. It 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 mismatch, or duration, between repricing dates of interest-bearing assets and liabilities;
- basis risk or assets and liabilities repricing to different reference rates, for example, customer asset and liability products repricing against BoE base rate and Sterling Over Night Indexed Average (SONIA); and
- customer optionality, e.g. the right to repay borrowing in advance of contractual maturity dates.

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 the price on these products, however, these risks are not a material component of the Group's risk profile. Controls include the hedging of these products as and when they arise.

Risk report (continued)

FINANCIAL RISK (continued)

Market risk (continued)

Measurement

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, net interest income sensitivity, value at risk (VaR), earnings at risk, economic value of equity, interest rate risk stress testing, and scenario analysis.

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

- basis point sensitivity analysis is performed daily and compares the potential impact of a one basis point (0.01%) change on the present value of all future cash flows;
- Net interest income sensitivity assesses changes to earnings over a 12-month time horizon as a result of interest rate movements and changes to customer behaviour;
- VaR is measured on a statistical basis using a 99% confidence level based on daily rate movements over a two year history set with a one day holding period;
- economic value of equity is measured in line with EBA guidance with all eight of the proposed EBA rate shocks assessed on a quarterly basis, including customer optionality stresses. Reporting is performed both including and excluding equity;
- static balance sheet (i.e. any new business is assumed to be matched, hedged or subject to immediate repricing);
- investment term for capital is modelled with a benchmark term agreed by ALCO;
- investment term for core non-interest bearing assets and liabilities is modelled on a behavioural basis with a benchmark term agreed by ALCO;
- assumptions covering the behavioural life of products and customer behaviour for optionality are reviewed and approved by ALCO; and
- credit spread risk in the banking book (CSRBB) is assessed through VaR applied to the Group's liquid asset buffer portfolio. CSRBB is measured at a 99% confidence level based on daily spread movements over a 10-year history set with a three month holding period. Asset swap spread risk is assessed through VaR applied to the Group's liquid asset buffer portfolio.

Foreign exchange risk is assessed based on the absolute exposure to each currency.

Mitigation

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

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. The fair value of these swaps is disclosed in note 3.6 of the Group's consolidated financial statements. 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 risks arise from variable interest rate assets and liabilities which are hedged using cross currency and interest rate swaps, and material non-GBP denominated assets which are hedged using foreign exchange forward contracts. There were no transactions for which cash flow hedge accounting had to be discontinued in the year as a result of the highly probable cash flows no longer being expected to occur. The fair value of derivatives is disclosed in note 3.6 of the Group's consolidated financial statements.

Risk report (continued)

FINANCIAL RISK (continued)

Market risk (continued)

Monitoring

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

Value at Risk (audited)	Group			
	Duration risk VaR(1)		Credit spread(2)	
	2020	2019	2020	2019
12 months to 30 September	£m	£m	£m	£m
As at 30 September	**2**	2	**49**	19
Average value during the year	**2**	2	**36**	23
Minimum value during the year	**1**	-	**23**	19
Maximum value during the year	**2**	2	**49**	26

(1) 2019 duration risk VaR restated from a three month to one day holding period to align to 2020 internal risk methodology.

(2) The history set for credit spread VaR was increased from 2 years to 10 years from 1 March 2020 under internal methodology driving the year on year increase. The average figures for 2020 include five months over a two year history and seven months over a 10-year history.

Risk report (continued)

FINANCIAL RISK (continued)

Market risk (continued)

Market risk linkage to the balance sheet (audited)

The following table shows the Group's principal market risks, linked to the balance sheet assets and liabilities:

	2020 £m	2019 £m	**Interest rate Duration risk**	**Optionality risk**	**Basis risk**	**Credit Spread risk**	**Foreign Exchange risk**
Assets							
Financial assets at amortised cost							
Loans and advances to customers	**72,428**	73,093	●	●	●		●
Cash and balances with central banks	**9,107**	10,296	●		●		
Due from other banks	**927**	1,018	●		●		●
Financial assets at fair value through profit or loss							
Loans and advances to customers	**190**	253	●	●	●		●
Derivative financial instruments	**318**	366	●		●		●
Other financial assets	**1**	8	●				●
Financial instruments at fair value through other comprehensive income	**5,080**	4,328	●		●	●	●
Other assets	**2,256**	1,739	●			●	
Total assets	**90,307**	91,101					
Liabilities							
Financial liabilities at amortised cost							
Customer deposits	**67,710**	64,000	●	●	●		●
Debt securities in issue	**5,933**	7,267	●		●		●
Due to other banks	**5,469**	8,916	●		●		●
Financial liabilities at fair value through profit or loss							
Customer deposits	**-**	4	●	●	●		●
Derivative financial instruments	**250**	273	●		●		●
Other liabilities	**5,955**	5,500	●				●
Total liabilities	**85,317**	85,960					

Risk report (continued)

FINANCIAL RISK (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. During Q3 2020 the Group shortened the tenor applied to equity and to deposits that are subject to behavioural assumptions. Further information can be found in the Chief Financial Officer's review, within the Virgin Money UK PLC Annual Report & Accounts 2020.

Group 2020	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							
Financial assets at amortised cost							
Loans and advances to customers	**3,130**	**14,308**	**15,101**	**38,802**	**1,087**	**-**	**72,428**
Cash and balances with central banks	**7,697**	**-**	**-**	**-**	**-**	**1,410**	**9,107**
Due from other banks	**167**	**760**	**-**	**-**	**-**	**-**	**927**
Financial assets at fair value through profit or loss							
Loans and advances to customers	**-**	**119**	**10**	**29**	**32**	**-**	**190**
Derivative financial instruments	**-**	**-**	**-**	**-**	**-**	**318**	**318**
Due from related entities	**11**	**-**	**-**	**-**	**-**	**-**	**11**
Financial instruments at fair value through other comprehensive income	**1,017**	**1,506**	**150**	**1,131**	**1,276**	**-**	**5,080**
Other assets	**-**	**-**	**-**	**-**	**-**	**2,246**	**2,246**
Total assets	**12,022**	**16,693**	**15,261**	**39,962**	**2,395**	**3,974**	**90,307**
Liabilities							
Financial liabilities at amortised cost							
Customer deposits	**27,503**	**22,837**	**10,201**	**7,167**	**2**	**-**	**67,710**
Debt securities in issue	**2,173**	**2,126**	**-**	**389**	**1,245**	**-**	**5,933**
Due to other banks	**5,469**	**-**	**-**	**-**	**-**	**-**	**5,469**
Financial liabilities at fair value through profit or loss							
Derivative financial instruments	**-**	**-**	**-**	**-**	**-**	**250**	**250**
Due to related entities	**-**	**69**	**30**	**1,848**	**875**	**-**	**2,822**
Other liabilities	**-**	**950**	**-**	**-**	**-**	**2,183**	**3,133**
Equity	**4,990**	**-**	**-**	**-**	**-**	**-**	**4,990**
Total liabilities and equity	**40,135**	**25,982**	**10,231**	**9,404**	**2,122**	**2,433**	**90,307**
Off balance sheet items							
Notional value of derivatives managing interest rate sensitivity	**32,965**	**6,185**	**(8,416)**	**(30,392)**	**(342)**	**-**	**-**
Total interest rate gap	**4,852**	**(3,104)**	**(3,386)**	**166**	**(69)**	**1,541**	**-**
Cumulative interest rate gap	**4,852**	**1,748**	**(1,638)**	**(1,472)**	**(1,541)**	**-**	**-**

Risk report (continued)

FINANCIAL RISK (continued)

Market risk (continued)

Repricing periods of assets and liabilities by asset/liability category (continued)

Group 2019	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							
Financial assets at amortised cost							
Loans and advances to customers	7,473	10,245	13,884	40,122	1,241	128	73,093
Cash and balances with central banks	8,254	572	12	62	-	1,396	10,296
Due from other banks	333	685	-	-	-	-	1,018
Financial assets at fair value through profit or loss							
Loans and advances to customers	-	21	87	145			253
Derivative financial instruments	-	-	-	-	-	366	366
Due from related entities	18	-	-	-	-	-	18
Financial instruments at fair value through other comprehensive income	684	1,099	410	836	1,299	-	4,328
Other assets	-	107	80	426	-	1,116	1,729
Total assets	16,762	12,729	14,473	41,591	2,540	3,006	91,101
Liabilities							
Financial liabilities at amortised cost							
Customer deposits	10,353	17,371	12,873	23,401	2	-	64,000
Debt securities in issue	300	5,600	300	203	864	-	7,267
Due to other banks	2,844	5,922	150	-	-	-	8,916
Financial liabilities at fair value through profit or loss							
Customer deposits	4						4
Derivative financial instruments	-	-	-	-	-	273	273
Due to related entities	-	40	-	1,025	1,250	-	2,315
Other liabilities	-	48	143	760	-	2,234	3,185
Equity	350	240	719	3,832	-	-	5,141
Total liabilities and equity	13,851	29,221	14,185	29,221	2,116	2,507	91,101
Off balance sheet items							
Notional value of derivatives managing interest rate	(2,253)	16,185	(800)	(13,149)	17	-	-
Total interest rate gap	658	(307)	(512)	(779)	441	499	-
Cumulative interest rate gap	658	351	(161)	(940)	(499)	-	-

Risk report (continued)

FINANCIAL RISK (continued)

Market risk (continued)

Repricing periods of assets and liabilities by asset/liability category (continued)

Bank 2020	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							
Financial assets at amortised cost							
Loans and advances to customers	**3,130**	**13,316**	**15,101**	**38,802**	**1,087**	**-**	**71,436**
Cash and balances with central banks	**7,697**	**-**	**-**	**-**	**-**	**1,410**	**9,107**
Due from other banks	**167**	**7**	**-**	**-**	**-**	**-**	**174**
Financial assets at fair value through profit or loss							
Loans and advances to customers	**-**	**119**	**10**	**29**	**32**	**-**	**190**
Derivative financial instruments	**-**	**-**	**-**	**-**	**-**	**134**	**134**
Due from related entities	**-**	**1,163**	**-**	**-**	**-**	**-**	**1,163**
Financial assets instruments at fair value through other comprehensive income	**1,017**	**1,506**	**150**	**1,131**	**1,276**	**-**	**5,080**
Other assets	**-**	**-**	**-**	**-**	**-**	**2,242**	**2,242**
Investment in related entities	**73**	**-**	**-**	**-**	**-**	**-**	**73**
Total assets	**12,084**	**16,111**	**15,261**	**39,962**	**2,395**	**3,786**	**89,599**
Liabilities							
Financial liabilities at amortised cost							
Customer deposits	**27,503**	**22,837**	**10,201**	**7,167**	**2**	**-**	**67,710**
Debt securities in issue	**607**	**-**	**-**	**-**	**1,245**	**-**	**1,852**
Due to other banks	**5,469**	**-**	**-**	**-**	**-**	**-**	**5,469**
Financial liabilities at fair value through profit or loss							
Derivative financial instruments	**-**	**-**	**-**	**-**	**-**	**250**	**250**
Due to related entities	**1,406**	**1,707**	**30**	**2,237**	**875**	**-**	**6,255**
Other liabilities	**-**	**950**	**-**	**-**	**-**	**2,182**	**3,132**
Equity	**4,931**	**-**	**-**	**-**	**-**	**-**	**4,931**
Total liabilities and equity	**39,916**	**25,494**	**10,231**	**9,404**	**2,122**	**2,432**	**89,599**
Off balance sheet items							
Notional value of derivatives managing interest rate	**32,965**	**6,185**	**(8,416)**	**(30,392)**	**(342)**	**-**	**-**
Total interest rate gap	**5,133**	**(3,198)**	**(3,386)**	**166**	**(69)**	**1,354**	**-**
Cumulative interest rate gap	**5,133**	**1,935**	**(1,451)**	**(1,285)**	**(1,354)**	**-**	**-**

Risk report (continued)

FINANCIAL RISK (continued)

Market risk (continued)

Repricing periods of assets and liabilities by asset/liability category (continued)

Bank 2019	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							
Financial assets at amortised cost							
Loans and advances to customers	5,870	7,389	5,594	13,500	161	128	32,642
Cash and balances with central banks	4,579	572	12	62	-	1,396	6,621
Due from other banks	-	225	-	-	-	-	225
Financial assets at fair value through profit or loss							
Loans and advances to customers	-	21	87	145	-	-	253
Derivative financial instruments	-	-	-	-	-	442	442
Due from related entities	500	1,606	370	-	-	-	2,476
Financial assets instruments at fair value through other comprehensive income	557	298	410	345	740	-	2,350
Other assets		107	80	426	-	815	1,428
Investment in related entities	1,776	-	-	-	-	-	1,776
Total assets	13,282	10,197	6,466	14,333	901	2,781	47,960
Liabilities							
Financial liabilities at amortised cost							
Customer deposits	10,355	2,887	4,970	11,557	2	-	29,771
Debt securities in issue	-	-	-	-	709	-	709
Due to other banks	3,829	31	-	-	-	-	3,860
Financial liabilities at fair value through profit or loss							
Customer deposits	4	-	-	-	-	-	4
Derivative financial instruments	-	-	-	-	-	292	292
Due to related entities	300	2,558	-	1,228	1,250	-	5,336
Other liabilities	-	48	143	760	-	2,081	3,032
Equity	1,765	160	479	2,552	-	-	4,956
Total liabilities and equity	16,253	5,684	5,592	16,097	1,961	2,373	47,960
Off balance sheet items							
Notional value of derivatives managing interest rate	(2,254)	1,296	(782)	129	1,611	-	-
Total interest rate gap	(5,225)	5,809	92	(1,635)	551	408	-
Cumulative interest rate gap	(5,225)	584	676	(959)	(408)	-	-

Risk report (continued)

FINANCIAL RISK (continued)

Market risk (continued)

LIBOR Replacement

The Group has a LIBOR transition programme to manage the impact of the BoE's plan to discontinue the use of LIBOR as a reference rate after 2021. The work to decommission LIBOR is focused on ceasing the issuance of new LIBOR lending in advance of the end of March 2021 industry deadline, developing and delivering alternative reference rate products, and implementing a back-book migration strategy based on consensual customer agreement and transition before the end of 2021. A similar approach is being taken with new and existing derivatives. All market-facing derivative flows are now executed against SONIA and the strategy to proactively manage the back-book of LIBOR derivatives is underway.

The Group has maintained engagement with the BoE's Working Group on Sterling Risk Free Reference Rates and other industry forums. The programme will ensure that the risks of being unable to offer products with suitable reference rates will be mitigated and that full consideration is given to the potential for any conduct issues that may arise through the transition.

Pension risk

The Group operates a defined benefit pension scheme, the Yorkshire and Clydesdale Bank Pension Scheme (the Scheme). Clydesdale Bank PLC (the Bank) is the Scheme's principal employer and there are no other participating employers. The Scheme was closed to future accrual on 1 August 2017 for most members. A small number of members remain on a defined benefit accruals basis subject to certain conditions.

Defined benefit pension schemes provide a promise to pay members a pre-determined level of income at retirement which is independent of the contributions, investments and returns (the scheme assets) used to fund these benefit promises (the scheme liabilities). The operation of a pension scheme gives rise to several risks, for example movements in equity valuations, changes in bond yields, life expectancy of scheme members, movements in interest and inflation rates and changes in legislation. The Group also supports a defined contribution scheme, however the nature of this type of scheme places the investment and liability risk on the member rather than the Group.

Pension risk is the risk that, at any point in time, the value of the scheme assets is not enough to meet the current or expected future value of the scheme liabilities. This risk will continue to exist until the scheme is formally wound up, either if all the liabilities are transferred to a third party (e.g. an insurer) or once all individual member benefits have been honoured.

Risk appetite

The Group's pension risk appetite is a component of the Group-wide RAS framework for the management of balance sheet risks and is considered in the context of potential capital impacts because of volatility in the Scheme's valuations.

Assets

The Trustee governs investments according to a Statement of Investment Principles. This is reviewed and agreed by the Trustee Board on a regular basis, with the Bank consulted on any proposed changes. The Statement of Investment Principles is drafted in accordance with the requirements of Section 35 of the Pensions Act 1995 (as amended by the Pensions Act 2004 and regulations made under it). This sets out the Scheme objectives and the journey plan to meet these objectives.

This results in an appropriate mix of return seeking assets as well as liability matching assets to better match future pension obligations. The split of Scheme assets is shown within note 3.12 of the Group's consolidated financial statements. The fair value of the assets was £4.7bn as at 30 September 2020 (30 September 2019: £4.7bn).

Risk report (continued)

FINANCIAL RISK (continued)

Pension risk (continued)

Liabilities

The retirement benefit obligations are a series of future cash outflows with relatively long duration and are responsive to movements on many of the inputs including interest rates. On an IAS 19 basis these cash flows are primarily sensitive to changes in the expected long-term price inflation rates (RPI/CPI), the life expectancy of members and the discount rate (linked to yields on AA corporate bonds):

- an increase in long-term expected inflation corresponds to an increase in liabilities;
- an increase in life expectancy corresponds to an increase in liabilities; and
- a decrease in the discount rate corresponds to an increase in liabilities.

Exposure

The Group's defined benefit pension scheme affects its regulatory capital in two ways:

- CET1 capital – while an IAS 19 surplus will increase the Group's balance sheet assets and reserves, any such amount is not recognised for the purposes of determining CET1 capital. However, an IAS 19 deficit, which increases balance sheet liabilities and reduces reserves, is recognised for regulatory capital purposes, and so will decrease CET1 capital.
- Pillar 2A capital – the Group is also required to determine the level of capital required to be held under Pillar 2A for pension obligation risk as part of the annual ICAAP process. This requirement forms part of the Group's regulatory Total Capital Requirement (TCR).

Within the Scheme itself, risk arises because the assets (e.g. equities, bonds/gilts, property) 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.

Mitigation

The Trustee and Group have a common view of the Scheme's long-term strategic aims, encapsulated by an agreed de-risking journey plan. Within the journey plan, several core principles have been established, including a long-term self-sufficiency funding target (i.e. the point in time when the Scheme would no longer need to call on the Bank for additional funding) with assumptions as to how this target is expected to be managed, monitored and met. Potential actions to address deviations in the actual funding level relative to the journey plan have also been considered.

Several other activities have been implemented by the Group and Trustee with the specific aim of reducing risk in the Scheme, including equity options which reduce the downside risk of a fall in equity values, increasing the levels of inflation and interest rate hedging and several member benefit reforms, culminating in closure to future accrual for most members.

In addition, the Group has signed a contingent security arrangement to give the Trustee a degree of protection against the risk of the Group defaulting on its obligations under the Recovery Plan and to provide an additional amount to partially mitigate adverse changes impacting the Scheme's assets or liabilities.

The Bank and the Trustee continue to explore other cost-effective options to further reduce risk within the Scheme.

Monitoring

Information on the Scheme's current valuations, asset holdings and discount and inflation rate assumptions are presented monthly to ALCO. The impact of the Scheme on the Group is also subject to risk oversight from the Risk function. In addition, semi-annual pension risk updates are provided to the Executive and Board Risk Committees.

Performance of the Scheme's asset portfolio against the various risk metrics is independently monitored by the Scheme investment adviser, Willis Towers Watson, and reported to the Investment Sub Committee, which includes Group representation, and Trustee Board on a quarterly basis.

Risk report (continued)

Model risk

The Group definition of a model is a quantitative method, system, or approach that applies statistical, economic, financial, or mathematical theories, techniques, and assumptions to process input data into quantitative estimates. This model definition also considers broader aspects within the model environment which may represent distinct and separable entities or be intrinsically linked to model structures.

The use of models invariably presents model risk, which is defined as the potential for adverse consequences from decisions based on incorrect or misused model outputs and reports. The model risk policy standard seeks to manage and mitigate model risk which encompasses the end-to-end model life cycle covering data (quality and lineage), model development, independent model validation, model governance, model implementation, model usage, model monitoring, model maintenance and model decommissioning.

Model risk increases with greater model complexity, higher uncertainty around inputs and assumptions, broader use, and larger potential impact. If left unmitigated, model risk can lead to poor decision making, misreporting or a failure to identify risks, which in turn could result in financial and reputational losses, as well as having a detrimental impact on customers.

Risk appetite

In delivering its strategic objectives, the Group accepts that a level of loss may arise from model error. The Board establishes the extent of its willingness, or otherwise, to accept results from using models and key controls are in place to ensure model errors remain within acceptable limits.

The Group's appetite for model risk is defined and articulated in the Group RAS. Metrics focus on whether the model validation process is managed within the timelines required by the Model Risk Policy, and on the outcomes of validations on the Group's most material models. Model risk appetite is reported regularly to both the Board and the Model Governance Committee (MGC).

Exposures

To enable senior management to gauge and manage model risk, each model is classified according to materiality.

The Group assesses model materiality using criteria of coverage, impact and complexity to define the level of risks associated with the model's use, purpose and strategic importance. A model's assessed materiality level determines its approval path through governance and the degree, frequency and depth of review and validation expected.

Changes in both customer behaviour and model performance have been driven by restrictions introduced to help curb the spread of COVID-19 and by government measures introduced to help support the economy. This has increased model risk with model inputs and outputs changing as a result.

To mitigate these risks, COVID-19 tactical calculators, or model adjustments, have been mobilised at pace, however this heightens the risk that particular implementations could contain errors or unexpected outcomes, which ultimately increases the risk of errors in model usage and in model outputs.

While the model risk impacts from governmental support measures and restrictions introduced to help combat the impacts of COVID-19 are being actively monitored and managed, there remains inherent uncertainty over the timing of relief run-off and the shape of the economic recovery.

The Group model inventory contains a comprehensive set of information on all models which are implemented for use, to be implemented, under development, recently retired or decommissioned, as well as listing challenger models. Any model which has a separate use or requires separate validation and approval is classified as a separate model. The Group Model Inventory covers a wide range of types of models from all parts of the bank and, as a consequence, there is interaction between model risk and a number of the Group's principal risk categories.

Measurement

The Board delegates to MGC to ensure that model risk is being managed through the model risk management policy standard.

Model risk is measured through regular model monitoring to the Board and MGC and the level of risk is assessed through RAS.

Risk report (continued)

Model Risk (continued)

Mitigation

The Group has a model risk policy framework in place to manage and mitigate model risk, which encompasses the end-to-end model life cycle. The model risk policy standard defines roles and responsibilities in terms of model risk management. Specifically, it sets out that the model owner has the responsibility of attesting to the compliance of the model risk policy standard requirements on an annual basis, including that the model is implemented correctly in an appropriate system, or advising exemptions.

A suitably qualified Independent Model Validation function conducts model validations prior to model implementation, both when a model is changed and on a periodic basis. The function assists with identifying model deficiency and raises mitigating actions and additional risk control. When significant model deficiencies and/or errors are identified during the validation process, the relevant model approval authority should consider whether the use of models should either be prohibited or permitted possibly under strict controls and mitigants. This may include measures such as the use of expert panels to adjust model outputs or identify appropriate PMAs or overlays.

Internal Audit assesses the overall effectiveness of the model RMF.

Monitoring

Model monitoring functions perform periodic monitoring of model performance to ensure parameter estimates and model constructs remain fit for purpose and use when sufficient new observations are available and to ensure model assumptions remain valid. The frequency of model monitoring should be commensurate with the nature and materiality of the models and risks, with due consideration given to model complexity.

MGC is the primary model approval authority and body responsible for overseeing model risk of the Group's most material models. The frequency and level of model monitoring required is detailed within Group procedural frameworks.

Regulatory and compliance risk

Regulatory and compliance risk is the risk of failing to understand and comply with relevant laws and regulatory requirements; not keeping regulators informed of relevant issues; not responding effectively to IRs nor meeting regulatory deadlines; or obstructing the regulator.

Privacy and data protection risks, which may result from non-compliance with data privacy, legal and regulatory obligations, have been transferred to regulatory and compliance risk, from technology risk, as part of this years RMF refresh.

Risk appetite

The Group has no appetite for actions which result in breaches of regulation or for inaction to address systemic process and control failures leading to material non-compliance. Notwithstanding the complexity and volume of the regulatory agenda, the Group ensures that all mandatory requirements are prioritised with sufficient resources to implement within required timescales in a customer-focused manner. The Group has an open dialogue with colleagues and regulators, escalating all issues they would reasonably expect to be made aware of.

Exposures

The Group remains exposed to regulatory and compliance risk as a result of significant ongoing and new regulatory change. COVID-19 has resulted in much of this change needing to be implemented at pace, increasing the potential risk for non-compliance with regulation.

Measurement

Regulatory and compliance risks are measured against a defined set of Board-approved risk appetite metrics relating to regulatory breaches, and past due regulatory implementations and actions. Thresholds are set and form part of the Board-approved RAS.

Mitigation

The following controls and procedures help to mitigate regulatory and compliance risk:

- a clearly defined regulatory and compliance policy statement (with supporting policy standards) and RAS signed off by the Board;
- ongoing development, maintenance and reporting of risk appetite measures for conduct risk to the Executive Risk Committee and the Board;
- maintenance of proactive and coordinated engagement with the Group's key regulators;
- continual assessment of evolving regulatory requirements, including regulatory business plans and thematic reviews;
- consideration of regulatory requirements in the context of product and proposition development and associated appropriate governance;
- oversight of key regulatory implementations including LIBOR transition and Payment Services Directive 2;
- oversight of regulatory and compliance risks and issues in relevant governance bodies;
- ongoing review and tracking of known regulatory and compliance issues and remediation actions being taken; and
- a risk-based assurance framework, designed to monitor compliance with regulation and assess customer outcomes.

Monitoring

All three lines of defence consider conduct risk as part of their oversight and assurance activities. A risk assurance plan, approved by the Board Risk Committee on an annual basis, independently assesses the control framework underpinning the Group's conduct risk management 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. In response to COVID-19, and the actions taken by the Group to support its customers during this time, a revised risk assurance plan was created and approved by the Board in April 2020.

Risk report (continued)

Conduct risk

Conduct risk is the risk of undertaking business in a way which is contrary to the interests of customers, resulting in the delivery of inappropriate customer 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.

Exposures

The Group remains exposed to conduct risk in the course of its provision of services and products to customers. In addition, the Group's response to COVID-19 has required processes to be introduced and decisions to be made at pace, increasing the potential risk for poor customer outcomes. Any issues identified are promptly addressed and remediation plans are initiated where required.

The Group continues to remediate a small number of legacy conduct issues, including payment protection insurance (PPI).

Measurement

Conduct risks are measured against a defined set of Board-approved risk appetite metrics, including measures on the quality of advised and non-advised sales, the volume of complaints and the quality of complaint handling. Thresholds are set and form part of the Board-approved RAS.

Mitigation

The following controls and procedures help to mitigate conduct risk:

- clearly defined conduct risk policy statement (with supporting policy standards) and RAS signed off by the Board;
- ongoing development, maintenance and reporting of risk appetite measures for conduct to the Executive Risk Committee and the Board;
- consideration of conduct risk in the context of product and proposition development and associated appropriate governance;
- regular management review of end-to-end conduct reporting, centred on core product areas and aligned to relevant businesses;
- oversight of conduct risks and issues in relevant governance bodies;
- analysis of customer experience oriented data, complaint handling quality and volumes and root causes of complaints discussed in the relevant governance bodies, with actions agreed and tracked by senior stakeholders;
- continuing development and nurture of a customer-centric culture aligned to the Group's Purpose;
- ongoing review and tracking of known conduct issues and remediation actions being taken; and
- a risk-based assurance framework, designed to monitor compliance with regulation and assess customer outcomes.

Monitoring

All three lines of defence consider conduct risk as part of their oversight and assurance activities. A risk assurance plan, approved by the Board Risk Committee on an annual basis, independently assesses the control framework underpinning the Group's conduct risk management 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. In response to COVID-19 and the actions taken by the Group to support its customers during this time, a revised risk assurance plan was created and approved by the Board in April 2020.

Risk report (continued)

Operational risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. It is a core component of the RMF and is embedded in day-to-day business activities focused on enabling operational efficiencies. Requirements and responsibilities are set out in the operational risk policy statement and supporting operational risk policy standard that seeks to identify, assess, mitigate, monitor, and report the operational risks, events and issues that could impact the achievement of business objectives or 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.

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 are taken to minimise customer disruption through recovery within defined timelines.

Exposures

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 or reputation. The Group strives to deliver operational efficiency in the implementation of its objectives and accepts that a level of loss may arise from operational failure. Implementing key controls and monitoring ensures that operational risks are managed, and losses remain within acceptable limits.

The Group’s exposure to operational risk is impacted through the need to engage with innovative, dynamic third parties; deliver new products and services; and make effective use of reliable data in a changing external environment to deliver on the Group’s strategic objectives. Alongside ongoing risk and control monitoring, operational risk oversight is focused on the following key areas:

Risk category	
Change risk	The risk associated with the 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 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. Ongoing performance management and assurance is undertaken to ensure that supplier relationships are controlled effectively.

Operational risk (continued)

Measurement

Material operational risk events are identified, reviewed and escalated in line with criteria set out in the RMF. Root cause analysis is undertaken and action plans are implemented.

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. Due to the nature of risk events, losses and recoveries can take time to crystallise and therefore may be restated for prior or subsequent financial years.

Operational risk losses

The majority of losses are recorded under two Basel categories: 'External fraud' and 'Execution, delivery and process management'. The volume of external fraud losses accounted for over 87% of the total. This category's higher volume of low-value events is in line with the industry and relates mainly to card and online fraud. 'Execution, delivery and process management' volumes are as expected and reflect the daily volume of transactions and customer interactions. The highest net losses for the year relate to the 'Damage to physical assets' category, which is the Basel II category used for natural disasters and is the best fit for operational risk losses directly attributable to COVID-19, which were aggregated under one event.

Operational risk losses by Basel category[(1)]

	% of total volume		% of total losses	
	2020	2019	**2020**	2019
Business disruption and system failures	**0.6%**	0.7%	**1.8%**	1.9%
Clients, products and business practices	**5.5%**	4.3%	**2.8%**	5.8%
Damage to physical assets	**0.3%**	0.2%	**45.9%**	0.8%
Employee practices and workplace safety	**-**	-	**-**	-
Execution, delivery and process management	**6.1%**	11.7%	**5.3%**	12.3%
External fraud	**87.5%**	82.9%	**44.2%**	71.5%
Internal fraud	**-**	0.2%	**-**	7.8%

(1) Losses greater than or equal to £5,000, excluding PPI.

Mitigation

In delivering to its strategic objectives, the Group strives to deliver operational efficiency and accepts that a level of loss may arise from operational failure. Implementing key controls and monitoring ensures that operational risks are managed and losses remain within acceptable limits.

Monitoring

The Group has identified, assessed and is currently monitoring all key operational risks across the above noted Basel II categories, including undertaking an assessment of control effectiveness, monitoring trends in key risk indicators and escalating events, in accordance with policy requirements. The Risk management function performs oversight of the Group's business planning process, including analysis of industry trends or forward-looking threats that could lead to material impact on our ability to deliver on the strategic objectives or result in a significant impact on assessment of operational risk capital. It also performs ongoing oversight of the Groups' management of operational risk, including risk and control assessment, issues and risk events.

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 the Risk function, 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 report (continued)

Technology risk

Technology risk is defined as the risk of loss resulting from inadequate or failed information technology processes through strategy, design, build or run components and internally or externally provided services.

Risk appetite

Technology risks are measured against a set of defined RAS metrics and reported to Executive and Board Committees.

Exposures

The Group's exposure to technology risk is materially impacted by the need to enhance digital capabilities, integrate two technology estates and rely on remote working. Technology risk is comprised of the following risk categories:

Risk category	
Cyber and information security risk	The risks arising from inadequate internal and external information and cyber security, where failures impact the confidentiality, integrity and availability of electronic data within our systems and processes. Continued focus is being placed on risks and controls associated with cyber security where the Group has recognised significant escalation of external cyber threats, regulatory penalty and resilience need, heavily influenced by COVID-19 and changing operating environment. *How this risk is managed* – Our Chief Information Security & Resilience Officer is responsible for ensuring robust cyber and information security policies and controls are in place and operating effectively. The Group continues to enhance and invest in the control environment, recognising the changing cyber landscape and the increased focus on digital capabilities and reliance on homeworking, as well as the changing risk profile of the business. All three lines of defence possess skilled resource in this discipline to protect the Group.
Physical security risk	The risk to the safety and protection of colleagues, customers and physical assets arising from unauthorised access to buildings, theft, robbery, intimidation, blackmail, sabotage, terrorism and other physical security risks. *How this risk is managed* – Physical and personal security standards are managed by the Group's Chief Information Security and Resilience Officer. Controls are in place to protect the Group's physical assets, as well as the security of colleagues and customers. Appropriate protection and security protocols are in place across the Group and partners with specialised expertise are leveraged as required.
IT resilience risk	IT resilience is the ability of the Group to quickly adapt to disruptions while maintaining continuous operations on critical processes, safeguarding technology and all associated assets in the face of adverse events, short term shocks, chronic disruptions or incremental changes. IT resilience risk includes the risks associated with technology, colleagues, suppliers and property. The Group recognises the significant regulatory focus on resilience as the market becomes more reliant on mobile and online banking, increased remote working, and the use of third-party and cloud solutions. *How this risk is managed* – IT resilience sits within the resilience framework with underlying risk metrics reported to Executive Committees and Board. The Group is well placed to respond to new regulations and standards in resilience and develops technology with resilience inbuilt as a principle. A programme of continuous monitoring of the currency of the technology estate alongside disaster recovery testing helps to minimise the likelihood of system failure. In preparation for an outage, the Group also maintains and tests critical end-to-end business recovery and contingency plans. All three lines of defence possess skilled resource in this discipline to protect the Group.

Risk report (continued)

Technology risk (continued)

Risk category

Payment risk	The payments industry is planning for significant changes to infrastructure and processing protocols over the next 12-24 months, brought on by the implementation of ISO20022, Real-Time Gross Settlement Renewal and New Payments Architecture, with the Group challenged to maintain the resilience of service during these implementations. There is the risk that financial transactions are not conducted per the instructions and parameters of our customers' payment, trading, clearing, settlement schemes or business requirements. This could lead payment delays, inaccuracies, duplicates, failures or rejections as well as system-based restrictions and errors. *How this risk is managed* – The payment risk framework outlines key scheme rules, regulations and compliance requirements alongside the risk-based approach to assurance oversight, control testing and change management to ensure that payment risk is managed within appetite, and impact to customers across the Group is minimised. All three lines of defence are actively involved in changes being made in this evolving environment. As such, the Group continues to invest in its payment services capability.
Data risk[(1)]	Data underpins decision making at all levels of the organisation. Poor quality data can lead to loss, customer disruption, non-compliance with GDPR (e.g., in relation to data minimisation, data accuracy and the Group's ability to respond adequately when data subject rights are exercised) and unnecessary rework. Data therefore needs to be controlled to the appropriate standards throughout its life cycle and be made available for re-use where appropriate. *How this risk is managed* – The Group has a data management framework governing the creation, storage, distribution, usage and retirement of data, which is aligned with GDPR requirements. Quality is attested to by each business area against three attributes: completeness, accuracy and appropriateness. Oversight is well established within all three lines of defence.

(1) The privacy and data protection risk category was transferred to regulatory and compliance risk as part of this year's RMF refresh.

Measurement

The Group has a number of technology risk Key Risk Indicators which cover the key risk areas outlined above. In addition, there is a suite of Board-approved RAS metrics which is monitored and reported monthly, with breaches escalated to the Board. All technology risks are assessed using the operational risk framework and are monitored and challenged by the Risk function in line with functional and corporate governance.

Mitigation

Through organisational design and management focus, considerable investment has been put into the above areas by the Group. Technology expertise exists in all three lines of defence. Technology risk policies, frameworks, thematic assurance reviews and oversight routines ensure that technology risk is identified, measured, monitored and reported on by the first line of defence and overseen and assured by the second and third lines of defence.

Monitoring

Business units are responsible for the day-to-day management of technology risk, with oversight from the risk management function, and independent assurance activities undertaken by internal audit. The Group conducts a series of planned independent assurances, deep dives, change assurance activities and continuous monitoring activities.

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.

Risk Appetite

Financial crime risk is measured and reported against a defined suite of metrics within the Group RAS. In particular:

Anti-money laundering and Counter Terrorist Financing
The Group applies a risk-based approach model which sets out the types of customer it has no risk appetite to onboard, as well as customers with whom the Group is prohibited from entering into or maintaining a relationship with.

Sanctions and embargoes
The Group has no appetite for non-compliance with the legal and regulatory obligations relating to sanctions and embargoes.

Bribery and corruption
The Group does not tolerate the direct or indirect offer, payment, solicitation or acceptance of bribes in any form.

External fraud
The Group accepts that an element of fraud loss is a cost of doing business. Fraud risk appetite is set annually by the Board, practically applied using the fraud policy standard and expressed in financial terms via the annual fraud loss plan. The application of the fraud RMF balances genuine customer impacts alongside the operational overhead of applying fraud controls to achieve fraud loss within budget and risk appetite.

Internal fraud
The Group has no appetite for internal fraud.

Exposures

Financial crime risk is inherent in doing business in the financial services industry and may arise from failure to:

- meet legal and regulatory requirements; and
- maintain effective systems and controls to prevent the risk that the Group might be used for further financial crime.

The Group continues to review the external environment for any change in regulatory or legislative direction, taking action as appropriate.

Measurement

All financial crime standards are reflected in the Group policy standards and financial crime prevention manual, the content of which is provided by financial crime risk and updated as appropriate. Financial crime related risk appetite metrics are monitored and reported to the Board on a monthly basis.

Mitigation

The Group adopts a risk-based approach to financial crime and the following controls and procedures support mitigation:

- a clearly defined financial crime risk policy statement (with supporting policy standards) and RAS signed off by the Board;
- ongoing development, maintenance and reporting of risk appetite measures for financial crime and fraud risk to the Executive Risk Committee and the Board;
- key performance metrics relative to critical financial crime systems are kept under review and presented through governance to ensure ongoing effectiveness;
- consideration of financial crime and fraud risk in the context of product and proposition development and associated appropriate governance;
- continuing to progress with key implementations such as push payment fraud and confirmation of payee;
- ongoing assessment of evolving regulatory policy requirements and ensuring the Group responds accordingly, including the 5th Anti-Money Laundering Directive; and
- regular oversight and review of systems, controls and higher risk activities and customers takes place as part of a formal oversight plan.

Risk report (continued)

Financial crime risk (continued)

Monitoring

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

Screening for politically exposed persons and customer transaction monitoring is carried out by Financial Crime Operations. 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.

Strategic and enterprise risk

Strategic and enterprise risk is the risk of significant loss of earnings or damage arising from decisions or actions that impact the long-term interests of the Group's stakeholders or from an inability to adapt to external developments. Strategic risk can arise if the Group: designs or implements an inappropriate strategic plan; designs an appropriate plan but fails to implement it; or implements the strategic plan as intended, failing to take account of a change in external circumstances.

Strategic risk also includes an inability to respond effectively to cultural, structural and regulatory change; failure to establish and execute a compelling digital strategy or increase organisational capability in support of this; being an inefficient, high-cost, uninspiring or uncompetitive provider of products and services; or failing to respond to climate change risks in direct and indirect operations.

Enterprise risk includes managing and implementing effective governance and reporting, and maintaining external relations to promote the brand and support the Group's ability to successfully achieve strategic goals.

Risk appetite

The risk position for strategic and enterprise risk, referenced in the Group's RAS, takes account of the fact the Group will need to take an acceptable level of risk to successfully grow the business and will need to implement transformational changes to the operating model and supporting frameworks to achieve this. There is, however, a requirement to pursue these goals in a controlled and prudent manner given the potential downside in financial, reputational, conduct and broader risk implications.

The risks and constraints to growth opportunities are fully evaluated through the Strategic and Financial Plan and RAS setting processes to ensure there is no detrimental impact to the broader strategy.

Reflective of the generally negative outlook, the RAS settings have either been held at existing levels or tightened to reflect the expectations of a tougher competitive and economic environment.

Exposures

COVID-19, and the global response, continue to materially impact the Group through economic, credit and operational risks and with respect to customer needs. This uncertainty has been exacerbated by continued Brexit risk, with negative implications for customers and the portfolio amplified by the increasing possibility of a No Deal.

In addition, the Group operates in an increasingly competitive environment, with the pace of change and complexity posing risks to strategic initiatives. Shareholder expectations, particularly in relation to climate change, continue to evolve, increasing the importance of being able to respond appropriately.

The Group is also exposed to execution risk as a result of ongoing transformation activity.

Measurement

The Group's RAS 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 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.

Risk report (continued)

Strategic and enterprise risk (continued)

Mitigation

The Group undertakes thorough and regular monitoring of emerging and crystallised strategic risks, including developments in the external geo-political environment, to ensure it is best placed to pro-actively respond to changes as and when required. Robust contingency plans are in place to ensure the impact of any changes on strategic initiatives is captured.

The Group continues to develop and embed its sustainability agenda in response to shareholder and societal sentiment. This includes increased due diligence activity in relation to the lending decisions being undertaken, and social interaction to promote inclusion and diversity in the communities in which the Group operates.

The Risk function undertakes regular risk oversight activity, placing customers' interests at the centre of all aspects of change. This includes workstreams focused solely on the execution risk of transformation. The strategic planning process for the FY21 investment slate was overseen by the Risk function to ensure a balanced portfolio within the funding available.

Monitoring

A range of financial and non-financial metrics, including return on tangible equity (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 continually monitored against the Financial Plan by the Group's Board and Executive Leadership Team, who react to deviations from targets and modify strategy accordingly. While the Group is unable to influence these metrics explicitly, they are included in order to provide sight of possible portfolio deterioration ahead of specific internal focused metrics.

During the year, additional Strategic and Enterprise Risk RAS metrics, specifically relating to our ability to meet the strategic plan, and the importance of the brand in delivering strategic initiatives are under consideration.

Following the outbreak of COVID-19, the Group recognises there is a risk other novel infectious diseases could materialise in the future. The potential impact of future infectious disease outbreaks on the Group's principal and emerging risk framework will continue to be monitored and managed going forward.

People risk

People risk is defined as 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. This could lead to inappropriate decision making that is detrimental to customers, colleagues or shareholders and could ultimately lead to regulatory sanction.

The Group's drive to foster a culture which engages and encourages colleagues to deliver customer-focused outcomes with a clear set of supporting values and behaviours is an important step in mitigating people risk.

Risk appetite

COVID-19 has presented a range of people risks and a changing external environment which impacts health, safety and well-being. These include safety in the workplace, resource gaps, employee relations and working from home for extended periods. The Group's priority in dealing with these exceptional challenges is to ensure the safety of and provision of support for colleagues, including adherence with the government's physical and health measures.

The Group does not accept a material increase in risk as a result of colleagues not conducting themselves in the manner expected, nor does the Group act in a manner that may affect the health and well-being of colleagues. The Group does not take intentional action that may impact on its ambition to build an inclusive culture and continues to embed activities that support the required cultural change.

Exposures

People risk is inherent in the day-to-day operation of the business and is controlled through Purpose, Values, Behaviours and policies, and embedded through our people practices.

Risk report (continued)

People risk (continued)

Measurement

The Group has a range of Tier 1 and Tier 2 RAS metrics in place which help to measure and report people risk.

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

Mitigation

People risk is mitigated 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, serving 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. The Group's strategy will have implications for colleagues and will create an increased level of people risk during periods of uncertainty. Therefore, material structural changes will follow organisational design principles, the Senior Manager and Certification Framework and have appropriate governance.
- *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. These include health and well-being, succession and conduct.
- *The role of the HR function:* The role of the HR function: HR partners support the Executive Leadership Team and provide broader support to 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 full business partnering for the Executive Leadership Team.

Monitoring

People risks are monitored and reported through Executive and Board Committees. Internal Audit will carry out independent deep dives in specific areas of the business, to complement existing reporting and measure alignment between actual and intended culture.

Stress Testing

The people risks associated with 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.

Climate risk

Climate risk is classified as a cross-cutting risk type that manifests through other principal risks, primarily strategic and enterprise risk, credit risk and operational risk.

The Group is exposed to physical, transition and reputation risks arising from climate change:

- Physical risks arising from climate and weather-related events, such as heatwaves, droughts, floods, storms, sea level rise, coastal erosion and subsidence. These risks can potentially result in large financial losses, impairing asset values and the creditworthiness of borrowers.
- Transition risks arising from the process of adjustment towards a low-carbon economy could lead to changes in policy, technology and sentiment, prompting a reassessment of the value of a large range of assets and creating credit exposures for banks and other lenders as costs and opportunities become apparent.
- Reputation risk arising from a failure to meet changing societal, investor or regulatory demands.

The relevant principal risk frameworks include detail on how the Group identifies, assesses and manages climate risk.

Governance

A plan to embed consideration of the impacts of climate change in line with the PRA's Supervisory Statement SS3/19 was presented to the Board Risk Committee in October 2019, with progress being reported throughout the year. Updates have been aligned with the Environmental, Social and Governance (ESG) strategy to ensure all planning supports the Group's broader ESG aspirations. A Board workshop was held on emerging climate risk management practices across the financial services industry to support the Board's oversight of climate-related risks and opportunities.

Climate risk was considered by the Board in its review and challenge of the strategic and financial plan, the Group's Sustainability Strategy, RAS and RMF.

The Group Chief Risk Officer has Senior Manager responsibility for the Group's approach to managing financial risks from climate change, which includes:

- embedding the consideration of the financial risks from climate change in governance arrangements;
- incorporating the financial risks from climate change into risk management practices;
- using long-term scenario analysis to inform strategy setting, risk identification and assessment; and
- developing approaches to disclosure of the financial risks from climate change in line with the Taskforce for Climate-related Financial Disclosures (TCFD).

The Group's Credit Risk Committee has specific responsibility for oversight of climate-related aspects of credit risk including recommending strategies to adjust the credit risk portfolio to react to change in the prevailing market or physical environmental conditions. During the year the Committee received regular updates on the credit risk aspects of climate change, including climate risk-specific analysis relating to lending portfolios. Climate change was also considered within Committee's review of the Group's Sensitive Sectors policy summary as part of the ESG framework.

The Group's Executive Risk Committee has responsibility for overseeing the Group's exposures and approach to managing the financial risks from climate change. During the year the Committee received regular progress updates on progress against plan through the Group Chief Risk Officer's Report and special papers as appropriate.

Strategy

The time horizons over which the Group evaluates its climate-related risks are: short term: 0-5 years; medium term: 5-10 years; long term: >10 years. This is longer than the Group's financial planning cycle of five years and reflects the longer period over which risks are likely to crystallise. Risk assessment to date has focused on the most material risks which may impact the Group's business. These risks are described in more detail below.

The Group has launched a new Sustainability Strategy which includes climate-related risks and opportunities. The Group will expand the dialogue with customers on climate risks in 2021, with initial focus on larger transactions and higher-risk sectors and will support relationship managers and credit underwriters through additional training. During 2021, the Group will also develop scenario analysis capability which will further inform future refreshes of strategy.

Risk report (continued)

Climate risk (continued)

Mortgages

As at 30 September 2020, the mortgage portfolio represented 81% of the Group's customer lending (2019: 82%). Changes in extreme variability in weather patterns may lead to increased incidence and severity of physical risks which, in addition to the disruption felt by customers, can lead to a decrease in the valuations of property taken as collateral to mitigate credit risk. In addition, tightening minimum energy efficiency standards for domestic buildings could impact on the value of mortgaged properties or the ability of borrowers to service debt.

Business Lending

The Group has low levels of lending to carbon related assets at 0.1% (2019: 0.1%) of the Group's customer lending assets.

However, the Group may also be exposed to future transition risks through the business portfolio. Lending to selected sectors is shown below.

	2020		2019	
Sector	**£m**	**% Lending**	£m	% Lending
Energy - coal mining	**-**	0.0%	-	0.0%
Oil and gas	**83**	0.1%	68	0.17%
Of which: Oil and gas field services	**79**	0.1%	66	0.1%
Utilities - electric and gas	**162**	0.2%	144	0.2%
Of which: Renewables	**150**	0.2%	126	0.2%
Agriculture, Forestry and Fishing	**1,567**	2.2%	1,575	2.1%
Construction and Commercial Real Estate	**874**	1.2%	692	0.9%
Transportation (Automotive, Aviation, Shipping, Rail, motor vehicle retailing and servicing)	**763**	1.1%	667	0.9%
Concrete, Chemicals and Steel Manufacture	**109**	0.1%	114	0.2%

Scenario analysis

Analysis of current river and sea flood risk to properties within the mortgage portfolio has been undertaken as an initial step in assessing the physical risk to the Group's lending and understanding data limitations. Similar analysis was completed for Business lending property collateral. Current flood risk does not reflect the increased risk due to climate change and scenario analysis work is being undertaken to consider the longer-term impacts and the high degree of uncertainty. Transition risk within the mortgage portfolio has also been considered with an assessment of the energy efficiency of properties. The portfolio is in line with market averages and the Group increasingly intends to use this information to support our customers to 'green' their homes.

Work has been completed to analyse transition risks within the business lending book. A top-down assessment of sectors (and sub-sectors) which may have a higher likelihood of being impacted by transition risks from moving to a lower carbon environment has been performed, to increase understanding of the possible risks facing our customers, and support prioritisation of areas where further analysis is required. Building scenario analysis capability is a key component of work planned for 2021.

Where a heightened environmental or climate-related risk is identified during customer due diligence or credit processes, additional scrutiny under the Group's ESG Policy is triggered. This may require additional environmental reports to be obtained.

A large proportion of our business lending customers are privately owned and/or are small or medium enterprises. Very few lending customers therefore report against voluntary disclosure initiatives such as CDP, TCFD or Sustainability Accounting Standards Board (SASB). Such businesses are key to the UK economy and may be vulnerable to the impacts of climate change therefore the Group's focus will be on how it can support customers with adaptation and mitigation.

A summary of the Group's ESG Policy is available at: www.virginmoneyukplc.com/corporate-sustainability.

Risk report (continued)

Operational resilience

Operational resilience risk underpins all the principal risks associated with the resilience of the Group. Operational resilience is defined as the ability of the Group to protect and sustain its most critical functions, and underlying assets, while adapting to expected or unexpected occurrences of operational stress or disruption and having the capacity to recover from issues as and when they arise.

The Group assesses its operational resilience risk for the people, technology, third parties and premises that underpin the principal risks, ensuring that the Group aims to provide a superior level of support and services to customers and stakeholders on a consistent and uninterrupted basis.

It is accepted that, on occasion, this will not be possible and at such times, the Group aims to recover critical services within tight timelines to minimise customer disruption. This may have an inadvertent impact on the Group's overall risk profile including an increase in other principal risk profiles.

Risk Appetite

The Group tolerates a low level of operational resilience risk for the failure of any critical end-to-end process and will take immediate steps to ensure the Group remains resilient. The Group acknowledges that it is impossible to eliminate all interruptions to critical end-to-end processes and has identified risk appetite measures designed to indicate where there may be an underlying problem that requires resolution to maintain the Group's resilience.

Operational resilience risk is included in the Group's RAS and is managed in accordance with the minimum control requirements, as set out in the relevant underlying policy standards: business resilience and recovery; crisis and incident management; operational risk; and third party and critical outsourcing.

Exposures

The need for strong operational resilience is inherent in the provision of services to customers. As customer expectations and use of services evolves, the Group will need to maintain focus on the resilience of services. The need to manage two heritage technology estates will present additional operational resilience risk until such time duplication is removed and critical processes are relying on a single infrastructure.

COVID-19 highlights the ongoing exposure to external risks and threats that can be unpredictable in nature and widespread in impact. The Group's response to COVID-19 ensured that critical services could continue in the safest manner possible for both customers and colleagues. The ongoing nature of this event will continue to present risks to the Group's resilience and these are continually monitored.

Measurement

An operational resilience framework is in place, owned by the Group Chief Operating Office which identifies Tier 1 and Tier 2 critical end-to-end business processes across the four policy standard areas outlined earlier.

Mitigation

Operational resilience is demonstrated in the mitigation of risks that impact our people, technology, third parties and premises and covered in the principal risk sections. By identifying critical end-to-end Tier 1 and Tier 2 process across the Group, focus can be given to those processes and the controls, including the management of the technology on which they rely, in place to minimise disruption.

Monitoring

Operational resilience is monitored and reported regularly through Executive and Board Committees. Its underlying components are also monitored through the relevant principal risk monitoring including operational risk, technology risk and people risk.

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 2020.

Corporate governance

Details of the corporate governance framework applying to the Bank is set out in the Corporate governance report within the Virgin Money UK PLC Annual Report & Accounts.

Profits and appropriations

The Group made a loss before tax for the year ended 30 September 2020 of £173m (2019: loss of £182m). The loss attributable to the shareholders for the year ended 30 September 2020 amounted to £191m (2019: loss of £124m). A final dividend of 16.1p (2019: Nil) per ordinary share amounting to £20m (2019: £Nil) was paid in respect of the year ended 30 September 2020. 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. The following directors resigned during the year:

- Clive Adamson (29 November 2019);
- Adrian Grace (1 May 2020);
- Jim Pettigrew (5 May 2020);
- Teresa Robson-Capps (30 June 2020);
- Fiona MacLeod (30 September 2020); and
- Ian Smith (30 September 2020).

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' indemnities

The Directors have each entered into individual deeds of access, insurance and indemnity with the Group 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 Bank or an associated company that they may incur as an officer of the Bank and any other subsidiary of the Group. 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 during the financial year to which this Report relates. Such deeds are available for inspection at the Bank's registered office.

The Group has an insurance policy in place for the benefit of all trustees, colleagues, Directors, officers, members and partners of the Bank whilst acting in the capacity of a trustee or administrator of employee benefit or pension plans. This policy therefore indemnifies the Directors, trustees and administrators of the occupational pension schemes operated by the Bank, 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 during the financial year to which this Report relates. Such policy is available for inspection at the Bank's registered office.

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

Report of the Directors (continued)

Colleagues

Policies and practices in respect of colleague issues are managed on a consistent basis across the Virgin Money UK PLC Group.

Stakeholder engagement and s.172(1) statement

In accordance with the Companies Act 2006 (the 'Act') (as amended by the Companies (Miscellaneous Reporting) Regulations 2018), the Directors provide this statement on pages 61 to 63 of the Virgin Money UK PLC (VMUK) Annual Report and Accounts, describing how they have had regard to the matters set out in section 172(1) of the Act, when performing their duty to promote the success of the Bank, under section 172. Further relevant information in this regard is also contained within the Corporate governance statement and the Directors' report in the Virgin Money UK PLC Annual Report and Accounts.

In accordance with the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (as amended by the Companies (Miscellaneous Reporting) Regulations 2018), this statement also provides details of how the Directors have engaged with and had regard to the interest of key stakeholders.

The Company is a subsidiary of Virgin Money UK PLC, and as such follows many of the processes and practices of this company, which are further referenced in this statement where relevant.

Our stakeholders

The Board is responsible for leading stakeholder engagement, ensuring that the Company fulfils its obligations to those impacted by the business. The Company's key stakeholders are set out below along with some examples of how we engage with them.

Colleagues

- Executive Directors host interactive 'Let's Talk' sessions (which Non-Executive Directors are also invited to join) with colleagues to understand their thoughts and views
- Colleagues are invited to take part in an annual 'myVoice' colleague survey, the results and key outcomes from which are considered by the Board

Customers

- Our monthly customer and marketing insight reports help bring us closer to our customers and how they feel about us
- We receive and respond to future money management worries through our 'Money on Your Mind' communication channels

Government and regulators

- We engage with the UK Government through regular bilateral meetings and events and our representation on the FiAB Board and Banking & Economy Group facilitates regular engagement with the Scottish Government
- Feedback from the FCA and PRA on specific matters is discussed regularly at Board and Committee meetings

Investors

The Bank is a wholly owned subsidiary of VMUK. The Directors, who are the same for both the Bank and VMUK, ensure that the strategy, priorities, processes and practices of the Bank are fully aligned where required to those of the VMUK Group, ensuring that the interests of VMUK as the Bank's sole shareholder are duly acknowledged. Further information in respect of the relationship of VMUK with its shareholders is included within the Strategic Report within the VMUK Annual Report & Accounts for 2020.

Partners and suppliers

- Senior executives represent the Group on the Boards of our Joint Venture (JV) partnerships with Salary Finance and Aberdeen Asset Management (AAM)
- Our use of an online supplier management portal, accessible by us and our suppliers, supports us in framing the regular discussions we have with our suppliers

Society

Significant time is spent engaging with our communities through the grassroots work carried out by the Virgin Money Foundation and the good causes supported by Virgin Money Giving, both of which are considered at Board level.

More information on the wider VMUK Group approach to colleagues, customers and society which includes the approach of the Company, can be found on page 61 in the VMUK Annual Report & Accounts for 2020.

Report of the Directors (continued)

Stakeholder engagement and s.172(1) statement (continued)

Considering stakeholders in Board decision making
It is important that our Board understands the areas of interest or concern for our key stakeholders when it makes decisions. To ensure stakeholder considerations are a key part of our decision making, papers impacting different stakeholder groups are presented throughout the year to the Board and its principal Committees. Like any business, there will be certain decisions that may have an adverse impact on one or more stakeholder groups but we strive to act in the best interests of the Company and all stakeholders and we always aim to be fair and balanced in our approach. The examples that follow are of strategically important matters during the year where the Board considered key strategic decisions that directly affected these groups, and the key outcomes as a result of the Board discussions.

COVID-19
The Company's response to the COVID-19 pandemic, and the impacts on our stakeholders, were discussed in-depth at Board meetings throughout the year as the pandemic progressed. The Board challenged and approved a number of specific COVID-19 responses as a result of these discussions. Further detail on the impacts to our stakeholders and how we have responded to the challenges that were raised by COVID-19 are set out on page 62 in the VMUK Annual Report & Accounts for 2020.
Stakeholders considered: Colleagues; Customers; Government and regulators; and Partners and suppliers.

Transformation of the Board
The Board has undergone several changes during the year as it looks to set itself up for the future. The appointment of a new Chairman was as a result of a carefully considered Board succession plan. During the appointment process, consideration was given by the Governance and Nomination Committee to the continuity that our new Chairman would bring given his prior role as Deputy Chairman and Senior Independent Director. Reducing the size of the Board in the last 12 months has also been achieved through our Board succession plan. We have also liaised with our regulators to successfully appoint new Chairs to all of our Board Committees with the exception of the Audit Committee which Tim Wade continues to Chair.
Stakeholders considered: Colleagues; and Government and regulators.

Pushing the digital boundaries
The Board supported the plans to build digital propositions that create memorable experiences for our customers and it considered the development and launch of our innovative Home Buying Coach app, created in collaboration with a third-party Fintech, which is designed to help first-time buyers achieve their goal of owning a home. The Board considered and supported the launch of the ‘M’ account – a market leading basic bank account designed for customers with financial difficulties or vulnerabilities, which is a vital part of our financial inclusion strategy, with full-service digital banking offered through an app and online. The Board also considered our additional investment in IT and homeworking equipment which has enabled the majority of our colleagues to work safely and productively from home during the COVID-19 pandemic and management continues to engage with colleagues to shape our future working model to reflect the changing attitude and requirements of both customers and colleagues.
Stakeholders considered: Colleagues; Society; Customers; and Partners and suppliers.

A life more Virgin
2020 has presented us with a number of operational challenges but it has also led to the Board considering and approving matters which allow us to continue on our transformation journey to the new Virgin Money. This included an updated and accelerated ESG strategy which set out our ESG ambition and key principles including the development and roll-out of a new ESG governance framework and putting in place a plan of action to improve the engagement with Black, Asian and ethnic minority colleagues and customers. The Board was presented with the opportunity to speak with, and listen to, ethnic minority colleagues to understand their perspectives and needs.
Stakeholders considered: Colleagues; Society; Customers; and partners and suppliers.

Progress on cost savings
The Board continues to closely monitor expenditure and its progress against the Group's cost saving targets through regular updates provided by the Group Chief Financial Officer. In March 2020, due to the ongoing uncertainty of the impacts of COVID-19 on our stakeholders, the Board considered and approved that the planned integration programme should be put on hold as we prioritised support for customers and colleagues during the pandemic. The Board considered carefully the appropriate moment to recommence this work and judged that reflecting the measures put in place during lockdown, our integration activity, which will deliver cost synergies in FY21, would restart in July 2020.
Stakeholders considered: Colleagues; and Customers.

Report of the Directors (continued)

Stakeholder engagement and s.172(1) statement (continued)

Governance and accountability
The Board considered and approved a new Delegation of Authority Framework which set out the matters delegated by the Board to the Chief Executive Officer and beyond and provided clarity for colleagues on responsibilities and approval limits including in relation to partner and supplier contract approval authorities. The Governance and Nomination Committee considered and agreed that the Company's approach to workforce engagement should be refreshed and recommended changes to improve its effectiveness in line with the Financial Reporting Council's recommendation and new governance requirements. Our July 2020 Board meeting was attended by senior representatives of the PRA which allowed the Board to hear and discuss current regulatory views and insights.
Stakeholders considered: Colleagues; Government and regulators; and Partners and suppliers

Shaping for the future
Specific Board sessions were held to consider the impact of COVID-19 on the Group's strategy. These sessions considered many stakeholder impacts including how to support customers during the crisis; how to keep our colleagues safe; the opportunities available to work with partners to accelerate our digitalisation agenda; our return and capital targets; and broadening the scope of our ESG agenda. Consideration of the size of our estate so that it meets the needs of our business and the communities we operate going forward was a key matter of focus for the Board in FY21. The Board approved that we will work with partners to redevelop our office 'Hubs' to refocus them as community space for our 'flexible colleagues' to meet, collaborate and celebrate, as well as offering touch down space for occasional working.
Stakeholders considered: Colleagues; Customers; Partners and suppliers; and Society.

Equality of employment opportunities

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 Virgin Money UK PLC Annual Report and Accounts.

Political donations

No political donations were made during the year (2019: £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 Virgin Money UK PLC can be found in the Virgin Money UK PLC Pillar 3 Report, www.virginmoneyukplc.com/investor-relations/results-and-reporting/financial-results/ and also within the Risk report section of the Virgin Money UK PLC Annual Report and Accounts.

Significant contracts

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

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 computer systems. Further details can be found in note 3.8 of the consolidated financial statements.

Report of the Directors (continued)

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 17 November 2020 we announced that Clifford Abrahams had been appointed Executive Director and Group Chief Financial Officer and that it was expected that he would join the Group in March 2021, subject to regulatory approval.

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
Group Company Secretary
24 November 2020

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 IAS 8: Accounting Policies, Changes in Accounting Estimates and Errors and then apply them consistently;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements 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.

The Directors confirm that to the best of their knowledge:

- the financial statements, prepared in accordance with the applicable set of accounting standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Group and Bank and the undertakings included in the consolidation taken as a whole; and
- the Strategic report includes a fair review of the development and performance of the business and the position of the Group and Bank, together with a description of the principal risks and uncertainties that they face. The Directors consider the Annual Report and Accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group and Bank's position and performance, business model and strategy.

Lorna McMillan
Group Company Secretary
24 November 2020

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 2020 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	Bank
Consolidated Income statement for the year ended 30 September 2020	
Consolidated statement of comprehensive income for the year ended 30 September 2020	
Consolidated balance sheet as at 30 September 2020	Company balance sheet as at 30 September 2020
Consolidated statement of changes in equity for the year ended 30 September 2020	Company statement of changes in equity for the year ended 30 September 2020
Consolidated statement of cash flows for the year ended 30 September 2020	Company statement of cash flows for the year ended 30 September 2020
Related notes 1.1 to 5.6 to the financial statements	Related notes 6.1 to 6.3 to 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 to 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 FRC's Ethical Standard as applied to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

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

Conclusions relating to going concern

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

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

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

Key audit matters	• Impairment of loans. • Revenue recognition – Effective interest method accounting.
Audit scope	• We performed an audit of the complete financial information of the Group and Company. • All audit work performed for the purposes of the Group audit was undertaken by the primary team.
Materiality	• Overall Group materiality was £26m which represents 0.5% of equity.

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 year 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
Impairment of loans *Consolidated balance sheet impairment of loans- £735m (2019: £362m)* *Consolidated income statement charge- £507m (2019: £252m)* Please refer to page 24 (risk report) and pages 137 and 138 (impairment provisions on credit exposures note). At 30 September 2020 the Group reported total gross loans of £72,923 million and £735 million of ECLs. There has been an increased risk of material misstatement of ECL in the year to 30 September 2020 due to the degree of judgement and inherent uncertainty in the assumptions underlying the COVID-19 related additional provisions.	We developed a detailed understanding of the Group's overall approach and accounting policies to ensure compliance with the requirements of IFRS 9. We tested the design and operating effectiveness of certain controls relevant to the ECL processes. This included credit monitoring, individual provisions and production of journal entries. We assessed the appropriateness of the Group's staging criteria including the application of qualitative watch list backstops and their logical application through the modelled environment. We reperformed staging assessments for all high risk portfolios through risk-based sampling of ECL models. This was performed by independently replicating the staging models and re-running the results in our own environment. We tested the assumptions, inputs and formulae used in a risk-based sample of ECL models with involvement of our internal credit modelling specialists. This included assessing the appropriateness of model design and the calculations used, and recalculating PD, LGD and EaD for portfolios determined through our risk-based sampling.	We communicated that we were satisfied that ECL provisions were reasonable and in compliance with the requirements of IFRS 9. We communicated to the Audit Committee that our independent testing of models and underlying modelling assumptions noted some minor differences that were considered to be immaterial in aggregate. We also communicated that our challenge in respect of the forecast economic inputs and scenarios adopted by the Directors concluded that the resulting position was considered to be within a reasonable range of outcomes. We also noted immaterial differences from our testing of PMAs and that the Group had recorded a significant increase in PMAs relating to COVID-19 overlays, consistent with other UK banks.

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

Key audit matters	Our response to the risk	Key observations communicated to the Board's Audit Committee
Impairment of loans (continued) Key matters in respect of the measurement of ECLs include the: • Allocation of assets to stage 1, 2, or 3 using criteria in accordance with the accounting standard; • Accounting interpretations and modelling assumptions used to build the models that calculate the ECLs; • Completeness and accuracy of data used to calculate the ECLs; • Inputs, assumptions and weightings used to estimate the impact of multiple economic scenarios, particularly those influenced by the COVID-19 pandemic; • Completeness and valuation of PMAs as well as any COVID-19 specific adjustments; • Measurements of individually assessed provisions, including the assessment of multiple scenarios and the impact of COVID-19 on collateral valuations and estimated workout strategies; and • Accuracy and adequacy of the financial statement disclosures.	To assess data quality, we tested data used in the ECL calculation by reconciling and performing sample tests for accuracy of key data fields to source systems. To test credit monitoring, we independently recalculated risk ratings for a sample of performing and non-performing non-retail loans and compared to the Group's determinations. We assessed the economic scenario base case and alternative economic scenarios adopted by the Directors with our Economics specialists. We challenged the probability weightings ascribed to the scenarios and compared them to other scenarios from a variety of external sources, as well as EY internally developed forecasts. With the assistance of our Economics specialists, we assessed whether forecast macroeconomic variables, such as GDP, unemployment, interest rates and HPI, CPI and average earnings were appropriate loan loss provision drivers, and that the forecast variables were reasonable. We assessed the completeness and appropriateness of the Group's PMAs, taking the current economic and market conditions into account. We assessed the appropriateness and the calculation of the overlays adopted in response to COVID-19 related economic uncertainty. With the support of our internal valuation specialists, we recalculated ECL provisions for a sample of individually assessed loans including comparing to alternative scenarios and challenging probability weightings assigned. We also assessed a sample of individual loans classified as performing loans within higher risk sectors, such as construction, retail, automotive, commercial real estate, shipping and oil and gas where no specific provision was held. We increased our sample of performing loans in comparison to prior year in response to the risk that the COVID-19 pandemic and support schemes could mask underlying customer deteriorations. We reviewed the adequacy of credit related disclosures in respect of COVID-19.	

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

Key audit matters	Our response to the risk	Key observations communicated to the Board's Audit Committee
Revenue recognition – effective interest method The Group records income on financial instruments under the EIR method. Please refer to in note 2.2 on page 130 and 131. As set out on page 130, the most material adjustments to interest income under EIR accounting are made in respect of the Group's mortgage and credit card portfolios. Following the Group's acquisition of Virgin Money Holdings (UK) PLC on 15 October 2018, fair value adjustments are also recorded on acquired portfolios and amortised through interest income over the projected behavioural lives of the financial instruments. As a result, the unwind of the fair value adjustment recorded on acquisition is naturally connected to the EIR calculation and its key assumptions. This adds additional complexity to the calculation of amounts recognised in the income statement under EIR accounting. The EIR method spreads the income statement recognition of income and expense cash flows that are, in substance, integral to the overall yield of the financial instrument over its modelled life. For both secured and unsecured lending the Group utilises models to predict future cashflows, and recognise interest income under the EIR accounting method. EIR models are sensitive to judgements about the expected behavioural lives and future yields of the product portfolios to which they relate. The complexity of the calculations, the degree of judgement exercised by the Directors in respect of forecast future cash flows (particularly given the uncertainty surrounding anticipated future economic and customer impacts of COVID-19), the different products for which fees are recognised, and the sensitivity of the amounts recognised in the financial statements to key assumptions are highly subjective and material to the financial statements, and we considered this to be a key audit matter.	We assessed the Group's EIR accounting policy and the estimation methodology adopted by the Group during the year for compliance with the accounting standards. We gained an understanding of the key processes, controls, assumptions and judgements used within the Group's EIR models. We also assessed the inclusion or exclusion of key streams of income and expenditure within the Group's EIR models. We compared the Directors' forecasts of customer behaviours and balance attrition rates to recent experience and historical trends within the associated lending portfolios. With respect to the amortisation of the fair value adjustments relating to the acquired portfolios, we assessed the key assumptions adopted by the Directors for consistency and appropriateness against the assumptions used in the Group's EIR models. We developed an independent assessment of the reasonable range of forecast future cashflows outcomes using the Group's historical experience our understanding of the industry and the anticipated potential impact of COVID-19 on future portfolio performance. We assessed the Directors' modelled EIR outcomes against this range. We performed data integrity testing on the key sources of information used within the EIR calculations. We assessed the accuracy of the financial statement disclosures made regarding key estimates within the EIR models, and their sensitivity to reasonable alternative assumptions.	We communicated that we were satisfied that EIR adjustments made to income were in compliance with the requirements of IFRS 9. We communicated to the Audit Committee that the models, assumptions and calculations informing the EIR calculations, and the EIR adjustments recorded as at 30 September 2020 were reasonable. We communicated our observations on the Directors' key assumptions. We noted the potential future risks to the EIR adjustments related to potential changes in customer behaviour as a result of COVID-19 and wider economic, market and regulatory pressures. We considered the modelling adjustments recorded by the Directors in respect of these risks to be within a reasonable range of outcomes. We also noted that the unwind of the fair value adjustments recorded by the Directors were reasonable in comparison to the customer behaviour assumptions used within the Group's EIR models.

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

In the prior year our auditor's report included key audit matters in respect of Provisions for PPI and Accounting for the acquisition of Virgin Money Holdings (UK) PLC.

In the current period the level of uncertainty in respect of the ultimate costs of the PPI remediation programme in respect of PPI has reduced. Together, the 29 August 2019 FCA time-bar on new PPI complaints and the volume of complaints processed by the Group during the year have reduced the estimation risk within PPI provisions calculations as at 30 September 2020. The acquisition of Virgin Money Holdings (UK) PLC was a non-recurring, non-routine transaction occurring in FY19 and so it was not considered a key audit matter for the current period.

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 £26.0 million (2019: £25.0 million), which is 0.5% of equity (2019: 3.8% of underlying profit on ordinary activities before tax). We believe that equity provides us with an appropriate measure given the Group's continuing loss making position and unusual circumstances in FY20 in respect of the COVID-19 pandemic.

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

On the basis of our risk assessments, together with our assessment of the Group's overall control environment, our judgement was that performance materiality was 75% (2019: 75%) of our planning materiality, namely £19.5m (2019: £18.8m). We 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 the 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 £1.3m (2019: £1.3m), 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.

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

Other information

The other information comprises the information included in the Strategic report set out on pages 2 to 11, the Risk report set out on pages 12 to 101, and Additional information set out on pages 192 to 200. 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 107, 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.

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

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 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 and stakeholders.
- 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 Financial Reporting Council's website at https://www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Other matters we are required to address

- Following the recommendation of the National Australia Bank (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 ended 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 16 years, covering the years ended 30 September 2005 to 30 September 2020.
- 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.

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

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
24 November 2020

1. The maintenance and integrity of the Clydesdale Bank 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	2020 £m	2019[1] £m
Interest income		**2,129**	2,420
Other similar interest		**8**	13
Interest expense and similar charges		**(853)**	(917)
Net interest income	2.2	**1,284**	1,516
Gains less losses on financial instruments at fair value		**(20)**	(20)
Other operating income		**171**	277
Non-interest income	2.3	**151**	257
Total operating income		**1,435**	1,773
Operating and administrative expenses before impairment losses	2.4	**(1,101)**	(1,703)
Operating profit before impairment losses		**334**	70
Impairment losses on credit exposures	3.2	**(507)**	(252)
Loss on ordinary activities before tax		**(173)**	(182)
Tax (expense)/credit	2.5	**(18)**	58
Loss for the year		**(191)**	(124)
Attributable to:			
Ordinary shareholders		**(250)**	(198)
Other equity holders		**59**	41
Non-controlling interests		**-**	33
Loss for the year		**(191)**	(124)

(1) The comparative has been restated in line with the current year presentation. Refer to note 1.10.

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

The notes on pages 123 to 191 form an integral part of these financial statements.

Consolidated statement of comprehensive income for the year ended 30 September

	2020 £m	2019[1] £m
Loss for the year	**(191)**	(124)
Items that may be reclassified to the income statement		
Change in cash flow hedge reserve		
(Losses)/gains during the year	**(133)**	73
Transfers to the income statement	**59**	(58)
Taxation thereon - deferred tax credit/(charge)	**20**	(9)
Taxation thereon - current tax credit	**(1)**	6
	(55)	12
Change in fair value through other comprehensive income reserve		
Gains during the year	**15**	13
Transfers to the income statement	**(16)**	(4)
Taxation thereon - deferred tax credit/(charge)	**1**	(2)
	-	7
Total items that may be reclassified to the income statement	**(55)**	19
Items that will not be reclassified to the income statement		
Change in asset revaluation reserve	**-**	-
Taxation thereon - deferred tax charge	**-**	(1)
Change in defined benefit pension plan	**292**	110
Taxation thereon - deferred tax charge	**(117)**	(56)
Taxation thereon - current tax credit	**9**	7
	184	61
Total items that will not be reclassified to the income statement	**184**	60
Other comprehensive income, net of tax	**129**	79
Total comprehensive losses for the year, net of tax	**(62)**	(45)
Attributable to:		
Ordinary shareholders	**(121)**	(119)
Other equity holders	**59**	41
Non-controlling interest	**-**	33
Total comprehensive losses for the year, net of tax	**(62)**	(45)

(1) The comparative has been restated in line with the current year presentation. Refer to note 1.10.

The notes on pages 123 to 191 form an integral part of these financial statements.

Balance sheets as at 30 September

	Note	Group 2020 £m	Group 2019 £m	Bank 2020 £m	Bank 2019 £m
Assets					
Financial assets at amortised cost					
Loans and advances to customers	3.1	**72,428**	73,093	**71,436**	32,389
Cash and balances with central banks	3.4	**9,107**	10,296	**9,107**	6,621
Due from other banks		**927**	1,018	**174**	225
Financial assets at fair value through profit or loss					
Loans and advances to customers	3.5	**190**	253	**190**	253
Derivative financial instruments	3.6	**318**	366	**134**	442
Other financial assets	3.5	**1**	8	**1**	1
Due from related entities	5.3	**11**	18	**1,163**	2,476
Financial instruments at fair value through other comprehensive income	3.7	**5,080**	4,328	**5,080**	2,350
Property, plant and equipment		**288**	145	**288**	85
Intangible assets and goodwill	3.8	**491**	516	**491**	398
Investments in controlled entities and associates	6.2	**-**	-	**73**	1,776
Current tax assets		**22**	10	**26**	29
Deferred tax assets	3.9	**382**	418	**375**	350
Defined benefit pension assets	3.10	**723**	396	**723**	396
Other assets		**339**	236	**338**	169
Total assets		**90,307**	91,101	**89,599**	47,960
Liabilities					
Financial liabilities at amortised cost					
Customer deposits	3.11	**67,710**	64,000	**67,710**	29,771
Debt securities in issue	3.12	**5,933**	7,267	**1,852**	709
Due to other banks	3.13	**5,469**	8,916	**5,469**	3,860
Financial liabilities at fair value through profit or loss					
Customer deposits		**-**	4	**-**	4
Derivative financial instruments	3.6	**250**	273	**250**	292
Due to related entities	5.3	**2,822**	2,315	**6,255**	5,336
Deferred tax liabilities	3.9	**271**	199	**270**	145
Provisions for liabilities and charges	3.14	**172**	459	**172**	439
Other liabilities	3.15	**2,690**	2,527	**2,690**	2,448
Total liabilities		**85,317**	85,960	**84,668**	43,004
Equity					
Share capital and share premium	4.1	**2,792**	2,792	**2,792**	2,792
Other equity instruments	4.1	**672**	672	**672**	672
Other reserves	4.1	**(69)**	(13)	**(52)**	18
Retained earnings		**1,595**	1,690	**1,519**	1,474
Total equity		**4,990**	5,141	**4,931**	4,956
Total liabilities and equity		**90,307**	91,101	**89,599**	47,960

The Bank made a loss of £230m (2019: loss of £307m) during the year.

The notes on pages 123 to 191 form an integral part of these financial statements.
These financial statements were approved by the Board of Directors on 24 November 2020 and were signed on its behalf by:

David Bennett
Chairman

David Duffy
Chief Executive Officer

Company name: Clydesdale Bank PLC
Company number: SC001111

Statements of changes in equity

Group

	Share capital and share premium	Other equity instruments	Asset reval' reserve (Other reserves)	FVOCI reserve (Other reserves)	Cash flow hedge reserve (Other reserves)	Retained earnings	Non controlling interest	Total equity
Note	4.1.1	4.1.2		4.1.3	4.1.3		4.1.4	
	£m	£m	£m	£m	£m	£m	£m	£m
As at 1 October 2018	1,013	425	2	4	(37)	1,863	-	3,270
Loss for the year[1]	-	-	-	-	-	(124)	-	(124)
Other comprehensive losses, net of tax	-	-	(1)	7	12	61	-	79
Total comprehensive (losses)/income for the year	-	-	(1)	7	12	(63)	-	(45)
Acquisition of Virgin Money Holdings (UK) PLC	1,549	-	-	-	-	(17)	422	1,954
Dividends paid to ordinary shareholders	-	-	-	-	-	(44)	-	(44)
AT1 distribution paid[1]	-	-	-	-	-	(42)	-	(42)
Distributions to non-controlling intererests[1]	-	-	-	-	-	(33)	-	(33)
Ordinary shares issued	230	-	-	-	-	-	-	230
Capital note redemption	-	-	-	-	-	29	(422)	(393)
Settlement of Virgin Money Holdings (UK) PLC share awards	-	-	-	-	-	(3)	-	(3)
AT1 issuance	-	247	-	-	-	-	-	247
At 30 September 2019	2,792	672	1	11	(25)	1,690	-	5,141
Adjustment on adoption of IFRS 16 (net of tax) (note 5.4)	-	-	-	-	-	1	-	1
As at 1 October 2019	2,792	672	1	11	(25)	1,691	-	5,142
Loss for the year	-	-	-	-	-	(191)	-	(191)
Other comprehensive losses/(income), net of tax	-	-	-	-	(55)	184	-	129
Total comprehensive losses	-	-	-	-	(55)	(7)	-	(62)
AT1 distribution paid	-	-	-	-	-	(59)	-	(59)
Dividends paid to ordinary shareholders	-	-	-	-	-	(20)	-	(20)
Release of asset revaluation reserve	-	-	(1)	-	-	-	-	(1)
Settlement of Virgin Money Holdings (UK) PLC share awards	-	-	-	-	-	(1)	-	(1)
FSMA Part VII transfer from Virgin Money PLC	-	-	-	-	-	(9)	-	(9)
At 30 September 2020	**2,792**	**672**	**-**	**11**	**(80)**	**1,595**	**-**	**4,990**

(1) The comparative has been restated in line with the current year presentation. Refer to note 1.10.

The notes on pages 123 to 191 form an integral part of these financial statements.

Statements of changes in equity

Bank

	Share capital and share premium	Other equity instruments	Asset reval' reserve	FVOCI reserve	Cash flow hedge reserve	Retained earnings	Total equity
			Other reserves				
Note	4.1.1	4.1.2		4.1.3	4.1.3		
	£m	£m	£m	£m	£m	£m	£m
As at 1 October 2018	1,013	425	2	4	(36)	1,806	3,214
Loss for the year[(1)]	-	-	-	-	-	(307)	(307)
Other comprehensive (losses)/income, net of tax	-	-	(1)	3	46	61	109
Total comprehensive (losses)/income for the year	-	-	(1)	3	46	(246)	(198)
Acquisition of Virgin Money Holdings (UK) PLC	1,549	-	-	-	-	-	1,549
Dividends paid to ordinary shareholders	-	-	-	-	-	(44)	(44)
AT1 distribution paid[(1)]	-	-	-	-	-	(42)	(42)
Ordinary shares issued	230	-	-	-	-	-	230
AT1 issuance	-	247	-	-	-	-	247
At 30 September 2019	2,792	672	1	7	10	1,474	4,956
Loss for the year	-	-	-	-	-	(230)	(230)
Other comprehensive losses/(income), net of tax	-	-	-	(2)	(73)	183	108
Total comprehensive losses	-	-	-	(2)	(73)	(47)	(122)
Dividends paid to ordinary shareholders	-	-	-	-	-	(20)	(20)
AT1 distribution paid	-	-	-	-	-	(59)	(59)
Gain on redemption of AT1 securities	-	-	-	-	-	12	12
Release of asset revaluation reserve	-	-	(1)	-	-	-	(1)
FSMA Part VII transfer from Virgin Money PLC	-	-	-	6	-	1,894	1,900
Impairment of investment in Virgin Money Holdings (UK) PLC	-	-	-	-	-	(1,735)	(1,735)
At 30 September 2020	**2,792**	**672**	**-**	**11**	**(63)**	**1,519**	**4,931**

(1) The comparative has been restated in line with the current year presentation. Refer to note 1.10.

The notes on pages 123 to 191 form an integral part of these financial statements.

Statement of cash flows
for the year ended 30 September

	Notes	Group 2020 £m	Group 2019[2] £m	Bank 2020 £m	Bank 2019[2] £m
Operating activities					
Loss on ordinary activities before tax		**(173)**	(182)	**(215)**	(380)
Adjustments for:					
Non-cash or non-operating items included in loss before tax	5.2	**(544)**	(934)	**(808)**	(295)
Changes in operating assets	5.2	**(102)**	(2,675)	**34**	(1,104)
Changes in operating liabilities	5.2	**1,878**	2,657	**1,497**	1,901
Payments for short-term and low value leases		**(2)**	-	**(1)**	-
Interest received		**2,151**	2,320	**2,071**	1,178
Interest paid		**(790)**	(808)	**(848)**	(21)
Tax (paid)/received - group relief		**(15)**	(8)	**(11)**	1
Net cash provided by operating activities		**2,403**	370	**1,719**	1,280
Cash flows from investing activities					
Interest received		**35**	27	**35**	17
Cash transfer on FSMA Part VII, net of consideration proceeds		**-**	-	**4,141**	-
Cash acquired on acquisition of Virgin Money Holdings (UK) PLC		**-**	4,656	**-**	-
Proceeds from maturity of financial instruments at FVOCI		**1,568**	659	**1,568**	50
Proceeds from sale of financial assets at FVOCI		**587**	352	**566**	77
Purchase of financial assets at FVOCI		**(2,838)**	(1,647)	**(2,838)**	(838)
Proceeds from sale of 50% (less one share) consideration in Virgin Money Unit Trust Managers Limited (UTM)		**-**	45	**-**	-
Purchase of shares issued by UTM		**(2)**	-	**-**	-
Proceeds from sale of property, plant and equipment		**5**	3	**5**	2
Purchase of property, plant and equipment		**(14)**	(20)	**(14)**	(16)
Purchase and development of intangible assets		**(78)**	(130)	**(78)**	(104)
Net cash (used in)/provided by investing activities		**(737)**	3,945	**3,385**	(812)
Cash flows from financing activities					
Interest received		**-**	-	**-**	24
Interest paid		**(87)**	(14)	**(19)**	(194)
Repayment of principal portion of lease liabilities[1]		**(30)**	-	**(29)**	-
Proceeds from issuance of other equity instruments		**-**	247	**-**	-
Repayment of AT1 securities classified as non-controlling interests		**-**	(160)	**-**	-
Redemption and principal repayment on RMBS and covered bonds	3.3	**(1,492)**	(2,003)	**-**	-
Redemption and principal repayment on medium-term notes		**(300)**	-	**(300)**	-
Issuance of RMBS and covered bonds	3.3	**491**	2,226	**-**	-
Amounts drawn under the TFSME		**1,300**	-	**1,300**	
Amounts repaid under the TFS		**(3,234)**	(1,295)	**(3,234)**	-
Net increase in amounts due from related entities		**9**	(12)	**186**	(1,311)
Net increase in amounts due to related entities		**439**	611	**(631)**	987
Ordinary dividends paid		**(20)**	(44)	**(20)**	(44)
AT1 distributions		**(59)**	(41)	**(59)**	(41)
Distributions to non-controlling interests		**-**	(33)	**-**	-
Net cash used in financing activities		**(2,983)**	(518)	**(2,806)**	(579)
Net (decrease)/increase in cash and cash equivalents		**(1,317)**	3,797	**2,298**	(111)
Cash and cash equivalents at the beginning of the year		**11,131**	7,334	**6,763**	6,874
Cash and cash equivalents at the end of the year	5.2	**9,814**	11,131	**9,061**	6,763

(1) The Group adopted IFRS 16 'Leases' on 1 October 2019. The payment of principal amounts of lease liabilities is now included as a deduction within financing activities whereas previously under IAS 17 'Leases' operating lease charges were included as a deduction within cash flow from operating activities. Interest on lease liabilities is included within interest paid and depreciation on right-of-use assets is included within depreciation.

(2) Cash and cash equivalents has been restated in the comparative year in line with the current year presentation, as detailed in note 1.11.

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

Movements in liabilities arising from financing activities

Group	TFS	Debt securities in issue	Intercompany loans	Lease liabilities[1]	Total
	£m	£m	£m	£m	£m
At 30 September 2019	7,308	7,267	2,315	-	16,890
Adjustment on transition to IFRS 16	-	-	-	205	205
Revised 1 October 2019	7,308	7,267	2,315	205	17,095
Cash flows:					
Issuances	-	491	448	-	939
Redemptions	1,300	-	-	-	1,300
Drawdowns	-	(1,792)	-	-	(1,792)
Repayment	(3,234)	-	(9)	(30)	(3,273)
Non-cash flows:					
Fair value adjustments and associated unwind on acquired TFS and debt securities in issue	36	7	-	-	43
Additions to right-of-use asset in exchange for increased lease liabilities	-	-	-	2	2
Remeasurement/disposal	-	-	-	(6)	(6)
Movement in accrued interest	(13)	(9)	2	4	(16)
Unrealised FX movements	-	(27)	6	-	(21)
Unamortised costs	-	(4)	(5)	-	(9)
Other movements	-	-	65	-	65
At 30 September 2020	**5,397**	**5,933**	**2,822**	**175**	**14,327**

Bank	TFS	Debt securities in issue	Intercompany loans	Lease liabilities[1]	Total
	£m	£m	£m		£m
At 1 September 2019	2,254	709	5,336	-	**8,299**
Adjustment on transition to IFRS 16	-	-	-	176	**176**
Revised 1 October 2019	2,254	709	5,336	176	**8,475**
Cash flows:					
Issuances	-	-	478	-	**478**
Draw downs	1,300	-	-	-	**1,300**
Repayments	(3,234)	-	(1,108)	(29)	**(4,371)**
Redemptions	-	(300)	-	-	**(300)**
Non-cash flows					
FSMA Part VII banking business transfer from Virgin Money PLC	5,092	1,424	1,801	29	**8,346**
Additions to right-of-use asset in exchange for increased lease liabilities	-	-	-	3	**3**
Remeasurement/disposal	-	-	-	(6)	**(6)**
Movement in accrued interest	(3)	(3)	4	4	**2**
Unamortised costs	-	(1)	2	-	**1**
Other movements	-	23	(258)	-	**(235)**
At 30 September 2020	**5,409**	**1,852**	**6,255**	**177**	**13,693**

(1) The Group adopted IFRS 16 'Leases' on 1 October 2019. The payment of principal amounts of lease liabilities is now included as a deduction within financing activities whereas previously under IAS 17 'Leases' operating lease charges were included as a deduction within cash flow from operating activities. Interest on lease liabilities is included within interest paid.

The notes on pages 123 to 191 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 which are relevant to the Group, and whether they are effective in 2020 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 Virgin Money UK PLC, a company registered in England and Wales. Virgin Money UK PLC also heads the largest and smallest group in which the results of the Group are consolidated. The financial statements of Virgin Money UK PLC may be obtained from Virgin Money UK PLC's registered office at Jubilee House, Gosforth, Newcastle upon Tyne, NE3 4PL.

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 certain financial assets and liabilities at FVTPL and other comprehensive income. 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 2020, the Directors have considered a number of factors, including the current balance sheet position, the Group's strategic and financial plan, taking account of possible changes in trading performance and funding retention, and stress testing and scenario analysis. The assessment concluded that, for the foreseeable future, the Group has sufficient capital and liquidity for the next 12 months. The Group's capital ratios and its total capital resources are comfortably in excess of PRA requirements and internal stress testing indicates the Group can withstand severe economic and competitive stresses. The Group's MREL ratio at 30 September 2020 comfortably exceeds its interim MREL requirements and is in line with its expected end-state MREL requirements. This means future MREL issuance is focused on building a prudent management buffer over the expected end-state MREL minimum requirement.

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

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. 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 Group's interests in JV entities are accounted for using the equity method and then assessed for impairment in the relevant holding companies' financial statements.

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 FVTPL or FVOCI 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.

Classification and measurement
The Group measures a financial asset or liability on initial recognition at its fair value, plus or minus transaction costs that are directly attributable to the acquisition or issue of the financial asset or the financial liability (with the exception of financial assets or liabilities at FVTPL, where transaction costs are recognised directly in the income statement as they are incurred).

Financial assets
Subsequent accounting for a financial asset is determined by the classification of the asset depending on the underlying business model and contractual cash flow characteristics. This results in classification within one of the following categories: i) amortised cost; ii) FVTPL; or iii) FVOCI.

1.7 Financial assets and liabilities (continued)

A financial asset is measured at amortised cost when: (1) the asset is held within a business model whose objective is achieved by collecting contractual cash flows; and (2) the contractual terms give rise to cash flows on specified dates which are solely payments of principal and interest on the principal amount outstanding. The amortised cost classification applies to the Group's loans and advances to customers (note 3.1), cash and balances from central banks (note 3.4) and balances due from other banks. Financial assets classified at amortised cost are subject to ECL requirements as detailed in note 3.2.

The accounting policies for financial assets at FVTPL and through other comprehensive income are detailed in notes 3.5 and 3.7 respectively.

Financial liabilities
All financial liabilities are measured at amortised cost, except for financial liabilities at FVTPL. Such liabilities include derivatives (other than derivatives that are financial guarantee contracts or are designated and effective hedging instruments) and liabilities designated at FVTPL on initial recognition.

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 offset the recognised amounts and intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

1.8 Property, plant and equipment

The Group's property, plant and equipment is 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.

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 operating expenses in the income statement.

The Group previously held freehold and long-term leasehold land and buildings at fair value as highlighted in note 1.10.

1.9 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. Actual results may differ from those on which management's estimates are based. Estimates and assumptions are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable. Estimates which are based on future economic conditions, and sensitive to changes in those conditions, have been impacted by COVID-19. This estimation impact has primarily been in the measurement of ECL,EIR and assessing the recoverability of deferred tax balances. Actual results may differ materially from these estimates.

The Group considers the most significant use of accounting estimates and judgements relate to the following areas:

- impairment provisions on credit exposures (note 3.2);
- EIR (note 2.2);
- deferred tax (note 3.9);
- PPI redress provision and other conduct related matters (note 3.14); and
- retirement benefit obligations (note 3.10).

1.10 New accounting standards and interpretations

The Group has adopted a number of International Accounting Standards Board (IASB) pronouncements in the current financial year.

IFRS 16 'Leases'
IFRS 16 'Leases' is effective for financial periods beginning on or after 1 January 2019 and replaces IAS 17 'Leases', IFRIC 4 'Determining whether an Arrangement contains a Lease,' SIC-15 'Operating Leases - Incentives' and SIC-27 'Evaluating the Substance of Transactions Involving the Legal Form of a Lease.'

1.10 New accounting standards and interpretations (continued)

IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases. The Group's accounting as a lessor is substantially unchanged from the previous approach under IAS 17; however, IFRS 16 resulted in most leases where the Group is a lessee being brought on to the balance sheet under a single lease model, removing the distinction between finance and operating leases. IFRS 16 requires a lessee to recognise a 'right-of-use' asset and a corresponding lease liability at the date on which the leased asset is available for use. Assets and liabilities arising from a lease are initially measured on a present value basis. The accounting policy for leases (note 3.17) has been revised.

As permitted by the new standard, the Group has implemented IFRS 16 using the 'modified retrospective' approach and recognised the cumulative impact of transition as an adjustment through retained earnings. Therefore, the comparative information has not been restated and is presented, as previously reported, under IAS 17 and related interpretations. Adoption of the new standard has had a material impact on the Group's financial statements, with right-of-use assets of £194m recognised on transition together with lease liabilities of £205m. As at 30 September 2020 the right-of-use assets and lease liabilities were £162m and £175m respectively. The right-of-use assets are presented in property, plant and equipment and the liabilities are presented in other liabilities. Further detail on the transitional impact of IFRS 16 can be found in note 5.4.

Interest Rate Benchmark Reform (Amendments to IFRS 9, IAS 39 and IFRS 7)
Amendments to IFRS 9, IAS 39 and IFRS 7 were issued in September 2019. The amendments are effective for financial years beginning on or after 1 January 2020 (with early adoption permitted) and were endorsed for use in the EU in January 2020. The amendments provide temporary reliefs which enable hedge accounting to continue during the period of uncertainty before the hedged items or hedging instruments affected by the current interest rate benchmarks are amended as a result of the ongoing interest rate benchmark reforms.

The Group exercised the accounting policy choice to continue hedge accounting under IAS 39 on adoption of IFRS 9 in October 2018. The Group has also early adopted the amendments and related disclosure requirements relating to IAS 39 and IFRS 7 with effect from 1 October 2019. Adopting these amendments allows the Group to continue hedge accounting during the period of uncertainty arising from interest rate benchmark reforms. Further detail is provided in note 3.6.

Other accounting standards and interpretations
Except where otherwise stated, the following IASB pronouncements did not have a material impact on the Group's consolidated financial statements:

- IFRIC interpretation 23: 'Uncertainty over Income Tax Treatments' issued in 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', 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'. The amendment to IAS 12 clarifies that the income tax consequences of distributions on financial instruments classified as equity should be recognised alongside the past transactions or events that generated the distributable profits. This means that the taxation impacts of distributions relating to AT1 securities and non-controlling interests are now recognised within tax expense in the income statement as opposed to being recognised directly in retained earnings within equity. The amendment impacts only the presentation of the related taxation and not the calculation, with no change to the Group's net assets but an increase in profit attributable to equity owners. Comparatives have been restated. The adoption of this amendment has resulted in a reduction in tax expense and an increase in profit for the year of £11m (12 months to 30 September 2019: £15m) for the Group and a reduction in tax expense and an increase in profit for the year of £11m (12 months to 30 September 2019: £8m) for the Bank;
- amendment to IAS 19: 'Plan amendment, curtailment or settlement' 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 year; and
- amendment to IAS 28: 'Long-term Interests in Associates and Joint Ventures' issued in October 2017 and effective for financial years beginning on or after 1 January 2019. The amendment clarifies that an entity applies IFRS 9 to long-term interests in an associate or JV to which the equity method is not applied but that, in substance, form part of the net investment in the associate or JV (long-term interests).

1.10 New accounting standards and interpretations (continued)

New accounting standards and interpretations not yet adopted

Interest Rate Benchmark Reform – Phase 2 (Amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16)

Following completion of the second part of the IASB's two-phased project, amendments were issued in August 2020 and are effective for financial years beginning on or after 1 January 2021. The amendments have not yet been endorsed for use by the EU and therefore have not been adopted by the Group.

The amendments address issues that might affect financial reporting as a result of the reform of an interest rate benchmark, including the effects of changes to contractual cash flows or hedging relationships arising from the replacement of an interest rate benchmark with an alternative benchmark rate. The amendments provide practical relief from certain requirements in IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16 relating to:

- changes in the basis for determining contractual cash flows of financial assets, financial liabilities and lease liabilities; and
- hedge accounting.

On application of the amendments, the Group does not expect any impact on amounts reported for 2020 or prior years.

The IASB has issued a number of other minor amendments to IFRSs that are not mandatory for 30 September 2020 reporting years and have not been early adopted by the Group. These amendments are not expected to have a material impact for the Group.

1.11 Other changes in the year

Freehold and long-term leasehold land and buildings – change in accounting policy

The Group changed its accounting policy with respect to freehold and long-term leasehold land and buildings. The Group now applies the cost model, where these assets are carried at cost less accumulated depreciation and any accumulated impairment. Prior to this change in policy, freehold and long-term leasehold land and buildings were recorded at their fair values. The Group concluded that the cost model provides a more reliable and more meaningful presentation following the adoption of IFRS 16 which introduced a significant property related right-of-use asset, held at cost, on the balance sheet in the year, and also removed the previous distinction between finance and operating leases. The application of the cost model is also standard market practice across the UK banking sector. For these reasons the Group determined it should harmonise the measurement basis for all property related assets to be at cost. This change in accounting policy has not had a material impact on the Group's balance sheet as there has been no difference of significance between the fair value and cost value on freehold and long-term leasehold land and buildings for a number of years. The £1m asset revaluation reserve that existed at 30 September 2019 has been released. Due to the immaterial effect of this change, comparatives have not been restated.

Cash and cash equivalents – change in definition

During the year, the Group has reassessed the individual elements that comprise 'cash and cash equivalents'. This has resulted in a revision to the definition that more closely aligns the Group's internal use of the cash and cash equivalents definition and cash management practices, with the changes resulting in an increase to the cash and cash equivalents balance primarily as a result of the inclusion of amounts due from other banks. The revised definition can be found in the Glossary at www.virginmoneyukplc.com/investor-relations/results-and-reporting/financial-results/. Comparative year have been restated to reflect this change in definition, with the Group balance for the 12 months to 30 September 2019 increasing by £1,011m from £10,120m to £11,131m, and the Bank balance for the 12 months to 30 September 2019 increasing by £218m from £6,545m to £6,763m.

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.

With effect from 1 October 2019, the business has been aligned operationally into three divisions: Mortgages, Personal and Business. However, the business continues to be reported to the Group's Chief Operating Decision Maker as a single segment and decisions made on the performance of the Group on that basis. Segmental information will therefore continue to be presented on this single segment basis until segment reporting has been fully embedded within the Group.

Summary income statement

	2020	2019
	£m	£m
Net interest income	**1,284**	1,516
Non-interest income	**151**	257
Total operating income	**1,435**	1,773
Operating and administrative expenses	**(1,101)**	(1,703)
Impairment losses on credit exposures	**(507)**	(252)
Segment loss before tax	**(173)**	(182)
Average interest earning assets	**86,826**	86,362

The Group has no operations outside the UK and therefore no secondary geographical area information is presented. The Group is not reliant on a single customer. Liabilities are managed on a centralised basis.

2.2 Net interest income

Accounting policy

Interest income is recognised 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 gross carrying amount of the non-credit impaired financial asset. Interest expense is recognised in the income statement using the same effective interest method on the amortised cost of the financial liability.

When calculating the EIR, 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 EIR 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 EIR calculation. Fees in relation to the non-utilisation of a commitment are 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 on financial assets in impairment Stages 1 and 2 is recognised on the unwind of the discount from the initial recognition of the ECL using the original effective rate of interest. Once a financial asset or group of similar financial assets has been categorised as credit-impaired (Stage 3), interest income is recognised on the net carrying value (after the ECL allowance) using the asset's original EIR. The interest income for POCI financial assets is calculated using the credit-adjusted EIR applied to the amortised cost of the financial asset from initial recognition. The Group recognises and presents the reversal of ECLs following the curing of a credit impaired financial asset as a reversal of impairment losses.

Interest income and interest expense on hedged assets and liabilities and financial assets and liabilities designated as FVTPL are also recognised as part of net interest income.

Interest income and expense on derivatives economically hedging interest bearing financial assets or liabilities (but not designated as hedging instruments) and other financial assets and liabilities held at FVTPL (either mandatory or by election) are presented within 'Other similar interest'.

Included in interest income is finance lease income which is recognised at a constant periodic rate of return on the net investment.

Critical accounting estimates and judgements

EIR

The EIR is determined at initial recognition based upon the Group's best estimate of the future cash flows of the financial instrument. In the event these estimates are revised at a later date, a present value adjustment to the carrying value of the EIR asset may be recognised in profit or loss. Such adjustments can introduce income statement volatility and consequently the EIR method introduces a source of estimation uncertainty. The Group considers that material risk of adjustments exists in relation to the application of EIR to the Group's mortgage and credit card portfolios.

Mortgages

The main accounting judgement when assessing the cash flows within the Group's secured lending EIR model is the product life (including assumptions based on observed historic customer behaviour when in a standard variable rate (SVR) period) and the early repayment charge income receivable. The Group currently assumes that 84% of customers will have fully repaid or remortgaged within two months of reverting to SVR. If this were to increase to 89%, the loans and advances to customers balance would reduce by £9m with the adjustment recognised in net interest income.

Credit cards

The Group measures credit card EIR by modelling expected cash flows based on assumptions of future customer behaviour, which is supported by observed experience. Key behavioural assumptions include an estimation of utilisation of available credit, future retail and cash transactions, repayment activity and the retention of the customer balance after the end of a promotional period.

The EIR of new business written in the current year is 5.60% (2019: 5.26%).

The Group specifically considered the impact of COVID-19 on the expected cash flows, and adjustments were made to assumptions of future customer behaviour, in particular utilisation of available credit, future retail transactions and repayment activity. In the weeks that followed the initial UK lockdown retail spend fell by almost 60% before beginning to recover as lockdown restrictions began to ease. Retail and cash transactions remain below the level of pre-COVID-19 volumes, at around 75% of pre-COVID-19 volumes. The Group currently assumes that retail and cash transaction activity will recover during 2021, however if current customer behaviour was to continue and retail and cash transaction activity remained at 75% of pre-COVID-19 volumes for the next 12 months to 30 September 2021, with an associated adjustment to expected repayment activity of 0.6% to account for the lower retail and cash transactions, the Group estimates this would result in a negative present value adjustment of approximately £20m as at 30 September 2020.

The Group holds an appropriate level of model risk reserve across both asset classes to mitigate the risk of estimation uncertainty.

The Group will continue to monitor the impact of COVID-19 and update key assumptions and judgements as required.

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

2.2 Net interest income (continued)

	2020 £m	2019 £m
Interest income		
Loans and advances to customers	**2,062**	2,320
Loans and advances to other banks	**35**	72
Financial assets at fair value through other comprehensive income	**32**	27
Other interest income	**-**	1
Total interest income	**2,129**	2,420
Other similar interest		
Financial assets at fair value through profit or loss	**15**	21
Derivatives economically hedging interest bearing assets	**(7)**	(8)
Total other similar interest	**8**	13
Less: interest expense and similar charges		
Customer deposits	**(588)**	(580)
Debt securities in issue	**(86)**	(112)
Due to other banks	**(68)**	(144)
Due to related entities	**(106)**	(72)
Other interest expense	**(5)**	(9)
Total interest expense and similar charges	**(853)**	(917)
Net interest income	**1,284**	1,516

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 FVTPL - these relate to the Group's fixed interest rate loan portfolio and related term deposits (note 3.5), which were designated at inception as FVTPL. 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 3.6).

Fees and commissions
Fees and commissions receivable which are not an integral part of the EIR are recognised as income as the Group fulfils its performance obligations. The Group's principal performance obligations arising from contracts with customers are in respect of current accounts, debit cards and credit cards. The Group provides the service and consequently generates the fees, with fees recognised in income on a point in time basis. Costs incurred to generate fee and commission income are charged to fees and commissions expense as they are incurred.

Income from insurance, protection and investments
This includes management fees generated from the sale of and management of funds, stocks and shares Individual Savings Accounts ('ISAs') and pensions to retail investors.

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

2.3 Non-interest income (continued)

	2020 £m	2019 £m
Gains less losses on financial instruments at fair value		
Held for trading derivatives	**16**	16
Financial assets and liabilities at fair value[(1)]	**(4)**	-
Ineffectiveness arising from fair value hedges (note 3.6)	**(21)**	(22)
Amounts recycled to profit and loss from cash flow hedges[(2)] (note 3.6)	**(5)**	-
Ineffectiveness arising from cash flow hedges (note 3.6)	**(6)**	(14)
	(20)	(20)
Other operating income		
Net fees and commission income	**142**	195
Margin on foreign exchange derivative brokerage	**17**	19
Gains on sale of financial assets at fair value through other comprehensive income	**16**	3
Gain on sale of Virgin Money Unit Trust Managers Limited	**-**	35
Share of joint venture loss after tax[(3)]	**(7)**	(2)
Other income	**3**	27
	171	277
Total non-interest income	**151**	257

(1) A credit risk gain on loans and advances at fair value of £1m, offset by a fair value loss of £5m, have been recognised in the current year (2019: £2m gain and £2m fair value loss).
(2) In respect of terminated hedges
(3) The share of joint venture loss after tax is included within continuing activities.

Non-interest income includes the following fee and commission income disaggregated by income type:

	2020 £m	2019 £m
- Current account and debit card fees	**94**	117
- Credit cards	**41**	42
- Insurance, protection and investments	**16**	37
- Other fees[(1)]	**31**	31
Total fee and commission income	**182**	227
Total fee and commission expense	**(40)**	(32)
Net fee and commission income	**142**	195

(1) Other fees include mortgages, invoice and asset finance and ATM fees.

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

2.4 Operating and administrative expenses before impairment losses

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 3.10 and 4.2 respectively.

	2020	2019
	£m	£m
Personnel expenses	**396**	419
Depreciation and amortisation expense[(1)]	**149**	108
Other operating and administrative expenses	**556**	1,176
Total operating and administrative expenses	**1,101**	1,703

Personnel expenses comprise the following items:

	2020	2019
	£m	£m
Salaries, wages and non-cash benefits and social security costs	**252**	256
Defined contribution pension expense	**49**	47
Defined benefit pension expense (note 3.10)	**-**	9
Equity based compensation (note 4.2)	**10**	4
Other personnel expenses	**85**	103
Personnel expenses	**396**	419

(1) Following the adoption of IFRS 16 from 1 October 2019, the depreciation charge arising on the right-of-use assets is reported within depreciation and amortisation expense. Prior to adoption of IFRS 16, the equivalent operating lease charges were reported within other operating and administrative expenses.

The average number of full time equivalent (FTE) employees of the Group during the year was made up as follows:

	2020	2019
	Number	Number
Managers	**2,911**	2,989
Clerical staff	**5,345**	5,714
	8,256	8,703

The average monthly number of employees was 9,275 (2019: 9,787).

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

2.4 Operating and administrative expenses before impairment losses (continued)

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

	2020	2019
	£'000	£'000
Fees payable to the Bank's auditor for the audit of the Bank's financial statements	**2,998**	2,613
Fees payable to the Bank's auditor for the audit of the Bank's subsidiaries[1]	**220**	354
Total audit fees	**3,218**	2,967
Audit related assurance services	**38**	-
Other assurance services	**329**	289
Fees payable to the Bank's auditor in respect of associated pension schemes	**91**	88
Total fees payable to the Bank's auditor	**3,676**	3,344

(1) Includes the audit of the Group's structured entities

Non-audit services of £0.3m (2019: £0.3m) performed by the auditor during the year included the review of the Interim Financial Report, comfort letters for the global medium-term note programme and AT1 issuance, and client money reviews.

In addition to the above, out of pocket expenses of £0.1m (2019: £0.2m) were borne by the Group, principally related to reimbursement of travel expenses incurred by staff when performing the above services.

2.5 Taxation

Accounting policy

Income tax on the profit or loss for the year comprises current and deferred tax. Income tax is recognised in the income statement except to the extent that it is related to items recognised directly in equity, in which case the tax is also recognised in equity (excluding AT1 distributions where the tax impact is recognised in the income statement).

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.

	2020	2019
	£m	£m
Current tax		
Current year	**15**	5
Adjustment in respect of prior years	**(5)**	(5)
	10	-
Deferred tax (note 3.9)		
Current year	**1**	(61)
Adjustment in respect of prior years	**7**	3
	8	(58)
Tax expense/(credit) for the year	**18**	(58)

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/(credit) is as follows:

	2020	2019
	£m	£m
Loss on ordinary activities before tax	**(173)**	(182)
Tax credit based on the standard rate of corporation tax in the UK of 19% (2019: 19%)	**(33)**	(35)
Effects of:		
Disallowable expenses	**5**	47
Deferred tax assets derecognised/(recognised)	**90**	(49)
Bank levy	**-**	1
Non-taxable gain on partial disposal of UTM (note 2.3)	**-**	(7)
Impact of rate changes	**(35)**	2
AT1 distribution	**(11)**	(15)
Adjustments in respect of prior years	**2**	(2)
Tax expense/(credit) for the year	**18**	(58)

Deferred tax assets derecognised represent historic losses that are now taken off the balance sheet in accordance with the Group's established deferred tax recognition methodology, reflecting their expected utilisation against future taxable profits. More information on deferred tax is given in note 3.9.

The rate change credit arises on the revaluation of the Group's net deferred tax assets. The valuation at 30 September 2019 reflected the enacted reduction to a 17% rate, but this reduction was cancelled in the Budget of 11 March 2020 with reversion to 19%.

As outlined in note 1.10, and in accordance with IASB improvements for periods commencing on or after 1 January 2019, the tax credit associated with the distribution on AT1 instruments has been presented in the income statement, rather than in equity. This change is presentational only; it has no effect on total shareholder assets. Prior year comparatives have been restated.

3.1 Loans and advances to customers

Accounting policy

Loans and advances to customers arise when the Group provides money directly to a customer and includes mortgages, term lending, overdrafts, credit card lending, lease finance and invoice financing. They are recognised initially at fair value and are subsequently measured at amortised cost, using the effective interest method, adjusted for ECLs (note 3.2). 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	
	2020	2019	**2020**	2019
	£m	£m	**£m**	£m
Gross loans and advances to customers	**72,923**	73,244	**71,925**	32,613
Impairment provisions on credit exposures (note 3.2)	**(735)**	(362)	**(729)**	(224)
Fair value hedge adjustment	**240**	211	**240**	-
	72,428	73,093	**71,436**	32,389

The Group and Bank have a portfolio of fair valued business loans of £190m (2019: £253m) which are classified separately as financial assets at FVTPL on the balance sheet (note 3.5). Combined with the above, this is equivalent to total loans and advances of £72,618m (2019: £73,346m) in respect of Group and £71,626m (2019: £32,642m) in respect of Bank.

The fair value hedge adjustment represents an offset to the fair value movement on derivatives designated in hedge relationships to manage the interest rate risk inherent in the Group's fixed rate mortgage portfolio.

The Group and Bank have transferred a proportion of mortgages to the securitisation and covered bond programmes (note 3.3).

Lease finance

The Group leases a variety of assets to third parties under finance lease arrangements, including vehicles and general plant and machinery. The cost of assets acquired by the Group during the year for the purpose of letting under finance leases and hire purchase contracts amounted to £61m (2019: £38m) and £346m (2019: £408m) respectively.

Finance lease receivables are presented in the statement of financial position within 'Loans and advances to customers'. The maturity analysis of lease receivables, including the undiscounted lease payments to be received are as follows:

Gross investment in finance lease and hire purchase receivables	**2020**	2019
	£m	£m
Less than 1 year	**265**	276
1-2 years	**186**	180
2-3 years	**125**	112
3-4 years	**65**	63
4-5 years	**32**	31
More than 5 years	**33**	23
	706	685
Unearned finance income	**(36)**	(36)
Net investment in finance lease and hire purchase receivables	**670**	649

Finance income recognised on the net investment in the lease was £22m (2019 £22m) and is included in interest income (note 2.2) in the income statement.

3.2 Impairment provisions on credit exposures

Accounting policy

At each reporting date, the Group assesses financial assets measured at amortised cost, as well as loan commitments and financial guarantees not measured at FVTPL, for impairment. The impairment loss allowance is calculated using an ECL methodology and reflects: (i) an unbiased and probability weighted amount; (ii) the time value of money which discounts the impairment loss; and (iii) 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.

ECL methodology is based upon the combination of PD, LGD and EAD estimates that consider a range of factors that impact on credit risk and consequently the level of impairment loss provisioning. The Group uses reasonable and supportable forecasts of future economic conditions in estimating the ECL allowance. The methodology and assumptions used in the ECL calculation are reviewed regularly and updated as necessary.

The ECL assessment is performed on either a collective or individual basis:

Collectively assessed: these assets are assessed and provided for on a group or a pooled basis due to the existence of shared risk characteristics for as long as they retain those similar characteristics. Financial assets are considered to have shared risk characteristics when, at a given point in time, they will tend to display a similar PD and credit risk profile.

Individually assessed: these assets are assessed and provided for at the financial instrument level, with the assessment (which is governed by the Group's Credit Policy) taking into consideration a range of likely potential outcomes relating to each customer and their associated financial assets.

Regardless of the calculation basis, the Group generates an allowance at the individual financial instrument level.

Significant increase in credit risk assessment and staging

The ECL is calculated as either a 12-month (Stage 1) or lifetime ECL depending on whether the financial asset has suffered a SICR since origination (Stage 2) or has otherwise become credit impaired (Stage 3) as at the reporting date. The Group uses a PD threshold curve (distinct for each portfolio) to assess for a SICR and also utilises the 30 DPD and 90 DPD backstops for recognising Stage 2 and Stage 3 provisions respectively.

In addition to the above stages, POCI financial assets are those which are assessed as being credit impaired upon initial recognition. Once a financial asset is classified as POCI, it remains there until derecognition irrespective of its credit quality. POCI financial assets are disclosed separately from those financial assets in Stage 3. The Group regards the date of acquisition as the origination date for purchased portfolios.

Financial assets can move between stages when the relevant staging criteria are no longer satisfied. If the level of impairment loss reduces in a subsequent year, the previously recognised impairment loss allowance is reversed and recognised in the income statement.

The Group has not made use of the low credit risk option under IFRS 9 for loans and advances at amortised cost.

Write-offs and recoveries

When there is no reasonable expectation of recovery for a loan, it is written off against the related provision. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of the impairment charge in the income statement.

The Group's impairment policy for debt instruments at FVOCI is included in note 3.7. The impact of the ECL methodology on the Group's cash and balances with central banks and due from other banks balances is immaterial.

Critical accounting estimates and judgements

The use of an ECL methodology under IFRS 9 requires the Group to apply estimates and exercise judgement when calculating an impairment allowance for credit exposures.

Further detail on the scenarios, macroeconomic assumptions and weightings used in the ECL calculation together with sensitivity analysis is detailed in the Risk report on pages 45 - 47.

3.2 Impairment provisions on credit exposures (continued)

Movement in impairment provision on credit exposures

	Group		Bank	
	2020	2019	**2020**	2019
	£m	£m	**£m**	£m
Opening balance	**362**	224	**224**	220
FSMA Part VII transfer from Virgin Money PLC	**-**	-	**138**	-
Charge for the year	**507**	252	**499**	61
Amounts written off	**(159)**	(142)	**(157)**	(69)
Recoveries of amounts written off in previous years	**25**	28	**25**	12
Closing balance	**735**	362	**729**	224
Individually assessed	**53**	47	**51**	45
Collectively modelled	**682**	315	**678**	179
	735	362	**729**	224

The Group impairment provision is classified by stage allocation as follows:

	Group		Bank	
	2020	2019	**2020**	2019
	£m	£m	**£m**	£m
Stage 1	**136**	79	**135**	42
Stage 2	**465**	168	**462**	91
Stage 3[(1)]	**134**	115	**132**	91
	735	362	**729**	224

(1) Stage 3 includes £2m (2019: £3m) of POCI gross loans and advances for Group and £2m (2019: £Nil) for Bank.

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

3.3 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, the full details of which can be found in note 6.2. The Group has no shareholding in these entities, but is exposed, or has rights, to variable returns and has the ability to affect those returns. The entities are consolidated in the Group's financial statements in accordance with note 1.5.

Securitisation

The Bank has securitised a portion of its retail mortgage loan portfolio under both master trust (Lanark and Lannraig) and standalone (Gosforth) securitisation programmes. The securitised mortgage loans have been assigned at principal value to bankruptcy remote structured entities. 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 externally held securitised notes in issue are included within debt securities in issue (note 3.12). There are a number of notes held internally by the Bank 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 bankruptcy remote limited liability partnerships, Clydesdale Covered Bond No 2 LLP and Eagle Place LLP, to provide a guarantee for the obligations payable on the covered bonds issued by the Bank.

The covered bond partnerships are consolidated with the mortgage loans retained on the consolidated balance sheet and the covered bonds issued included within debt securities in issue (note 3.12). The covered bond holders have dual recourse: firstly, to the bond issuer on an unsecured basis; and secondly, to the appropriate LLP under the Covered Bond Guarantee secured against the mortgage loans.

Under both the securitisation and covered bond programmes, the mortgage loans do not qualify for balance sheet derecognition because the Group remains exposed to the majority of the risks and rewards of the mortgage loan portfolio, principally the associated credit risk. The Group continues to service the mortgage loans in return for an administration fee and is also entitled to any residual income after all payment obligations due under the terms of the programmes and senior programme expenses have been met. A deemed loan liability is recognised in the mortgage originator for the proceeds of the funding transaction.

Significant restrictions

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

3.3 Securitisation and covered bond programmes (continued)

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

Group	**2020**		2019	
	Loans and advances securitised	**Notes in issue**	Loans and advances securitised	Notes in issue
	£m	**£m**	£m	£m
Securitisation Programmes				
Lanark Master Issuer	**5,686**	**4,757**	5,009	4,597
Lannraig Master Issuer	**860**	**765**	1,032	838
Gosforth 2014-1	**-**	**-**	372	385
Gosforth 2015-1	**-**	**-**	707	630
Gosforth 2016-1	**1,141**	**947**	1,142	1,048
Gosforth 2016-2	**-**	**-**	701	579
Gosforth 2017-1	**910**	**709**	934	852
Gosforth 2018-1	**1,227**	**1,060**	1,353	1,267
	9,824	**8,238**	11,250	10,196
Less held by the Group		**(4,236)**		(5,154)
		4,002		5,042
Covered Bond Programmes				
Clydesdale Bank PLC	**905**	**781**	1,253	776
Clydesdale Bank PLC (formerly Virgin Money PLC)	**3,446**	**1,137**	2,622	1,126
	4,351	**1,918**	3,875	1,902

Bank	**2020**		2019	
	Loans and advances securitised	**Notes in issue**	Loans and advances securitised	Notes in issue
	£m	**£m**	£m	£m
Covered Bond Programmes				
Clydesdale Bank PLC	**905**	**699**	1,253	699
Clydesdale Bank PLC (formerly Virgin Money PLC)	**3,446**	**1,143**	-	-
	4,351	**1,842**	1,253	699

Following the FSMA Part VII transfer Clydesdale Bank PLC is now the issuer and principal debtor under the Clydesdale Bank PLC (formerly Virgin Money PLC) Global Covered Bond Programme.

3.3 Securitisation 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 3.12.

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 transaction. These mortgages are included in the securitised asset balances disclosed in the table above, which is based on whether notes are issued from Group or Bank, and all securitised mortgages are recognised on the Bank balance sheet.

The fair values of financial assets and associated liabilities relating to the securitisation programmes where the counterparty to the liabilities has recourse only to the financial assets were £9,807m and £3,988m respectively (2019: £11,329m and £5,085m).

There were no events during the year that resulted in any Group or Bank transferred 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 Group and Bank provide credit support to the structured entities via reserve funds, which are partly funded through subordinated debt arrangements and by holding junior notes. Exposures are shown in the table below:

	Group		Bank	
	2020	2019	**2020**	2019
	£m	£m	**£m**	£m
Beneficial interest held	**1,795**	1,467	**1,795**	721
Subordinated loans	**46**	100	**46**	21
Junior notes held	**1,299**	1,722	**1,299**	887
	3,140	3,289	**3,140**	1,629

Looking forward through future reporting years 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 £520m (2019: £699m) in the Clydesdale Bank PLC programme and £2,314m (2019: £1,490m) in the Clydesdale Bank PLC (formerly Virgin Money PLC) programme. From time to time the obligations of the Group to provide over-collateralisation may increase due to the formal requirements of the programme.

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

3.4 Cash and balances with central banks

Accounting policy

Cash and balances with central banks are measured at amortised cost, using the effective interest method, adjusted for ECLs, and are derecognised when the rights to receive cash flows have expired or the Group has transferred substantially all the risks and rewards of ownership. These balances are generally of a short-term nature and repayable on demand or within a short timescale, generally three months.

	Group		Bank	
	2020	2019	**2020**	2019
	£m	£m	**£m**	£m
Cash assets	**1,560**	1,574	**1,560**	1,571
Balances with central banks (including EU payment systems)	**7,547**	8,722	**7,547**	5,050
	9,107	10,296	**9,107**	6,621
Less mandatory deposits with central banks[1]	**(220)**	(183)	**(220)**	(83)
Included in cash and cash equivalents (note 5.2)	**8,887**	10,113	**8,887**	6,538

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

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

Accounting policy

A financial asset is measured at FVTPL if it (i) does not fall into one of the business models for amortised cost (note 1.7) or FVOCI (note 3.7); (ii) is specifically designated as FVTPL on initial recognition in order to eliminate or significantly reduce a measurement mismatch; or (iii) is classified as held for trading.

Financial liabilities are measured at FVTPL where they are trading liabilities or where they are designated at FVTPL (e.g. an accounting mismatch) or where the performance is evaluated on a fair value basis in accordance with risk management and investment strategies.

A financial instrument is classified as held for trading if it is acquired principally for the purpose of selling in the near term, forms part of a portfolio of financial instruments that are managed together and for which there is evidence of short-term profit taking, or it is a derivative not in a qualifying hedge relationship.

Associated gains and losses are recognised in the income statement as they arise (note 2.3).

	Group		Bank	
	2020	2019	**2020**	2019
	£m	£m	**£m**	£m
Financial assets at fair value through profit or loss				
Loans and advances	**190**	253	**190**	253
Other financial assets	**1**	8	**1**	1
	191	261	**191**	254

Loans and advances

Included in financial assets at FVTPL 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 £190m (2019: £253m) including accrued interest receivable of £1m (2019: £1m). The cumulative loss in the fair value of the loans attributable to changes in credit risk amounts to £3m (2019: £4m) and the change for the current year is a decrease of £1m (2019: decrease of £4m), of which £1m (2019: £2m) has been recognised in the income statement.

Other financial assets

Refer to note 3.16 for further information on the valuation methodology applied to financial assets held at FVTPL and their classification within the fair value hierarchy. Details of the credit quality of financial assets is provided in the Risk report.

3.6 Derivative financial instruments

Accounting policy

The Group uses derivative financial instruments to manage exposure to interest rate and foreign currency risk. Interest rate risk arises when there is a mismatch between fixed interest rate and floating interest rates, and different repricing characteristics between assets and liabilities. Currency risk arises when assets and liabilities are not denominated in the functional currency of the entity. Derivatives are recognised on the balance sheet at fair value on trade date and are 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.

Netting
Derivative assets and liabilities are offset against collateral received and paid respectively, and the net amount reported in the 'due to and from other banks' in the balance sheet only when there is a legally enforceable right to offset the recognised amounts, and there is an intention to settle on a net basis. Amounts offset on the balance sheet represent the Group's centrally cleared derivative financial instruments and collateral paid to/from central clearing houses, which meet the criteria for offsetting under IAS 32.

Hedge accounting
The Group elects to apply hedge accounting for the majority of its risk management activity that uses derivatives. This results in greater alignment in the timing of recognition of gains and losses on hedged items and hedging instruments and therefore reduces income statement volatility. The Group does not have a trading book, however derivatives that do not meet the hedging criteria, or for which hedge accounting is not applied, are classified as held for trading.

The Group has elected, as a policy choice permitted under IFRS 9, to continue to apply hedge accounting in accordance with IAS 39. 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).

As highlighted in note 1.10, the Group has early adopted the 'Amendments to IAS 39 and IFRS 7 Interest Rate Benchmark Reform' issued in September 2019. In accordance with the transition provisions, the amendments have been adopted retrospectively in respect of hedging relationships that existed at the start of the reporting year or were designated thereafter, and to the amount accumulated in the cash flow hedge reserve at that date.

The amendments provide temporary relief from applying specific hedge accounting requirements to hedging relationships directly affected by IBOR (Interbank Offered Rates) reform. The reliefs have the effect that IBOR reform should not generally cause hedge accounting to terminate. However, any hedge ineffectiveness continues to be recorded in the income statement. Furthermore, the amendments set out triggers for when the reliefs will end, which include the uncertainty arising from interest rate benchmark reform no longer being present.

In summary, the reliefs provided by the amendments that apply to the Group are:
• When considering the 'highly probable' requirement, the Group has assumed that the IBOR interest rates upon which the hedged items are based do not change as a result of IBOR reform;
• In assessing whether the hedge is expected to be highly effective on a prospective basis the Group has assumed that the IBOR interest rates upon which the cash flows of the hedged items and the hedging instruments that hedge them are based are not altered by IBOR reform;
• The Group will not discontinue hedge accounting should the retrospective assessment of hedge effectiveness fall outside the 80-125 per cent range and the hedging relationship be subject to interest rate benchmark reforms. For those hedging relationships that are not subject to the interest rate benchmark reforms the Group will continue to cease hedge accounting if retrospective effectiveness is outside the 80-125 per cent range;
• The Group has retained the cumulative gain or loss in the cash flow hedge reserve for designated cash flow hedges that are subject to interest rate benchmark reforms even though there is uncertainty arising from the interest rate benchmark reform with respect to the timing and amount of the cash flows of the hedged items. Should the Group consider the hedged future cash flows are no longer expected to occur due to reasons other than interest rate benchmark reform, the cumulative gain or loss will be immediately reclassified to profit or loss; and
• The Group has assessed whether the hedged IBOR risk component is a separately identifiable risk only when it first designates a hedged item in a fair value hedge and not on an ongoing basis.

3.6 Derivative financial instruments (continued)

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 year 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. This movement in the fair value of the hedged item 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 over the remaining life of the asset or liability.

Derivatives held for trading
Changes in value of held for trading derivatives are immediately recognised in the income statement (note 2.3).

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 year for which the hedge is designated are expected to offset in a range of 80% to 125%.

3.6 Derivative financial instruments (continued)

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

	Group		Bank	
	2020	2019	**2020**	2019
	£m	£m	**£m**	£m
Fair value of derivative financial assets				
Designated as hedging instruments	**198**	315	**66**	398
Designated as held for trading	**120**	51	**68**	44
	318	366	**134**	442
Fair value of derivative financial liabilities				
Designated as hedging instruments	**158**	191	**158**	215
Designated as held for trading	**92**	82	**92**	77
	250	273	**250**	292

In respect of derivatives with other banks, cash collateral totalling £53m (2019: £55m) has been pledged and £93m has been received (2019: £149m). These amounts are included within due from and due to other banks respectively. Collateral placed with clearing houses, which did not meet offsetting criteria, totalled £202m (2019: £55m) and is included within other assets.

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

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

3.6 Derivative financial instruments (continued)

Group Total derivative contracts	2020 Notional Contract Amount £m	2020 Fair value Of assets £m	2020 Fair value Of liabilities £m	2019 Notional Contract Amount £m	2019 Fair value Of assets £m	2019 Fair value Of liabilities £m
Derivatives designated as hedging instruments						
Cash flow hedges						
Interest rate swaps (gross)	**29,645**	**74**	**215**	25,023	105	121
Less: net settled interest rate swaps[1]	**(19,187)**	**(13)**	**(171)**	(14,513)	(47)	(75)
Interest rate swaps (net)[2]	**10,458**	**61**	**44**	10,510	58	46
Cross currency swaps[2]	**420**	**28**	**-**	1,446	162	-
	10,878	**89**	**44**	11,956	220	46
Fair value hedges						
Interest rate swaps (gross)	**37,803**	**182**	**751**	25,492	146	526
Less: net settled interest rate swaps [1]	**(30,603)**	**(92)**	**(642)**	(23,872)	(60)	(389)
Interest rate swaps (net)[2]	**7,200**	**90**	**109**	1,620	86	137
Cross currency swaps[2]	**1,448**	**19**	**5**	808	9	8
	8,648	**109**	**114**	2,428	95	145
Total derivatives designated as hedging instruments	**19,526**	**198**	**158**	14,384	315	191
Derivatives designated as held for trading						
Foreign exchange rate related contracts						
Spot and forward foreign exchange[2]	**1,003**	**15**	**15**	728	16	15
Cross currency swaps[2]	**1,263**	**56**	**7**	1,123	11	9
Options[2]	**1**	**-**	**-**	2	-	-
	2,267	**71**	**22**	1,853	27	24
Interest rate related contracts						
Interest rate swaps (gross)	**704**	**28**	**47**	1,159	24	53
Less: net settled interest rate swaps[1]	**-**	**-**	**-**	(363)	(5)	(2)
Interest rate swaps (net)[2]	**704**	**28**	**47**	796	19	51
Swaptions[2]	**10**	**-**	**2**	11	-	2
Options[2]	**426**	**2**	**3**	465	2	3
	1,140	**30**	**52**	1,272	21	56
Commodity related contracts	**131**	**19**	**18**	55	2	2
Equity related contracts	**-**	**-**	**-**	3	1	-
Total derivatives designated as held for trading	**3,538**	**120**	**92**	3,183	51	82

(1) Presented within other assets.
(2) Presented within derivative financial instruments.

3.6 Derivative financial instruments (continued)

Bank Total derivative contracts	2020 Notional Contract Amount £m	2020 Fair value Of assets £m	2020 Fair value Of liabilities £m	2019 Notional Contract Amount £m	2019 Fair value Of assets £m	2019 Fair value Of liabilities £m
Derivatives designated as hedging instruments						
Cash flow hedges						
Interest rate swaps (gross)	**29,645**	**74**	**215**	89,114	463	442
Less: net settled interest rate swaps(1)	**(19,187)**	**(13)**	**(171)**	(41,480)	(65)	(364)
Interest rate swaps (net)(2)	**10,458**	**61**	**44**	47,634	398	78
Fair value hedges						
Interest rate swaps (gross)	**37,103**	**92**	**751**	2,370	47	238
Less: net settled interest rate swaps (1)	**(30,603)**	**(92)**	**(642)**	(1,750)	(47)	(101)
Interest rate swaps (net)(2)	**6,500**	**-**	**109**	620	-	137
Cross currency swaps(2)	**526**	**5**	**5**	-	-	-
Total derivatives designated as hedging instruments	**17,484**	**66**	**158**	48,254	398	215
Derivatives designated as held for trading						
Foreign exchange rate related contracts						
Spot and forward foreign exchange(2)	**1,003**	**15**	**15**	728	16	15
Cross currency swaps(2)	**764**	**4**	**7**	1,034	5	4
Options(2)	**1**	**-**	**-**	2	-	-
	1,768	**19**	**22**	1,764	21	19
Interest rate related contracts						
Interest rate swaps (gross)	**704**	**28**	**47**	796	19	51
Less: net settled interest rate swaps(1)	**-**	**-**	**-**	11	-	2
Interest rate swaps (net)(2)	**704**	**28**	**47**	807	19	53
Swaptions(2)	**10**	**-**	**2**	-	-	-
Options(2)	**426**	**2**	**3**	465	2	3
	1,140	**30**	**52**	1,272	21	56
Commodity related contracts	**131**	**19**	**18**	55	2	2
Total derivatives designated as held for trading	**3,039**	**68**	**92**	3,091	44	77

(1) Presented within other assets.
(2) Presented within derivative financial instruments.

Hedge accounting

The hedging strategy of the Group is divided into micro hedges, where the hedged item is a distinctly identifiable asset or liability, and portfolio hedges, where the hedged item is a homogenous portfolio of assets and liabilities.

In some hedge accounting relationships, the Group designates risk components of hedged items as follows:

- benchmark interest rate risk as a component of interest rate risk, such as the SONIA component;
- exchange rate risk for foreign currency financial assets and financial liabilities; and
- components of cash flows of hedged items, for example certain interest payments for part of the life of an instrument.

Other risks such as credit risk and liquidity risk are managed by the Group but are not included in the hedge accounting relationship. Changes in the designated risk component usually account for the largest portion of the overall change in fair value or cash flows of the hedged item.

3.6 Derivative financial instruments (continued)

Portfolio cash flow hedges
The Group applies macro cash flow hedge accounting to a portion of its floating rate financial assets and liabilities. The hedged cash flows are a group of forecast transactions that result in cash flow variability from resetting of interest rates, reinvestment of financial assets, or refinancing and rollovers of financial liabilities. This cash flow variability can arise on recognised assets or liabilities or highly probable forecast transactions. The hedged items are designated as the gross asset or liability positions allocated to time buckets based on projected repricing and interest profiles. The Group aims to maintain a position where the principal amount of the hedged items is greater than or equal to the notional amount of the corresponding interest rate swaps used as the hedging instruments. The hedge accounting relationship is reassessed on a monthly basis with the composition of hedging instruments and hedged items changing frequently in line with the underlying risk exposures. If necessary, the hedge relationships are de-designated and redesignated based on the effectiveness test results.

Micro cash flow hedges
Floating rate issuances that are denominated in currencies other than the functional currency of the Group are designated in cash flow hedges with cross currency swaps.

Portfolio fair value hedges
The Group applies macro fair value hedging to its fixed rate mortgages. During the year fair value hedging of fixed rate deposits was discontinued. The Group determines hedged items by identifying portfolios of homogeneous loans or deposits based on their contractual maturity and other risk characteristics. Loans or deposits within the identified portfolios are allocated to repricing time buckets based on expected, rather than contractual, repricing dates. The hedging instruments are designated to those repricing time buckets. Hedge effectiveness is measured on a monthly basis, by comparing fair value movements of the designated proportion of the bucketed loans due to the hedged risk against the fair value movements of the derivatives.

The aggregated fair value changes in the hedged loans and deposits are recognised on the Group's balance sheet as an asset and liability respectively. At the end of every month, in order to minimise the ineffectiveness from early repayments and accommodate new exposures, the Group voluntarily de-designates the hedge relationships and redesignates them as new hedges.

Micro fair value hedges
The Group uses this hedging strategy on GBP and foreign currency denominated fixed rate assets held at FVOCI and GBP and foreign currency denominated fixed rate debt issuances by the Group.

Hedge ineffectiveness
Hedge ineffectiveness can arise from:

- mismatches between the contractual terms of the hedged item and hedging instrument, including basis differences;
- differences in timing of cash flows of hedged items and hedging instruments;
- changes in expected timings and amounts of forecast future cash flows; and
- derivatives used as hedging instruments having a non-zero fair value at the time of designation.

Additionally, for portfolio fair value hedges of the Group's fixed rate mortgage portfolio, ineffectiveness also arises from the difference between forecast and actual repayments (e.g. prepayment risk and impact of short-term payment holidays granted to customers in response to COVID-19).

Interest Rate Benchmark Reform
The Group has cash flow and fair value hedge accounting relationships that are exposed to different IBORs, predominantly GBP LIBOR but also Euro Interbank Offer Rate (EURIBOR), which are subject to IBOR reform.

As at 30 September 2020, the principal of the hedged items designated into cash flow hedge relationships that is directly affected by the interest rate benchmark reform is £611m. The principal of the hedged items designated in fair value hedge relationships that is directly affected by the interest rate benchmark reform is £780m, of which £78m relates to EURIBOR. These fair value hedges principally relate to GBP and foreign currency denominated fixed rate assets, and GBP fixed rate debt.

At 30 September 2020, the principal amount of the hedging instruments in hedge relationships to which these amendments apply was £908m, of which £778m relates to fair value hedges and £130m relates to cash flow hedges. Page 85 of the Risk report describes how the Group is managing the transition to new benchmark interest rates.

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

3.6 Derivative financial instruments (continued)

Interest Rate Benchmark Reform (continued)

The Group will continue to apply the amendments to IAS 39 until the uncertainty arising from IBOR reform, with respect to the timing and the amount of the underlying cash flows that the Group is exposed to, ends. The Group has assumed that this uncertainty will not end until the Group's contracts that reference IBORs are amended to specify the date on which the interest rate benchmark will be replaced, the cash flows of the alternative benchmark rate and the relevant spread adjustment.

The table below discloses the impact derivatives held in micro hedging relationships are expected to have on the timing and uncertainty of future cash flows. All notional principal amounts and carrying values are presented gross, prior to any netting permitted for balance sheet presentation as this reflects the derivative position used for risk management and the impact on future cash flows.

2020 - Group	**3 months or less**	**3 to 12 months**	**1 to 5 years**	**Total**
Cash flow hedges				
Foreign exchange risk				
Cross currency swaps				
Notional principal (£m)	**185**	**235**	**-**	**420**
Average GBP/EUR rate	**1.4149**	**1.4149**	**-**	**n/a**
Average GBP/USD rate	**1.3023**	**1.2984**	**-**	**n/a**

2019 - Group	3 months or less	3 to 12 months	1 to 5 years	Total
Cash flow hedges				
Foreign exchange risk				
Cross currency swaps				
Notional principal (£m)	107	445	894	1,446
Average GBP/EUR rate	1.3459	1.3423	1.3680	n/a
Average GBP/USD rate	1.3263	1.3228	1.3089	n/a

3.6 Derivative financial instruments (continued)

Summary of hedging instruments in designated hedge relationships

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

Group	2020				2019			
		Carrying amount				Carrying amount		
	Notional contract amount £m	Assets £m	Liabilities £m	Change in fair value of hedging instrument in the year used for ineffectiveness measurement(2) £m	Notional Contract Amount £m	Assets £m	Liabilities £m	Change in fair value of hedging Instrument in the year used for Ineffectiveness measurement(2) £m
CASH FLOW HEDGES								
Interest rate risk								
Interest rate swaps(1)	**29,645**	**74**	**(215)**	**(80)**	25,023	105	(121)	-
Foreign exchange risk								
Cross currency swaps	**420**	**28**	**-**	**(59)**	1,446	162	-	59
Total derivatives designated as cash flow hedges	**30,065**	**102**	**(215)**	**(139)**	26,469	267	(121)	59
FAIR VALUE HEDGES								
Interest rate risk								
Interest rate swaps(1)	**37,803**	**182**	**(751)**	**(40)**	25,492	146	(526)	(283)
Foreign exchange and interest rate risk								
Cross currency swaps	**1,448**	**19**	**(5)**	**-**	808	9	(8)	1
Total derivatives designated as fair value hedges	**39,251**	**201**	**(756)**	**(40)**	26,300	155	(534)	(282)

Bank	2020				2019			
		Carrying amount				Carrying amount		
	Notional Contract Amount £m	Assets £m	Liabilities £m	Change in fair value of hedging Instrument in the year used for Ineffectiveness measurement(2) £m	Notional Contract Amount £m	Assets £m	Liabilities £m	Change in fair value of hedging Instrument in the year used for Ineffectiveness measurement(2) £m
CASH FLOW HEDGES								
Interest rate risk								
Interest rate swaps(1)	**29,645**	**74**	**(215)**	**(94)**	89,114	463	(442)	48
Total derivatives designated as cash flow hedges	**29,645**	**74**	**(215)**	**(94)**	89,114	463	(442)	48
FAIR VALUE HEDGES								
Interest rate risk								
Interest rate swaps(1)	**37,103**	**92**	**(751)**	**(58)**	2,370	47	(238)	(53)
Foreign exchange and interest rate risk								
Cross currency swaps	**526**	**5**	**(5)**	**3**	-	-	-	-
Total derivatives designated as fair value hedges	**37,629**	**97**	**(756)**	**(55)**	2,370	47	(238)	(53)

(1) As shown in the total derivatives contracts table on pages 145 - 146, for centrally cleared derivatives, where the IAS 32 *'Financial Instruments: Presentation'* netting criteria is
met, the derivative balances are offset within other assets. For all other derivatives, the derivative balances are presented within derivative financial instruments.
(2) Changes in fair value of cash flow hedging instruments are recognised in other comprehensive income. Changes in fair value of fair value hedging instruments are
(3) recognised in the income statement in non-interest income.

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

3.6 Derivative financial instruments (continued)

Summary of hedged items in designated hedge relationships

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

Group	2020			2019		
		Cash flow hedge reserve			Cash flow hedge reserve (excluding deferred tax)	
	Change in fair value of hedged item in the year used for ineffectiveness measurement £m	Continuing Hedges £m	Discontinued hedges £m	Change in fair value of hedged item in the year used for ineffectiveness measurement £m	Continuing Hedges £m	Discontinued hedges £m
CASH FLOW HEDGES						
Interest rate risk						
Gross floating rate assets and gross floating rate liabilities[(1)]	**74**	**(123)**	**17**	(14)	(15)	(19)
Foreign exchange risk						
Floating rate currency issuances[(2)]	**59**	**(1)**	**-**	(59)	-	-
Total	**133**	**(124)**	**17**	(73)	(15)	(19)

Group	2020				2019			
	Carrying amount Of hedged items		Accumulated amount of fair value adjustments on the hedged item	Change in fair value of hedged items in the year used for ineffectiveness measurement	Carrying amount Of hedged items		Accumulated amount of fair value adjustments on the hedged item[(6)]	Change in fair value of hedged items in the year used for ineffectiveness measurement
	Assets £m	Liabilities £m	£m	£m	Assets £m	Liabilities £m	£m	£m
FAIR VALUE HEDGES								
Interest rate risk								
Fixed rate mortgages[(3)]	**31,110**	**-**	**240**	**29**	16,436	-	211	209
Fixed rate customer deposits[(4)]	**-**	**-**	**(11)**	**1**	-	(4,769)	(10)	(9)
Fixed rate FVOCI debt instruments[(5)]	**3,001**	**-**	**74**	**16**	2,940	-	166	133
Fixed rate issuances[(6)]	**-**	**(2,565)**	**132**	**(27)**	-	(2,368)	103	(73)
Foreign exchange and interest rate risk								
Fixed rate currency FVOCI debt instruments[(5)]	**83**	**-**	**5**	**3**	82	-	3	4
Fixed rate currency issuances[(6)]	**-**	**(1,389)**	**4**	**(3)**	-	(530)	1	(4)
Total	**34,194**	**(3,954)**	**444**	**19**	19,458	(7,667)	474	260

(1) Highly probable future cash flows arising from loans and advances to customers, due to customers and debt securities in issue.
(2) Hedged item is recorded in debt securities in issue.
(3) Hedged item and the cumulative fair value changes, are recorded in loans and advances to customers.
(4) Hedge relationship was discontinued during the year. The fair value adjustment taken will be amortised over the remaining life of the hedged items, and is recorded in due to customers
(5) Hedged item is recorded in financial assets at FVOCI.
(6) £1,725m of the hedged item is recorded in debt securities in issue, including £86m of accumulated fair value adjustments. £2,229m of the hedged item is recorded in due to related entities, including £50m of accumulated fair value adjustments.

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

3.6 Derivative financial instruments (continued)

Bank	2020			2019		
		Cash flow hedge reserve			Cash flow hedge reserve (excluding deferred tax)	
	Change in fair value of hedged item in the year used for ineffectiveness measurement £m	Continuing Hedges £m	Discontinued hedges £m	Change in fair value of hedged item in the year used for ineffectiveness measurement £m	Continuing Hedges £m	Discontinued hedges £m
CASH FLOW HEDGES						
Interest rate risk						
Gross floating rate assets and gross floating rate liabilities[(1)]	**90**	**(123)**	**37**	(62)	12	1
Total	**90**	**(123)**	**37**	(62)	12	1

Bank	2020				2019			
	Carrying amount Of hedged items		Accumulated amount of fair value adjustments on the hedged item	Change in fair value of hedged items in the year used for ineffectiveness measurement	Carrying amount Of hedged items		Accumulated amount of fair value adjustments on the hedged item[(6)]	Change in fair value of hedged items in the year used for ineffectiveness measurement
	Assets £m	Liabilities £m	£m	£m	Assets £m	Liabilities £m	£m	£m
FAIR VALUE HEDGES								
Interest rate risk								
Fixed rate mortgages[(3)]	**31,110**	**-**	**240**	**29**	-	-	-	-
Fixed rate customer deposits[(4)]	**-**	**-**	**(11)**	**1**	-	-	-	-
Fixed rate FVOCI debt instruments[(5)]	**3,001**	**-**	**74**	**30**	1,742	-	102	81
Fixed rate issuances[(6)]	**-**	**(1,769)**	**50**	**(21)**	-	(1,278)	29	(30)
Foreign exchange and interest rate risk								
Fixed rate currency FVOCI debt instruments[(5)]	**83**	**-**	**5**	**3**	-	-	-	-
Fixed rate currency issuances[(6)]	**-**	**(455)**	**(1)**	**(6)**	-	-	-	-
Total	**34,194**	**(2,224)**	**357**	**36**	1,742	(1,278)	131	51

(1) Highly probable future cash flows arising from loans and advances to customers, due to customers and debt securities in issue.
(2) Hedged item is recorded in debt securities in issue.
(3) Hedged item and the cumulative fair value changes, are recorded in loans and advances to customers.
(4) Hedge relationship was discontinued during the year. The fair value adjustment taken will be amortised over the remaining life of the hedged items, and is recorded in due to customers
(5) Hedged item is recorded in financial assets at FVOCI.
(6) £1,725m of the hedged item is recorded in debt securities in issue, including £86m of accumulated fair value adjustments. £2,229m of the hedged item is recorded in due to related entities, including £50m of accumulated fair value adjustments.

3.6 Derivative financial instruments (continued)

Group	2020				2019			
			Reclassified into Income statement as				Reclassified into Income statement as	
	Hedge ineffectiveness recognised in income statement[(1)] £m	Effective portion recognised in other comprehensive income £m	Net interest income £m	Non-interest income £m	Hedge ineffectiveness recognised in income statement[(1)] £m	Effective portion recognised in other comprehensive income £m	Net interest income £m	Non-interest income £m
CASH FLOW HEDGES								
Interest rate risk								
Gross floating rate assets and gross floating rate liabilities	**(6)**	**(74)**	**5**	**(5)**	(14)	14	1	-
Foreign exchange risk								
Floating rate currency issuances	**-**	**(59)**	**-**	**(59)**	-	59	-	57
Total losses on cash flow hedges	**(6)**	**(133)**	**5**	**(64)**	(14)	73	1	57

Group	Hedge ineffectiveness recognised in income	
	2020 £m	2019 £m
FAIR VALUE HEDGES		
Interest rate risk		
Fixed rate mortgages	**(22)**	(24)
Fixed rate customer deposits	**3**	4
Fixed rate FVOCI debt instruments	**-**	(2)
Fixed rate issuances	**(2)**	(1)
Foreign exchange and interest rate risk		
Fixed rate currency FVOCI debt instruments	**-**	-
Fixed rate currency issuances	**-**	1
Total losses on fair value hedges[(1)]	**(21)**	(22)

(1) Recognised in gains less losses on financial assets at fair value.

Bank	2020				2019			
			Reclassified into Income statement as				Reclassified into Income statement as	
	Hedge ineffectiveness recognised in income statement[(1)] £m	Effective portion recognised in other comprehensive income £m	Net interest income £m	Non-interest income £m	Hedge ineffectiveness recognised in income statement[(1)] £m	Effective portion recognised in other comprehensive income £m	Net interest income £m	Non-interest income £m
CASH FLOW HEDGES								
Interest rate risk								
Gross floating rate assets and gross floating rate liabilities	**(4)**	**(90)**	**8**	**-**	(14)	62	1	-
Total losses on cash flow hedges	**(4)**	**(90)**	**8**	**-**	(14)	62	1	-

Bank	Hedge ineffectiveness recognised in income	
	2020 £m	2019 £m
FAIR VALUE HEDGES		
Interest rate risk		
Fixed rate mortgages	**(15)**	-
Fixed rate customer deposits	**(1)**	-
Fixed rate FVOCI debt instruments	**-**	(2)
Fixed rate issuances	**(3)**	-
Total losses on fair value hedges[(1)]	**(19)**	(2)

(1) Recognised in gains less losses on financial assets at fair value.

3.7 Financial assets at fair value through other comprehensive income

Accounting policy

A financial asset is measured at FVOCI when (i) the asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets; and (ii) the contractual terms give rise to cash flows on specified dates which are solely payments of principal and interest on the principal amount outstanding unless the financial asset is designated at FVTPL on initial recognition. An option for equity investments that are not held for trading can be taken to classify them at FVOCI where an irrevocable election is made at initial recognition. This option is available for each separate investment. The Group has not exercised this option for any equity investments

Interest income and impairment gains and losses on FVOCI assets are measured in the same manner as for assets measured at amortised cost and are recognised in the income statement, with all other gains or losses recognised in other comprehensive income as a separate component of equity in the year in which they arise. Gains and losses arising from changes in fair value are included as a separate component of equity until sale when the cumulative gain or loss is transferred to the income statement. For all FVOCI assets, the gain or loss is calculated with reference to the gross carrying amount.

Debt instruments at FVOCI are subject to the same impairment criteria as amortised cost financial assets (note 3.2), with the ECL element recognised directly in the income statement. As the financial asset is fair valued through other comprehensive income, the change in its value includes the ECL element, with the remaining fair value change recognised in other comprehensive income. Any reversal of the ECL is recorded in the income statement up to the value recognised previously.

The Group exercises the low credit risk option for debt instruments classified as FVOCI, recognising the high credit quality of the instruments, accordingly a 12-month ECL is calculated on the assets.

	Group		Bank	
	2020	2019	**2020**	2019
	£m	£m	**£m**	£m
Listed securities	**5,080**	4,328	**5,080**	2,350
Total financial assets at fair value through other comprehensive income	**5,080**	4,328	**5,080**	2,350

Refer to note 3.16 for further information on the valuation methodology applied to financial instruments at FVOCI at 30 September 2020 and their classification within the fair value hierarchy. Details of the credit quality of financial assets are provided in the Risk report.

3.8 Intangible assets and goodwill

Accounting policy

Capitalised software is 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 software costs are amortised on a straight line basis over their expected useful lives, usually between three and ten years. Impairment losses are recognised in the income statement as incurred.

Goodwill arises on the acquisition of an entity and represents the excess of the fair value of the purchase consideration and direct costs of making the acquisition over the fair value of the Group's share of the net assets at the date of the acquisition. Goodwill is not subject to amortisation and is tested for impairment on an annual basis.

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.

3.8 Intangible assets and goodwill (continued)

Group	Capitalised software £m	Goodwill £m	Core deposit £m	Total £m
Cost				
At 1 October 2018	733	-	-	733
Acquisition of Virgin Money Holdings (UK) PLC	172	11	6	189
Additions	130	-	-	130
Write-off	(85)	-	-	(85)
At 30 September 2019	950	11	6	967
Additions	78	-	-	78
At 30 September 2020	**1,028**	**11**	**6**	**1,045**
Accumulated amortisation				
At 1 October 2018	321	-	-	321
Charge for the year	82	-	1	83
Impairment	115	-	-	115
Write-off	(68)	-	-	(68)
At 30 September 2019	450	-	1	451
Charge for the year	102	-	1	103
At 30 September 2020	**552**	**-**	**2**	**554**
Net book value				
At 30 September 2020	**476**	**11**	**4**	**491**
At 30 September 2019	500	11	5	516

£4m (2019: £31m) of the £78m (2019: £130m) software additions in both Group and Bank do not form part of internally generated software projects.

Bank	Capitalised software £m	Goodwill £m	Core deposit £m	Total £m
Cost				
At 1 October 2018	733	-	-	733
Additions	104	-	-	104
Write-off	(85)	-	-	(85)
At 30 September 2019	752	-	-	752
FSMA Part VII transfer from Virgin Money PLC	269	11	6	286
Additions	78	-	-	78
At 30 September 2020	**1,099**	**11**	**6**	**1,116**
Accumulated amortisation				
At 1 October 2018	321	-	-	321
Charge for the year	71	-	-	71
Impairment	30	-	-	30
Write-off	(68)	-	-	(68)
At 30 September 2019	354	-	-	354
FSMA Part VII transfer from Virgin Money PLC	167	-	1	168
Charge for the year	102	-	1	103
At 30 September 2020	**623**	**-**	**2**	**625**
Net book value				
At 30 September 2020	**476**	**11**	**4**	**491**
At 30 September 2019	398	-	-	398

3.9 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 £382m (2019: £418m), the principal components of which are tax losses and capital allowances.

The Group has assessed the recoverability of these deferred tax assets at 30 September 2020 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. This aassessment is based on the latest stratgic plan which has taken account of the volatile and uncertain macro-economic conditions in the UK due to the COVID-19 pandemic and the uncertainty around Brexit. Deferred tax assets are recognised to the extent that they are expected to be utilised over six years from the balance sheet date. If instead of six years the period was five years or seven years the recognised deferred tax asset would be £340m or £424m respectively. All tax assets arising will be used within the UK.

Movement in net deferred tax asset

	Group		Bank	
	2020	2019	**2020**	2019
	£m	£m	**£m**	£m
At 1 October	**219**	228	**205**	225
Recognised in the income statement (note 2.5)	**(8)**	58	**(13)**	54
Recognised directly in equity	**(100)**	(67)	**(90)**	(74)
Transfers from other group entities	**-**	-	**3**	-
At 30 September	**111**	219	**105**	205

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

3.9 Deferred tax (continued)

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

	Group		Bank	
	2020	2019	**2020**	2019
Deferred tax assets	**£m**	£m	**£m**	£m
Tax losses carried forward	**215**	249	**213**	249
Capital allowances	**113**	90	**110**	79
Cash flow hedge reserve	**23**	3	**23**	-
Acquisition accounting adjustments[1]	**1**	44	**-**	-
Transitional adjustment - IFRS 9	**15**	16	**15**	7
Transitional adjustment - available for sale	**-**	1	**-**	1
Employee equity based compensation	**5**	4	**5**	3
Pension spreading	**9**	11	**9**	11
Other	**1**	-	**-**	-
	382	418	**375**	350
Deferred tax liabilities				
Defined benefit pension scheme surplus	**(253)**	(139)	**(253)**	(139)
Acquisition accounting adjustments[1]	**(11)**	(51)	**(10)**	-
Cash flow hedge reserve	**-**	-	**-**	(3)
Intangible assets	**(3)**	(4)	**(3)**	-
Gains on available for sale investments	**-**	-	**-**	-
Gains on financial instruments at fair value through other comprehensive income	**(4)**	(5)	**(4)**	(3)
	(271)	(199)	**(270)**	(145)
Net deferred tax asset	**111**	219	**105**	205

(1) Following the execution of FSMA part VII, the deferred tax assets and liabilities in respect of acquisition accounting adjustments have been offset to provide a single number that will unwind in the same entity over coming years.

The deferred tax assets and liabilities detailed above arise primarily in the Bank.

The value of tax losses carried forward of £215m (2019: £249m) has decreased due to losses written off following the reduction in forecast profits in the plan period. At 30 September 2020, the Group had an unrecognised deferred tax asset of £217m (2019: £114m) representing trading losses with a gross value of £1,142m valued at 19% (2019: £668m valued at 17%).

3.10 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 its obligation to make 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 future payments is available.

Defined benefit pension scheme

A liability or asset is recognised on the balance sheet in respect of the defined benefit scheme and is measured as the difference between 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 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 ultimately be recovered.

Pension expense attributable to the Group's defined benefit scheme comprises current service cost, past service cost resulting from a scheme amendment or curtailment, net interest on the net defined benefit obligation/asset, 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 year 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 following table summarises the present value of the defined benefit obligation and fair value of plan assets for the Scheme as at 30 September:

Group and Bank	**2020**	2019
	£m	£m
Active members' defined benefit obligation	**(23)**	(30)
Deferred members' defined benefit obligation	**(2,064)**	(2,537)
Pensioner and dependant members' defined benefit obligations	**(1,871)**	(1,744)
Total defined benefit obligation	**(3,958)**	(4,311)
Fair value of Scheme assets	**4,681**	4,707
Net defined benefit pension asset	**723**	396

The Group's pension arrangements

The Group operates both defined benefit and defined contribution arrangements. Clydesdale Bank PLC is the sponsoring employer in one funded defined benefit pension scheme, the Yorkshire and Clydesdale Bank Pension Scheme ('the Scheme'). The current version of the Scheme was established under trust on 30 September 2009 with the assets held in a trustee administered fund. The Trustee is 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 has implemented a number of reforms to the Scheme to manage the obligation. 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 Group's existing defined contribution scheme, 'Total Pension'. The income statement charge for this is separately disclosed in note 2.4.

The Group also provides post-retirement healthcare under a defined benefit scheme for pensioners and their dependant relatives for which provision has been made on a basis consistent with the methodology applied to the defined benefit pension scheme. This is a closed scheme and the provision will be utilised over the life of the remaining scheme members. The obligation in respect of this scheme was £2m at 30 September 2020 (2019: £3m) and is included within other liabilities in note 3.15.

3.10 Retirement benefit obligations (continued)

Scheme valuations
There are a number of means of measuring liabilities in the defined benefit schemes, with the ultimate aim of the Trustee being that the Scheme is 100% funded on an agreed self-sufficiency basis (which is where the Scheme is essentially self-funded and does not need to call on the Group for any additional funding). The two bases used by the Group to value its obligations are: (i) an IAS 19 accounting basis; and (ii) a Trustee's Technical Provision basis.

(i) IAS 19 accounting basis

The valuations of the Scheme assets and obligations are calculated on an accounting basis in accordance with the applicable accounting standard IAS 19 which provides the basis for the accounting framework and methodology for entries in the income statement, balance sheet and capital reporting. The principal purpose of this valuation is to allow comparison of pension obligations between companies. The obligation under an accounting valuation can be higher or lower than those under a Trustee's Technical Provision valuation.

The rate used to discount the obligation on an IAS 19 basis is a key driver of any potential volatility and is based on yields on AA rated high-quality corporate bonds, regardless of how the Trustee of the Scheme invests the assets. The accounting valuation under IAS 19 can therefore move adversely because of low rates and narrowing credit spreads which are not fully matched by the Scheme assets. Inflation is another key source of volatility and arises as a result of member benefits having an element of index linking, which causes the obligation to increase in line with rises in long-term inflation assumptions. In practice however, over the long term, the relationship between interest and inflation rates tends to be negatively correlated resulting in a degree of risk offset.

(ii) Trustee's Technical Provision basis

This valuation basis reflects how much money the Trustee considers is required now in order to provide for the promised benefits as they come up for payment in the future. The Trustee is responsible for ensuring that the calculation is conducted prudently on an actuarial basis, taking into account factors including the Scheme's investment strategy and the relative financial strength of the sponsoring employer.

A key aspect of this valuation is the investment strategy the Trustee proposes to follow as part of the policy for meeting the Scheme's obligations. Because there are no guarantees about investment returns over long periods, legislation requires the Trustee to consider carefully how much of their expected future investment returns it would be prudent for them to account for in advance.

During the current year the Trustee concluded the latest triennial valuation for the Scheme, which was conducted in accordance with Scheme data and market conditions as at 30 September 2019. The valuation resulted in an improvement in the Scheme's funding position, with a reported surplus of £144m (previously a deficit of £290m) and a Technical provisions funding level of 103% (previously 94%). As the 2019 valuation outcome was a funding surplus, future payments to the Scheme are limited solely to those relating to a payment holiday agreed between the Group and Scheme Trustee in respect of contributions due under the prior 2016 valuation. These total £52m and will be paid at the rate of £2m per month over the period January 2021 to April 2023.

Scheme assets are not subject to the same valuation differences as Scheme obligations and are consistently valued at current market value.

Notes to the consolidated financial statements (continued)

Section 3: Assets and liabilities (continued)

3.10 Retirement benefit obligations (continued)

IAS 19 position

The Scheme movements in the year are as follows:

Group and Bank

	2020				2019			
	Present value of obligation	**Fair value of plan assets**	**Total**	**Cumulative impact in OCI**	Present value of obligation	Fair value of plan assets	Total	Cumulative impact in OCI
	£m	**£m**	**£m**	**£m**	£m	£m	£m	£m
Balance sheet surplus at 1 October	**(4,311)**	**4,707**	**396**	**(594)**	(3,746)	3,958	212	(704)
Total expense								
Current service cost	**-**	**-**	**-**		-	-	-	
Past service cost	**(1)**	**-**	**(1)**		(11)	-	(11)	
Interest (expense)/income	**(75)**	**82**	**7**		(100)	107	7	
Administrative costs	**-**	**(6)**	**(6)**		-	(5)	(5)	
Total (expense)/income recognised in the consolidated income statement	**(76)**	**76**	**-**		(111)	102	(9)	
Remeasurements								
Return on Scheme assets greater than discount rate	**-**	**61**	**61**	**61**	-	772	772	772
Actuarial:								
Gain/(loss) - experience adjustments	**140**	**-**	**140**	**140**	(9)	-	(9)	(9)
Gain - demographic assumptions	**116**	**-**	**116**	**116**	30	-	30	30
Loss - financial assumptions	**(25)**	**-**	**(25)**	**(25)**	(683)	-	(683)	(683)
Remeasurement gains/(losses) recognised in other comprehensive income	**231**	**61**	**292**	**292**	(662)	772	110	110
Contributions and payments								
Employer contributions	**-**	**35**	**35**		-	83	83	
Benefit payments	**105**	**(105)**	**-**		96	(96)	-	
Transfer payments	**93**	**(93)**	**-**		112	(112)	-	
	198	**(163)**	**35**		208	(125)	83	
Balance sheet surplus at 30 September	**(3,958)**	**4,681**	**723**	**(302)**	(4,311)	4,707	396	(594)

In the prior year the Group included an allowance of £11m in the income statement for GMP equalisation following a judgement by the High Court against Lloyds Banking Group which ruled that defined benefit schemes are required to equalise pension benefits for men and women. On 20 November 2020, a further judgement was announced in respect of the Lloyds case, which determined that schemes would also be required to revisit and, where necessary, top up historic cash equivalent transfer values that were calculated on an unequalised basis, in the event that an affected member makes a successful claim. This ruling applies to benefits accrued between 17 May 1990 and 5 April 1997. It is not possible at this stage to quantify the potential financial impact of this ruling for the Scheme, and consequently for the Group.

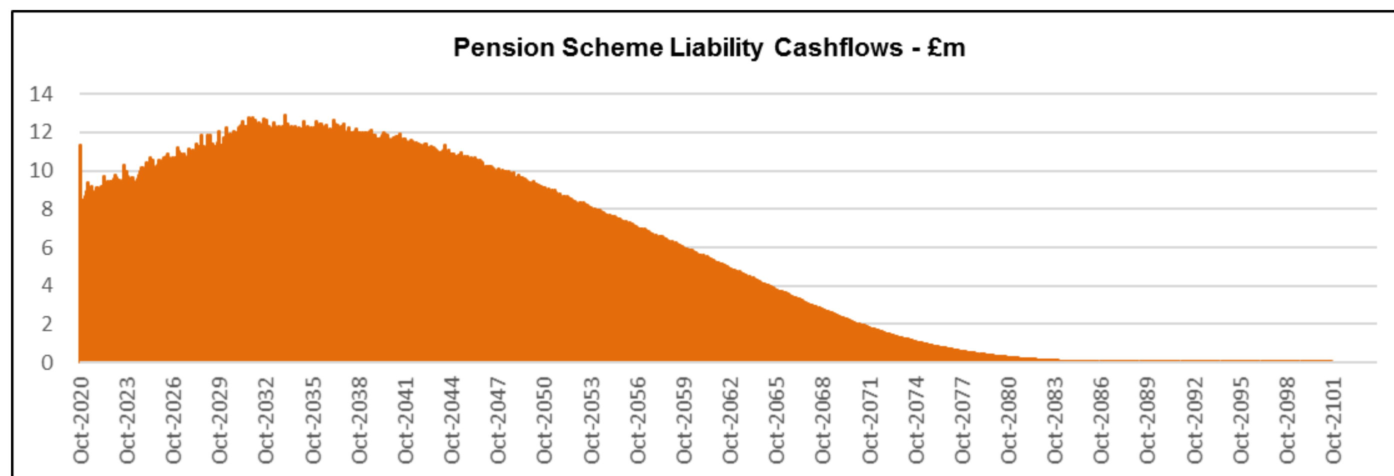
3.10 Retirement benefit obligations (continued)

The expected contributions and expected benefit payments for the year ending 30 September 2021 are £39m (2020: £56m) and £108m (2020: £108m) respectively.

The Group and Trustee have entered into a contingent security arrangement (the 'Security Arrangement') (note 5.3).

Maturity of Scheme liabilities

The estimated maturity period of Scheme obligations on an IAS 19 accounting basis is as follows:



The discounted mean term of the defined benefit obligation at 30 September 2020 is 19 years (2019: 20 years).

Scheme assets

In order to meet the obligations of the Scheme, the Trustee invests in a diverse portfolio of assets, with the level and volatility of asset returns being a key factor in the overall investment strategy. The investment portfolio is subject also to a range of risks typical of the types of assets held, such as: equity risk; credit risk on bonds; currency risk; interest rate and inflation risk; and exposure to the property market. The Trustee's investment strategy (including physical assets and derivatives) seeks to reduce the Scheme's exposure to these risks. In managing interest rate and inflation risks, the investment strategy seeks to hold portfolios of matching assets (including derivatives) that enable the Scheme's assets to better match movements in the value of liabilities due to changes in interest rates and inflation.

As at 30 September 2020, the interest rate and inflation rate hedge ratios were around 97% and 84% respectively (2019: 85% and 75%) of the obligation when measured on a self-sufficiency basis. This strategy reflects the Scheme's obligation 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.

The Trustee's investment strategy involves two main categories of investments:

- matching assets – a range of investments that provide a match to changes in obligation values; and
- return seeking assets – a range of investments designed to provide specific, planned and consistent returns.

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

3.10 Retirement benefit obligations (continued)

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

	2020				2019			
	Quoted £m	**Unquoted £m**	**Total £m**	**%**	Quoted £m	Unquoted £m	Total £m	%
Bonds								
Fixed government	**930**	**-**	**930**		569	-	569	
Index linked government	**2,001**	**-**	**2,001**		1,757	-	1,757	
Global sovereign	**115**	**1**	**116**		20	1	21	
Corporate and other	**879**	**48**	**927**		531	305	836	
	3,925	**49**	**3,974**	**85%**	2,877	306	3,183	68%
Equities[1]								
Global equities	**-**	**368**	**368**		-	503	503	
Emerging market equities	**-**	**43**	**43**		-	50	50	
UK equities	**-**	**114**	**114**		-	32	32	
	-	**525**	**525**	**11%**	-	585	585	12%
Other								
Secured income	**-**	**165**	**165**		-	358	358	
Derivatives[2]	**-**	**78**	**78**		-	219	219	
Repurchase agreements	**-**	**(1,025)**	**(1,025)**		-	(534)	(534)	
Property	**-**	**122**	**122**		-	129	129	
Alternative credit	**-**	**563**	**563**		-	409	409	
Infrastructure	**-**	**127**	**127**		-	352	352	
Cash	**-**	**146**	**146**		-	1	1	
Equity options	**6**	**-**	**6**		5	-	5	
	6	**176**	**182**	**4%**	5	934	939	20%
Total Scheme assets	**3,931**	**750**	**4,681**	**100%**	2,882	1,825	4,707	100%

(1) Equity investments are classified as unquoted reflecting the nature of the funds in which the scheme invests directly. The underlying investments in these funds are, however, mostly quoted.

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

At 30 September 2020, the Scheme had employer-related investments within the meaning of Section 40 (2) of the Pensions Act 1995 totalling £2m (2019: £2m).

3.10 Retirement benefit obligations (continued)

Actuarial assumptions

The following assumptions were used in arriving at the IAS 19 defined benefit obligation:

	2020	2019
	% p.a.	% p.a.
Financial assumptions		
Discount rate	**1.58**	1.77
Inflation (RPI)	**2.93**	3.20
Inflation (CPI)	**2.03**	2.20
Career average revalued earnings (CARE) revaluations:		
Pre 31 March 2012 benefits (RPI)	**2.93**	3.20
Post 31 March 2012 benefits (CPI capped at 5% per annum)	**2.03**	2.20
Pension increases (capped at 2.5% per annum)	**2.01**	2.10
Pension increases (capped at 5% per annum)	**2.85**	3.07
Rate of increase for pensions in deferment	**2.03**	2.20

	2020	2019
	Years	Years
Demographic assumptions		
Post retirement mortality:		
Current pensioners at 60 - male	**27.2**	28.0
Current pensioners at 60 - female	**29.3**	29.6
Future pensioners at 60 - male	**28.2**	29.1
Future pensioners at 60 - female	**30.4**	30.8

3.10 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:

Discount rate applied: this is set with reference to market yields at the end of the reporting year on high quality corporate bonds in the currency and with a term consistent with the Scheme's obligations. The average duration of the Scheme's obligations is approximately 20 years. The market for bonds with a similar duration is illiquid and, as a result, significant management judgement is required to determine an appropriate yield curve on which to base the discount rate.

Inflation assumptions: this is set with reference to market expectations of the RPI measure of inflation for a term consistent with the Scheme's obligations, based on data published by the BoE. Other measures of inflation (such as CPI, or inflation measures subject to an annual cap) are derived from this assumption.

Mortality assumptions: the cost of the benefits payable by the Scheme will also depend upon the life expectancy of the members. The assumptions for mortality rates are based on standard mortality tables (as adjusted to reflect the characteristics of Scheme members) which allow for future improvements in life expectancies.

The table below sets out the sensitivity and impact on the balance sheet surplus position of the Scheme, the defined benefit obligation and pension cost to changes in the key actuarial assumptions:

Assumption change		Balance sheet surplus £m	Obligation £m	Pension cost £m
Discount rate	+ 0.25%	**(29)**	**(180)**	**(5)**
	- 0.25%	**33**	**192**	**4**
Inflation	+ 0.25%	**(23)**	**128**	**2**
	- 0.25%	**26**	**(124)**	**(2)**
Life expectancy	+1 year	**(161)**	**161**	**3**
	-1 year	**156**	**(156)**	**(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.

3.11 Customer deposits

	Group		Bank	
	2020	2019	**2020**	2019
	£m	£m	**£m**	£m
Interest bearing demand deposits	**41,866**	38,551	**41,866**	20,714
Term deposits	**21,107**	22,239	**21,107**	5,995
Non-interest bearing demand deposits	**4,549**	3,002	**4,549**	2,993
Other wholesale deposits	**-**	1	**-**	1
	67,522	63,793	**67,522**	29,703
Accrued interest payable	**188**	207	**188**	68
	67,710	64,000	**67,710**	29,771

3.12 Debt securities in issue

Accounting policy

Debt securities comprise short and long-term debt issued by the Group including commercial paper, medium-term notes, covered bonds and residential mortgage-backed securities (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:

2020

Group	**Medium-term notes £m**	**Securitisation £m**	**Covered bonds £m**	**Total £m**
Amortised cost	**-**	**3,992**	**1,842**	**5,834**
Fair value hedge adjustments	**-**	**10**	**76**	**86**
Total debt securities	**-**	**4,002**	**1,918**	**5,920**
Accrued interest payable	**-**	**3**	**10**	**13**
	-	**4,005**	**1,928**	**5,933**

2019

Group	Medium-term notes £m	Securitisation £m	Covered bonds £m	Total £m
Amortised cost	300	5,040	1,828	7,168
Fair value hedge adjustments	1	2	74	77
Total debt securities	301	5,042	1,902	7,245
Accrued interest payable	3	9	10	22
	304	5,051	1,912	7,267

2020

Bank	**Medium-term notes £m**	**Securitisation £m**	**Covered bonds £m**	**Total £m**
Amortised cost	**-**	**-**	**1,842**	**1,842**
Fair value hedge adjustments	**-**	**-**	**-**	**-**
Total debt securities	**-**	**-**	**1,842**	**1,842**
Accrued interest payable	**-**	**-**	**10**	**10**
	-	**-**	**1,852**	**1,852**

2019

Bank	Medium-term notes £m	Securitisation £m	Covered bonds £m	Total £m
Amortised cost	-	-	699	699
Fair value hedge adjustments	-	-	-	-
Total debt securities	-	-	699	699
Accrued interest payable	-	-	10	10
	-	-	709	709

Following the FSMA Part VII transfer Clydesdale Bank PLC is now the issuer under the Clydesdale Bank PLC (formerly Virgin Money PLC) Global Covered Bond Programme.

3.12 Debt securities in issue (continued)

Key movements in the year are shown in the table below[1]. Full details of all notes in issue can be found at https://www.virginmoneyukplc.com/investor-relations/debt-investors/. There were no issuances or redemptions of covered bonds during the year.

	Issuances		Redemptions	
	Denomination	£m	Denomination	£m
Medium-term notes	EUR	-	GBP	(300)
Securitisation	USD, GBP	491	USD, EUR, GBP	(1,492)
		491		(1,792)

(1) Other movements relate to foreign exchange, amortisation of issuance costs and the unwinding of acquisition accounting adjustments.

The following table provides details of the medium-term notes in issuance at 30 September:

	2020	2019
Medium-term notes (excluding accrued interest)	**£m**	£m
VM PLC 2.25% fixed rate senior notes due 2020	**-**	301

Details of securitisation and covered bond issues are included in note 3.3.

3.13 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	
	2020	2019	**2020**	2019
	£m	£m	**£m**	£m
Secured loans	**5,397**	7,308	**5,397**	2,254
Securities sold under agreements to repurchase[1]	**-**	1,554	**-**	1,554
Transaction balances with other banks	**15**	12	**15**	12
Deposits from other banks	**57**	42	**57**	40
	5,469	8,916	**5,469**	3,860

(1) The underlying securities sold under agreements to repurchase have a carrying value of £Nil (2019: £2,324m).

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

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**
With the FCA's timebar deadline on PPI complaints having now passed and significant progress having been made into the large stock of complaints and IRs received in the weeks preceding the time bar, the level of uncertainty in determining the quantum of PPI related liability has reduced. The provision, however, continues to be subject to inherent uncertainties as a result of the subjective nature of the assumptions used in quantifying the overall estimated position at 30 September 2020, consequently the provision calculated may be subject to change in the future 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.

	Group		Bank	
	2020	2019	**2020**	2019
	£m	£m	**£m**	£m
PPI redress provisions				
Opening balance	**379**	275	**379**	275
Charge to the income statement	**-**	415	**-**	415
Utilised	**(272)**	(311)	**(272)**	(311)
Closing balance	**107**	379	**107**	379
Customer redress and other provisions				
Opening balance	**25**	41	**22**	41
Adoption of IFRS 16 (note 5.4)	**8**	-	**7**	-
Opening balance (restated)	**33**	41	**29**	41
Virgin Money provision on acquisition	**-**	11	**3**	-
Charge to the income statement	**28**	18	**28**	17
Utilised	**(30)**	(45)	**(29)**	(36)
Closing balance	**31**	25	**31**	22
Property closure and redundancy provision				
Opening balance	**55**	15	**38**	15
Adoption of IFRS 16 (note 5.4)	**(11)**	-	**(7)**	-
Opening balance (restated)	**44**	15	**31**	15
Virgin Money provision on acquisition	**-**	2	**11**	-
Charge to the income statement	**19**	64	**18**	36
Utilised	**(29)**	(26)	**(26)**	(13)
Closing balance	**34**	55	**34**	38
Total provisions for liabilities and charges	**172**	459	**172**	439

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

3.14 Provision for liabilities and charges (continued)

PPI redress

In common with the wider UK retail banking sector, the Group continues to deal with complaints received in the period up to the time bar in August 2019. The Group has made good progress in reviewing and closing the remaining IRs and related complaints and considers the remaining provision to be enough to meet current and future expectations in relation to the mis-selling of PPI policies and therefore no additional charge was required in the year. The total provision raised to date in respect of PPI is £3,055m (2019: £3,055m), with £107m of this remaining (2019: £379m).

At 30 September 2020 the Group had received 730,000 complaints with c.30,000 of those left to review.

The overall provision continues to be based on several assumptions derived from a combination of past experience, estimated future experience, industry comparison and the exercise of judgement in the key areas identified. Our experience since the time bar has been within expectations, particularly around the validity of complaints requiring redress (uphold rate). The PPI operation is now moving into the final months and the main area of variability is the uphold rate on the remaining complaints. Until this process is fully complete there remains a residual risk that existing provisions for PPI customer redress may not cover all potential costs.

Customer redress and other provisions

Other provisions include amounts in respect of a number of non-PPI customer redress matters, legal proceedings, claims arising in the ordinary course of the Group's business and other matters. The Group has raised £26m of further provisions in relation to non-PPI customer redress matters in the year. The ultimate cost to the Group of these 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.

3.15 Other liabilities

Accounting policy
Deferred grants
Deferred grants are recognised when there is reasonable assurance that the grant will be received and that any conditions attached to the grant will be complied with. Where the grant relates to costs, it is released to the income statement on a systematic basis in line with the incurring of the related costs. Where the grant relates to the cost of an asset, it is released and recognised directly against the cost of the asset when incurred.

	Group		**Bank**	
	2020	2019	**2020**	2019
	£m	£m	**£m**	£m
Notes in circulation	**2,319**	2,277	**2,319**	2,277
Accruals and deferred income	**91**	124	**90**	90
Deferred grant	**35**	-	**35**	-
Other	**245**	126	**246**	81
	2,690	2,527	**2,690**	2,448

During the year, the Group applied for and was successful in receiving £35m from the Capability and Innovation Fund (as part of the RBS alternative remedies package). This will be utilised under the terms of the grant application in future financial years.

3.16 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 a financial 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 FVTPL 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 year 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, and their fair values, where these are not approximately equal.

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

Group

	2020		2019	
	Carrying value	**Fair value**	Carrying value	Fair value
Financial assets	**£m**	**£m**	£m	£m
Loans and advances to customers[1]	**72,428**	**71,786**	73,093	73,117
Financial liabilities				
Due to other banks[2]	**5,469**	**5,469**	8,916	8,874
Customer deposits[2]	**67,710**	**67,809**	64,000	64,166
Debt securities in issue[3]	**5,933**	**5,990**	7,267	7,365
Due to related entities[2]	**2,822**	**2,950**	2,315	2,318

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

3.16 Fair value of financial instruments (continued)

Bank	30 September 2020		30 September 2019	
	Carrying value	**Fair value**	Carrying value	Fair value
Financial assets	**£m**	**£m**	£m	£m
Loans and advances to customers[1]	**71,436**	**70,794**	32,389	32,609
Financial liabilities				
Due to other banks[2]	**5,469**	**5,469**	3,860	3,837
Customer deposits[2]	**67,710**	**67,809**	29,771	29,813
Debt securities in issue[3]	**1,852**	**2,002**	709	850
Due to related entities[2]	**6,255**	**6,383**	5,336	5,337

(1) Loans and advances to customers are categorised as Level 3 in the fair value hierarchy with the exception of £1,060m (2019: £1,513m) of overdrafts which are categorised as Level 2.
(2) Categorised as Level 2 in the fair value hierarchy.
(3) Categorised as Level 2 in the fair value hierarchy In 2019, £305m of listed debt was categorised as Level 1.

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 is determined by firstly segregating them into portfolios which have similar characteristics. Contractual cash flows are then adjusted for ECLs 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.

(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) *Customer deposits* - The fair value of deposits is determined using a replacement cost method which assumes alternative funding is raised in the most advantageous market. The contractual cash flows have been discounted using a funding curve with credit spreads reflecting the tenor of each deposit.

(d) *Debt securities in issue* - The fair value is taken directly from quoted market prices where available or determined from a discounted cash flow model using current market rates for instruments of similar terms and maturity.

(e) *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 Virgin Money UK PLC 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.

(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 2020				Fair value measurement at 2019			
	Level 1	**Level 2**	**Level 3**	**Total**	Level 1	Level 2	Level 3	Total
	£m	**£m**	**£m**	**£m**	£m	£m	£m	£m
Financial assets								
Financial assets at fair value through other comprehensive income	**5,080**	**-**	**-**	**5,080**	4,328	-	-	4,328
Loans and advances at fair value through profit or loss	**-**	**190**	**-**	**190**	-	253	-	253
Other financial assets at fair value through profit or loss	**-**	**-**	**1**	**1**	-	-	8	8
Derivative financial assets	**-**	**318**	**-**	**318**	-	366	-	366
Total financial assets at fair value	**5,080**	**508**	**1**	**5,589**	4,328	619	8	4,955
Financial liabilities								
Customer deposits	**-**	**-**	**-**	**-**	-	4	-	4
Derivative financial liabilities	**-**	**250**	**-**	**250**	-	273	-	273
Total financial liabilities at fair value	**-**	**250**	**-**	**250**	-	277	-	277

3.16 Fair value of financial instruments (continued)

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

Bank	Fair value measurement at 2020				Fair value measurement at 2019			
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets								
Financial assets at fair value through other comprehensive income	5,080	-	-	5,080	2,350	-	-	2,350
Loans and advances at fair value through profit or loss	-	190	-	190	-	253	-	253
Other financial assets at fair value through profit or loss	-	-	1	1	-	-	1	1
Derivative financial assets	-	134	-	134	-	442	-	442
Total financial assets at fair value	5,080	324	1	5,405	2,350	695	1	3,046
Financial liabilities								
Customer deposits	-	-	-	-	-	4	-	4
Derivative financial liabilities	-	250	-	250	-	292	-	292
Total financial liabilities at fair value	-	250	-	250	-	296	-	296

There were no transfers between Level 1 and 2 in the current or prior year for either the Group or the Bank.

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) *Fair value through other comprehensive income* – The fair values of listed investments are based on quoted closing market prices.

(b) *Financial assets and liabilities at fair value through profit or loss:*

- Loans and advances to customers and customer deposits (Level 2) – The 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.

- Other financial assets at fair value through profit or loss (Level 3) – Represents unlisted debt and equity investments for which the Group's share of the net asset value or the transaction price respectively is considered the best representation of the exit price and is the Group's best estimate of fair value.

(c) *Derivative financial assets and liabilities (Level 2)* - 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.

3.16 Fair value of financial instruments (continued)

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

Level 3 movements analysis:	**2020**	2019
Group	**Financial assets at fair value through profit or loss £m**	Financial assets at fair value through profit or loss £m
Balance at the beginning of year	**8**	11
Fair value gains recognised[1]		
In profit or loss - unrealised	**5**	-
In profit or loss - realised	**-**	3
Purchases	**-**	1
Sales	**(10)**	(4)
Settlements	**(2)**	(3)
Balance at the end of the year	**1**	8

Level 3 movements analysis:	**2020**	2019
Bank	**Financial assets at fair value through profit or loss £m**	Financial assets at fair value through profit or loss £m
Balance at beginning of year	**1**	5
Fair value gains recognised[1]		
In profit or loss - realised	**-**	3
Sales	**-**	(4)
Settlements	**-**	(3)
Balance at the end of the year	**1**	1

(1) Net gains or losses were recorded in non-interest income or FVOCI reserve as appropriate.

Sensitivity of Level 3 fair value measurements to reasonably possible alternative assumptions

The Group, and Bank has a limited 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.

3.17 Lessee accounting

Accounting policy

The Group as lessee

The Group leases offices, stores and other premises, and sub-leases certain premises which are no longer occupied by the Group.

The Group applies a single lessee accounting model to all lease arrangements it enters into from the date on which the leased asset is available for use, with the exception of low value leases and short-term leases (less than 12 months) in respect of which the associated lease payments are expensed in the income statement on a straight line basis over the lease term.

Under the single lessee accounting model, the Group recognises a right-of-use asset and a lease liability at the commencement date of the lease. The right-of-use asset is initially measured at cost, comprising the initial amount of the lease liability plus any initial direct costs incurred and any lease payments made at or before the lease commencement date, less any lease incentives received. The right-of-use asset is subsequently depreciated using the straight line method from the commencement date to the earlier of the end of the useful life of the asset or the end of the lease term, subject to review for impairment. The lease liability is initially measured at the present value of the lease payments, discounted using the interest rate implicit in the lease, or if that rate cannot readily be determined (as is the case in the majority of the leasing activities of the Group), the incremental borrowing rate. The liability is remeasured when there is a change in future lease payments arising from a change in an index or a rate or a change in the Group's assessment of whether it will exercise an extension or termination option. When the lease liability is remeasured, a corresponding adjustment is made to the right-of-use asset or is recorded in the income statement if the carrying amount of the right-of-use asset has been reduced to zero.

Termination options are included in a number of leases across the Group with a small number of leases having extension options. These terms are used to maximise operational flexibility in terms of managing contracts. In determining judgements on the lease term, management considers all facts and circumstances that create an economic incentive to exercise an extension option, or not exercise a termination option. Periods covered by termination options are only included in the lease term if it is reasonably certain that the lease will not be terminated. The assessment of the lease term is reviewed if a significant event or a significant change in circumstances occurs that is within the control of the Group.

The Group as sub-lessor

Sub-leases are classified as finance leases if substantially all the risks and rewards incidental to ownership of the underlying asset are transferred, otherwise they are classified as operating leases. Finance sub-leases are recognised in other assets 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 reflecting a constant periodic rate of return. Operating sub-lease income is recognised in the income statement on a straight line basis over the lease term.

a) ***Amounts recognised in the income statement***

The income statement includes the following amounts related to leases:	2020	
	Group	**Bank**
	£m	**£m**
Interest expense and similar charges		
Interest expense	**(3)**	**(3)**
Other operating income		
Amounts receivable under leases where the Group is a lessor	**1**	**1**
Operating and administrative expenses		
Depreciation and impairment of right-of-use assets	**(30)**	**(30)**
Expense relating to short-term leases	**(3)**	**(3)**
Expense relating to leases of low-value assets that are not short-term leases	**(2)**	**(2)**
Total	**(37)**	**(37)**

The total leasing cash outflow in the year was £30m (Bank: £30m).

3.17 Lessee accounting (continued)

b) ***Amounts recognised on the balance sheet***

Right-of-use assets

	2020	
	Group	**Bank**
	£m	**£m**
As at 30 September 2019	**-**	**-**
Adjustment on transition to IFRS 16	**194**	**168**
As at 1 October 2019	**194**	**168**
Additions	**3**	**3**
Acquisition through business combination (FSMA Part VII)	**-**	**25**
Remeasurements	**(6)**	**(6)**
Depreciation and impairment	**(30)**	**(30)**
As at 30 September 2020	**161**	**160**

All right-of-use assets relate to leases of land and buildings.

On 31 July 2020 the Group announced plans for the closure of 35 properties leased by the Group. The value of the right-of-use asset associated with these properties at that time was £10m. Following the announcement, the recoverable amount of the right-of-use assets was assessed. Where it is expected the Group can sub-lease the property, the value-in-use was determined on expected sub-lease income. Where the Group does not expect to be able to generate any cash inflows beyond the closure date the value-in-use was determined to be Nil. The discount rates used in the value-in-use calculations ranged from 0.8%-1.6%. The total value-in-use was £4m resulting in an impairment charge of £6m, which has been recognised in other operating and administration expenses. In addition to the impairment charge relating to the right-of-use assets, a provision has been recognised for other costs associated with the closures note 3.14.

On 30 September 2020 the Group also reviewed its existing surplus estate population for impairment. It was concluded that 27 properties should be impaired following this assessment. The discount rates used in the value-in-use calculations ranged from 0.7%-1.7%. The total value-in-use was £4m resulting in an impairment charge of £0.5m, which has been recognised in other operating and administrative expenses.

Sub-leases

Future undiscounted minimum payments receivable in respect of sub-leased assets at 30 September were as follows:

	Group & Bank	
	2020	2019
	£m	£m
Operating leases	**4**	7
Finance leases	**5**	-
	9	7

Lease liabilities

	2020 Group and Bank
	£m
Lease liabilities[1]	**175**

(1) Lease liabilities are presented within other liabilities on the balance sheet.

Future undiscounted minimum payments under lease liabilities at 30 September 2020 were as follows:

	2020 Group and Bank
Amounts falling due	**£m**
Within 1 year	**27**
Between 1 and 5 years	**84**
Over 5 years	**88**
	199

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

c) ***Lease commitments not recognised on the balance sheet***

In addition to the lease liabilities recognised on the balance sheet, the Group also has lease commitments relating to leases which have not yet commenced at the balance sheet date. Future undiscounted minimum payments on leases which are yet to commence were as follows:

	2020		2019[1]	
	Group	**Bank**	Group	Bank
	£m	**£m**	£m	£m
Amounts falling due				
Within 1 year	**-**	**-**	35	27
Between 1 and 5 years	**18**	**18**	135	114
Over 5 years	**112**	**112**	244	232
	130	**130**	414	373

(1) The 2019 disclosure includes all lease commitments and is presented on an IAS 17 basis, prior to the adoption of IFRS 16 on 1 October 2019. As such, the prior year is not directly comparable with the undiscounted lease liability payments in the current year due to differences between the cash flows included in the measurement of the lease liability compared to the basis of calculation for the 2019 commitment disclosure. Refer to note 5.4 for a reconciliation of the prior year commitment to the opening lease liability balance.

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

4.1 Equity

Accounting policy

Equity

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

(a) they impose no contractual obligations upon the Bank 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 Bank's own equity instruments, it is either a non-derivative that includes no obligation to deliver a variable number of the Bank's own equity instruments, or is a derivative that will be settled by the Bank exchanging a fixed amount of cash or other financial assets for a fixed number of its own equity instruments.

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

Incremental costs directly attributable to the issue of new shares or options or to the acquisition of a business are shown in equity as a deduction, net of tax, from the proceeds.

Dividends

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 and share premium

	2020 £m	2019 £m
Share capital	**1,243**	1,243
Share premium	**1,549**	1,549
Share capital and share premium	**2,792**	2,792

Group and Bank	**2020**	2019	**2020**	2019
Allotted, called up and fully paid	**Number of shares**	Number of shares	**£m**	£m
Ordinary shares of £0.10 each				
Opening ordinary share capital	**12,431,538,208**	10,131,538,207	**1,243**	1,013
Issued during the year	**-**	2,300,000,001	**-**	230
Closing ordinary share capital	**12,431,538,208**	12,431,538,208	**1,243**	1,243

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 2020 rank equally with regard to the Bank's residual assets.

A final dividend of 16.1p (2019: Nil) per ordinary share amounting to £20m (2019: £Nil) was paid in respect of the year ended 30 September 2020. These dividends were deducted from retained profits in the current year.

Share premium represents the aggregate of all amounts that have ever been paid above par value to the Bank when it has issued ordinary shares.

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

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

4.1 Equity (continued)

4.1.2 Other equity instruments

Other equity instruments consist of the following Perpetual Contingent Convertible Notes which were issued to Virgin Money UK PLC:

- Perpetual securities (fixed 8% up to the first reset date) issued on 8 February 2016 with a nominal value of £450m and optional redemption on 8 December 2022; and
- Perpetual securities (fixed 9.25% up to the first reset date) issued on 13 March 2019 with a nominal value of £250m and optional redemption on 8 June 2024.

The issues are treated as equity instruments in accordance with IAS 32 'Financial Instruments: Presentation' with the proceeds included in equity, net of transaction costs of £3m (30 September 2019: £3m). AT1 distributions of £59m were paid in the year (2019: £41m paid). Following revisions to the tax rules on hybrid capital which took effect from 1 January 2019, Hybrid Capital Instruments elections covering the Group's AT1s that existed at 1 January 2019 were made to HMRC on 27 September 2019. Accordingly, in line with the revised standard, the tax credits for these payments have been recognised in the income statement.

4.1.3 Other reserves

Cash flow hedge reserve

The cash flow hedge reserve represents the effective portion of 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.

	Group		Bank	
	2020	2019	**2020**	2019
	£m	£m	**£m**	£m
At 1 October	**(25)**	(37)	**10**	(36)
Amounts recognised in other comprehensive income:				
Cash flow hedge – interest rate risk				
Effective portion of changes in fair value of interest rate swaps	**(74)**	14	**(90)**	62
Amounts transferred to the income statement	**-**	(1)	**(8)**	(1)
Taxation	**19**	(3)	**25**	(15)
Cash flow hedge – foreign exchange risk				
Effective portion of changes in fair value of cross currency swaps	**(59)**	59	**-**	-
Amounts transferred to the income statement	**59**	(57)	**-**	-
At 30 September	**(80)**	(25)	**(63)**	10

FVOCI reserve

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

4.1.4 Non-controlling interests

On 15 October 2018, the date on which it was acquired by Virgin Money UK PLC, Virgin Money Holdings (UK) PLC (now an intermediate holding company within the Group) had in issue Fixed Rate Resettable AT1 securities issued on the Luxembourg Stock Exchange. In accordance with IAS 32 these were classified as equity instruments. The Group did not acquire the AT1 securities at that time, consequently these represented a non-controlling interest. As the AT1 instruments were actively traded, the fair value on acquisition of £422m was calculated based on the market price on the Luxembourg Stock Exchange at its close of business on 12 October 2018. Subsequently on 20 August 2019, there was a change in obligor from Virgin Money Holdings (UK) PLC to Virgin Money UK PLC, following which these instruments have been recognised within other equity (note 4.1.2).

There were no distributions to non-controlling interests in the current year (2019: £33m paid, £26m net of tax).

4.2 Equity based compensation

Accounting policy

The Group operates a number of equity settled share based compensation plans in respect of services received from certain of its employees. The fair value of the services received is recognised as an expense. The total amount to be expensed is measured by reference to the fair value of Virgin Money'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 £10m (2019: £4m).

Virgin Money UK PLC awards

The Group issues awards to employees under the following share plans:

Plan	Eligible employees	Nature of award	Vesting conditions[1]	Grant dates[2]
Deferred Equity Plan (DEP) [3]	Selected employees	Conditional rights to shares	Continuing employment or leaving in certain limited circumstances	2016, 2017, 2018 and 2019
Long Term Incentive Plan (LTIP)	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, 2018 and 2019
Share Incentive Plan (SIP)	All employees	Non-conditional share award	Continuing employment	2016, 2017 and 2018

(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 DEP are made the year following the financial year to which they relate.

Further detail on each plan is provided below:

DEP

Under the plan, employees are awarded conditional rights to Virgin Money UK 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; and
- buyout of equity from previous employment.

LTIP

Under the plan, employees are awarded conditional rights to Virgin Money UK 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 Group's strategic goals. Measures, relative weightings and the quantum for assessing performance are outlined in the Directors' remuneration report section of the Virgin Money UK PLC Annual Report and Accounts.

4.2 Equity based compensation (continued)

SIP

At the date of the award eligible employees are awarded Virgin Money UK PLC shares which are held in the 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 and 2017 awards, 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 2019	Number awarded	Number forfeited	Number released	**Number outstanding at 30 September 2020**	**Average fair value of awards at grant pence**
Deferred Equity Plan						
2015 Demerger	28,224	-	-	(28,224)	-	196.96
2016 Bonus	10,703	-	-	(10,703)	-	266.03
2016 Commencement	20,404	-	-	(14,694)	5,710	266.03
2017 Bonus	231,070	-	-	(7,706)	223,364	313.20
2017 Commencement	5,109	-	-	(5,109)	-	313.20
2018 Bonus	171,805	-	-	(1,156)	170,649	192.35
2019 Bonus	-	1,710,334	(7,969)	(1,610,437)	91,928	174.50
2019 Commencement	-	67,528	-	(35,890)	31,638	174.50
Long Term Incentive Plan						
2016 LTIP	2,028,468	-	(803,312)	(1,225,156)	-	266.03
2017 LTIP	2,106,953	-	(63,551)	-	2,043,402	313.20
2018 LTIP	5,795,804	-	(149,594)	-	5,646,210	190.47
2019 LTIP	-	8,976,526	(39,509)	-	8,937,017	174.50
Share Incentive Plan						
2015 Demerger	1,026,492	-	(2,560)	(95,903)	928,029	194.67
2017 Free Share	836,976	-	(4,611)	(62,328)	770,037	313.20
2019 Free Share	2,210,802	-	(110,208)	(119,802)	1,980,792	202.53

Determination of grant date fair values

The grant date fair value of the awards has been taken as the market value of Virgin Money UK PLC'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 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.

The ECL requirements as described in note 3.2 apply to loan commitments and financial guarantee contracts.

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 customers 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**	
	2020	2019	**2020**	2019
	£m	£m	**£m**	£m
Financial guarantees				
Guarantees and assets pledged as collateral security:				
Due in less than 3 months	**18**	24	**18**	24
Due between 3 months and 1 year	**15**	24	**15**	24
Due between 1 year and 3 years	**14**	6	**14**	6
Due between 3 years and 5 years	**2**	11	**2**	11
Due after 5 years	**46**	48	**46**	48
	95	113	**95**	113
Other credit commitments				
Undrawn formal standby facilities, credit lines and other commitments to lend at call	**16,775**	15,158	**16,714**	6,677

Of the Group's total loan commitments and financial guarantee contracts of £16,870m, £15,155m (89.8%) are held under Stage 1 for IFRS 9 purposes, with £1,666m in Stage 2 and £49m in Stage 3. ECLs of £7m (2019: £5m) are held for undrawn exposures, of which £1m was held under Stage 1 and £6m under Stage 2. In terms of credit quality, over 95% of the loan commitments and financial guarantee contracts were classed as either 'Good' or 'Strong' under the Group's internal PD rating scale.

Capital commitments

The Group and Bank had future capital expenditure which had been contracted for, but not provided for, at 30 September 2020 of £0.4m (2019: £0.2m).

The Group has committed to providing additional funding of up to £10.9m over the next 12 months to support the strategic and customer proposition development of UTM. AAM, the other shareholder in UTM, has also committed to providing additional funding of up to £10.9m over the same timeframe.

5.1 Contingent liabilities and commitments (continued)

Other contingent liabilities

Conduct risk related matters

There continues to be 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. Following the August 2019 time bar for PPI complaints the Group has made good progress in reviewing and closing the IRs and related complaints. Until all matters are closed the final amount required to settle the Group's potential liabilities for these, and other conduct related matters, remains 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.

5.2 Notes to the statement of cash flows

	Group		Bank	
	2020	2019	**2020**	2019
	£m	£m	**£m**	£m
Adjustments included in loss before tax				
Interest receivable	**(2,137)**	(2,432)	**(2,060)**	(1,222)
Interest payable	**853**	917	**840**	354
Depreciation and amortisation (note 2.4)	**149**	108	**146**	87
Derivative financial instruments fair value movements	**20**	94	**12**	2
Impairment losses on credit exposures (note 3.2)	**507**	252	**499**	61
Software impairments and write-offs	**-**	132	**-**	48
IFRS 16 impairment losses on PPE	**6**	-	**6**	-
Equity based compensation (note 4.2)	**10**	-	**8**	-
Costs recharged to parent entity	**56**	30	**(264)**	72
Impairment of investment in subsidiaries	**-**	-	**19**	303
Gain on sale of 50% (less one share) consideration in Virgin Money Unit Trust Managers Limited	**-**	(35)		-
Gain on disposal of FVOCI assets (note 2.3)	**(16)**	-	**(16)**	-
Other non-cash movements	**8**	-	**2**	-
	(544)	(934)	**(808)**	(295)
Changes in operating assets				
Net increase in:				
Balances with supervisory central banks	**(38)**	(22)	**(48)**	(8)
Due from other banks	**-**	(143)	**-**	(143)
Derivative financial instruments	**(123)**	(45)	**314**	(318)
Financial assets at FVOCI	**-**	(11)	**-**	-
Financial assets at fair value through profit or loss	**65**	98	**67**	113
Loans and advances to customers	**134**	(2,655)	**(116)**	(842)
Defined benefit pension assets	**(35)**	(74)	**(36)**	(74)
Other assets	**(105)**	177	**(147)**	168
	(102)	(2,675)	**34**	(1,104)
Changes in operating liabilities				
Net increase in:				
Due to other banks	**(1,531)**	5	**(1,531)**	1,082
Derivative financial instruments	**(23)**	(129)	**(45)**	(69)
Financial liabilities at fair value through profit or loss	**(4)**	(11)	**(4)**	(12)
Customer deposits	**3,728**	2,837	**3,388**	862
Provisions for liabilities and charges	**(294)**	128	**(292)**	108
Other liabilities	**2**	(173)	**(19)**	(70)
	1,878	2,657	**1,497**	1,901

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 2020	Group 2019	Bank 2020	Bank 2019
Cash and balances with central banks (less mandatory deposits)	**8,887**	10,113	**8,887**	6,538
Due from other banks	**927**	1,018	**174**	225
	9,814	11,131	**9,061**	6,763

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

5.3 Related party transactions

Amounts due from related entities	Group		Bank	
	2020 £m	2019 £m	**2020 £m**	2019 £m
Loans				
Virgin Money UK PLC	**2**	11	**2**	11
Controlled entities of the Bank	**-**	-	**1,008**	2,353
	2	11	**1,010**	2,364
Other receivables				
Virgin Money UK PLC	**9**	7	**9**	7
Controlled entities of the Bank	**-**	-	**144**	105
	9	7	**153**	112
Total amounts due from related entities	**11**	18	**1,163**	2,476
Interest income on the above amounts was as follows:				
Controlled entities of the Bank	**-**	-	**17**	24
	-	-	**17**	24

Amounts due to related entities	Group		Bank	
	2020 £m	2019 £m	**2020 £m**	2019 £m
Deposits				
Controlled entities of the Bank	-	-	**586**	248
Debt securities				
Virgin Money UK PLC	**2,814**	2,311	**2,814**	2,311
Other payables				
Virgin Money UK PLC	**8**	4	**8**	-
Controlled entities of the Bank	**-**	-	**2,847**	2,777
	8	4	**2,855**	2,777
Total amounts due to related entities	**2,822**	2,315	**6,255**	5,336
Interest expense on the above amounts was as follows (note 2.2):				
Virgin Money UK PLC	**106**	72	**106**	72
Controlled entities of the Bank	**-**	-	**63**	42
	106	72	**169**	114

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

5.3 Related party transactions (continued)

Debt securities

	Group and Bank	
	2020	2019
	£m	£m
Subordinated debt	**757**	732
Medium-term notes	**2,057**	1,579
Total debt securities	**2,814**	2,311

Subordinated debt comprises dated, unsecured loan capital and is issued to Virgin Money UK 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 Virgin Money UK 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.

Derivatives held with related entities:	Group		Bank	
	2020	2019	**2020**	2019
	£m	£m	**£m**	£m
Derivative financial assets				
Designated as hedging instruments	**-**	-	**-**	339
Derivative financial liabilities				
Designated as hedging instruments	**-**	-	**-**	(31)
Interest income on the above amounts was as follows (note 2.2):				
Controlled entities of the Bank	**-**	-	**-**	4

Other transactions with related entities	Group		Bank	
	2020	2019	**2020**	2019
	£m	£m	**£m**	£m
Non-interest income received				
Controlled entities of the Bank(1)	**-**	-	**23**	244
Other expenses				
Controlled entities of the Bank	**15**	14	**15**	-

(1) No dividend income was received during the year ending 30 September 2020 (2019: £232m).

5.3 Related party transactions (continued)

Other Related Party Transactions	Group		Bank	
	2020	2019	**2020**	2019
	£m	£m	**£m**	£m
Investments in joint ventures and associates				
Virgin Money Unit Trust Managers Limited[1]	**3**	8	-	-
Salary Finance Loans Limited[2]	**-**	-	-	-
Loans and advances				
Salary Finance Loans Limited[2]	**119**	53	**119**	53
Other assets				
Amounts due from Virgin Money Unit Trust Managers Limited[1]	**3**	2	**3**	-
Total assets with related entities	**125**	63	**122**	53
Customer deposits				
The Virgin Money Foundation	**-**	1	**-**	-
Other liabilities				
Group pension deposits[3]	**17**	17	**17**	17
Commissions and charges due to Virgin Atlantic Airways Limited[4]	**1**	6	**1**	-
Total liabilities with related entities	**18**	24	**18**	17
Non-interest income				
Net fees and commissions to Virgin Atlantic Airways Limited[4]	**(12)**	(15)	**(12)**	-
Share of post-tax result of Virgin Money Unit Trust Managers Limited[1]	**(6)**	(1)	**-**	-
Operating and administrative expenses				
Donations to the Virgin Money Foundation (net of costs)[5]	**(1)**	(2)	**(1)**	-
Costs recharged to Virgin Money Unit Trust Managers Limited[1]	**7**	2	**7**	
Total income statement	**(12)**	(16)	**(6)**	**-**

(1) The Group has a JV with AAM, named UTM. During the year, the Group purchased additional shares in the JV totalling £1.6m as part of a commitment to provide £12.5m of additional funding over the 12 month period to April 2021. Amounts due from UTM and costs recharged to UTM relate to the recharge of relevant Group costs such as systems support, staff costs, and marketing.

(2) The Group has a JV with Salary Finance Limited, where both shareholders own a 50% equity share in Salary Finance Loans Limited. The JV connects to the payroll of participating employers to offer salary-deducted loans. The Group provides a revolving credit facility funding line, of which the current gross lending balance is £119m (2019: £53m). The facility is held under Stage 1 for credit risk purposes with a minimal amount of ECLs held. The undrawn facility is £81m (2019: £47m). The share of loss is £0.2m (2019: £0.3m).

(3) The Group and the 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 £0.1m (2019: £0.1m), were charged to the Group sponsored scheme. Information on the pension schemes operated by the Group is provided in note 3.10. Pension contributions of £35m (2019: £83m) were made to the Scheme (note 3.10).

(4) The Group incurs credit card commissions and air mile charges from Virgin Atlantic Airways Limited (VAA) in respect of an agreement between the two parties. Cash costs payable to VAA totalling £1m (2019: £4m) have been deferred on the balance sheet.

(5) The Group has made donations to the Foundation in the current year to enable the Foundation to pursue its charitable objectives. The Group has also provided a number of support services to the Foundation on a pro bono basis, including use of facilities and employee time. The estimated gift in kind for support services provided during the year was £0.4m (2019: £0.6m) and is included in the total value disclosed above.

5.3 Related party transactions (continued)

Compensation of key management personnel (KMP)

KMP comprise Directors of the Bank and members of the Executive Leadership Team.

	2020	2019
	£m	£m
Salaries and short-term benefits	**10**	14
Termination benefits	**1**	5
Equity based compensation[(1)]	**4**	2
	15	21

(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 2020 were £4m (2019: £5m).

For the year ended 30 September 2020 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 2020 (2019: none). None of the Directors were members of the Group's defined benefit pension scheme during 2020 (2019: none).

None of the Directors hold share options and none were exercised during the year (2019: none).

Disclosures in respect of the highest paid Director

	2020	2019
	£m	£m
Aggregate remuneration[(1)]	**2**	2

(1) Aggregate remuneration includes amounts paid for the 2020 year and amounts paid under the LTIP in 2020 relating to the 2016 LTIP award released in 2020 (£0.2m).

The highest paid Director does not hold any share options, nor were they a member of any pension plan during 2020, nor 2019.

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.

Transactions with KMPs

	2020	2019
	£m	£m
Loans and advances	**4**	4
Deposits	**2**	3

No provisions have been recognised in respect of loans provided to KMPs (2019: £Nil). There were no debts written off or forgiven during the year to 30 September 2020 (2019: £Nil). Included in the above are eight (2019: four) loans totalling £1m (2019: £1m) made to Directors. In addition to the above, there are guarantees of £Nil (2019: £Nil) made to Directors and their related parties.

5.4 Transition to IFRS 16 'Leases'

The Group has adopted IFRS 16 Leases from 1 October 2019 and elected to apply the modified retrospective approach, under which the cumulative effect of initial application is recognised in retained earnings as at 1 October 2019 and comparatives are not restated. Under the modified retrospective approach, at transition, lease liabilities have been measured at the present value of the remaining lease payments, discounted at the Group's incremental borrowing rate as at 1 October 2019. The weighted-average borrowing rate applied to these lease liabilities on transition was 1.7%.

For the purposes of applying the modified retrospective approach, the Group has elected to:

- measure the right−of−use asset at an amount equal to the lease liability at the date of initial application adjusted by the amount of any prepaid or accrued lease payments;
- apply the exemption not to recognise right−of−use assets and liabilities for leases with less than 12 months of lease term;
- apply the practical expedient to rely on its assessment as to whether the lease was onerous under IAS 37 and therefore adjust the right-of-use asset at the date of initial application by the onerous lease provision rather than conduct an impairment test; and
- apply the practical expedient to grandfather the assessment of which transactions are leases. It will apply IFRS 16 only to contracts that were previously identified as leases by IAS 17. Contracts that were not identified as leases under IAS 17 and IFRIC 4 will not be reassessed. Therefore, the definition of a lease under IFRS 16 will only be applied to contracts entered into or changed on or after 1 October 2019.

The impact of the adoption of IFRS 16 on the opening balance sheet as at 1 October 2019 is shown in the table below:

Group	As at 30 September 2019	Impact of IFRS 16	Restated as at 1 October 2019
	£m	**£m**	**£m**
Property, plant and equipment	145	194	339
Other assets	236	-	236
Provisions	459	(3)	456
Other liabilities	2,527	196	2,723
Equity	5,141	1	5,142

Bank	As at 30 September 2019	Impact of IFRS 16	Restated as at 1 October 2019
	£m	**£m**	**£m**
Property, plant and equipment	85	168	253
Other assets	169	2	171
Provisions	439	-	439
Other liabilities	2,448	170	2,618

The adoption of IFRS 16 has absorbed 11bps of the Group's CET1 capital, principally through the risk weighting of assets now recognised on balance sheet.

Lease liabilities amounting to £205m (Bank: £176m) in respect of leased properties previously accounted for as operating leases were recognised at 1 October 2019. Included in the £196m (Bank: £170m) movement in other liabilities on adoption is a £9m (Bank: £6m) transfer of rent-free period accruals out of other liabilities on transition.

5.4 Transition to IFRS 16 'Leases' (continued)

The following is a reconciliation of operating lease commitments disclosed at 30 September 2019 to the lease liability recognised at 1 October 2019:

	Group £m	Bank £m
Undiscounted future minimum lease payments under operating leases at 30 September 2019	414	372
Leases not yet commenced at 1 October 2019	(129)	(124)
Irrecoverable VAT included in future minimum lease payments	(49)	(45)
Short-term leases recognised on a straight line basis as an expense	(2)	(1)
Lease prepayments	(6)	(4)
Discounted at the incremental borrowing rate	(24)	(22)
Other	1	-
Total lease liability recognised as at 1 October 2019	**205**	**176**

IFRS 16 amends the criteria applied to assess whether a sub-lease is an operating lease or a finance lease. Changes to the classification of sub-leases where the Group is lessor under IFRS 16 has resulted in certain sub-leases of surplus estate previously classified as operating leases being reclassified as finance leases. In those cases, any difference between the value of the impaired right-of-use asset on transition and the sub-lease receivable recognised on transition is recognised as a gain or loss directly within equity.

Under IFRS 16, the operating lease expense previously recorded in operating and administrative costs has been replaced by a depreciation charge (also included within operating and administrative costs), which is lower than the operating lease expense recognised under IAS 17, and a separate interest expense, recorded in 'interest expense'. While the decision to transition using the modified retrospective approach impacts comparability with prior years within the Group's consolidated income statement, the line item impact is not material.

There is no net cash flow impact arising from the adoption of the new standard.

The Group's revised accounting policy is disclosed in note 3.17.

5.5 Pillar 3 disclosures

Basel III CRD IV

Pillar 3 disclosure requirements are set out in Part Eight of the CRR. The consolidated disclosures of Virgin Money UK PLC, for the 2020 financial year, will be issued concurrently with the Annual Report and Accounts and can be found at www.virginmoneyukplc.com/investor-relations/results-and-reporting/financial-results/.

5.6 Post balance sheet events

On 17 November 2020 we announced that Clifford Abrahams had been appointed Executive Director and Group Chief Financial Officer and that it was expected that he would join the Group in March 2021, subject to regulatory approval.

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.

	Bank	
	2020	2019
	£m	£m
At 30 September	**73**	1,776

The table below represents the wholly-owned subsidiary undertakings of the Group and Company as at 30 September 2020:

Wholly-owned subsidiary undertakings	Nature of business	Class of share held	Proportion held	Country of incorporation	Registered office	Financial year end
Direct holdings						
Clydesdale Bank Asset Finance Limited	Leasing	Ordinary	100%	Scotland	30 St Vincent Place, Glasgow, G1 2HL	30 September
CYB Intermediaries Limited	Insurance intermediary	Ordinary	100%	England	20 Merrion Way, Leeds, Yorkshire, LS2 8NZ	30 September
St Vincent (Equities) Limited	Investment company	Ordinary	100%	Scotland	30 St Vincent Place, Glasgow, G1 2HL	30 September
Virgin Money Holdings (UK) PLC	Banking	Ordinary	100%	England	Jubilee House, Gosforth, Newcastle upon Tyne, NE3 4PL	30 September
Yorkshire Bank Home Loans Limited	Mortgage finance	Ordinary	100%	England	20 Merrion Way, Leeds, Yorkshire, LS2 8NZ	30 September
CB Nominees Limited	Dormant	Limited by guarantee	100%	Scotland	30 St Vincent Place, Glasgow, G1 2HL	30 September
CYB SSP Trustee Limited	Dormant	Ordinary	100%	England	20 Merrion Way, Leeds, Yorkshire, LS2 8NZ	30 September
Yorkshire Bank PLC	Dormant	Ordinary	100%	England	20 Merrion Way, Leeds, Yorkshire, LS2 8NZ	30 September
Northern Rock Limited	Dormant	Ordinary	100%	England	Jubilee House, Gosforth, Newcastle upon Tyne, NE3 4PL	30 September

Notes to the consolidated financial statements (continued)
Section 6: Notes to the Bank financial statements (continued)

6.2 Bank investments in controlled entities (continued)

Indirect holdings						
Virgin Money Giving Limited	Charitable donations	Ordinary	100%	England	Jubilee House, Gosforth, Newcastle upon Tyne, NE3 4PL	30 September
Virgin Money Management Services Limited	Service company	Ordinary	100%	England	Jubilee House, Gosforth, Newcastle upon Tyne, NE3 4PL	30 September
Virgin Money Personal Financial Service Limited	Insurance Intermediary	Ordinary	100%	England	Jubilee House, Gosforth, Newcastle upon Tyne, NE3 4PL	30 September
Virgin Money PLC	Banking	Ordinary	100%	England	Jubilee House, Gosforth, Newcastle upon Tyne, NE3 4PL	30 September
CGF No 9 Limited	Leasing	Ordinary	100%	Scotland	30 St Vincent Place, Glasgow, G1 2HL	30 September

Interest in Charitable Foundations
The Group has an interest in The Virgin Money Foundation, a charitable foundation registered in England as a company limited by guarantee. Virgin Money Holdings (UK) PLC acts as guarator for £1 and Clydesdale Bank PLC is a donor. The Yorkshire and Clydesdale Bank Foundation, a charitable foundation registered in Scotland as a company limited by guarantee, was wound up during the year. Clydesdale Bank PLC acted as a guarantor for £10 and was the main donor.

Impairment in Virgin Money Holdings (UK) PLC
An impairment test on the carrying value of the Bank's investment in Virgin Money Holdings (UK) PLC has been undertaken during the year, resulting in an impairment charge of £1,754m as at 30 September 2020 (2019: £303m). For the purposes of the impairment test, Virgin Money Holdings (UK) PLC is regarded as the cash generating unit with the value in use (VIU) calculation compared to the current carrying value of the investment in Virgin Money Holdings (UK) PLC in the Bank balance sheet. The impairment has arisen due to the transfer of the trade and assets of VM plc as described in note 6.3. The recoverable amount of Virgin Money Holdings (UK) PLC is £62m as at 30 September 2020.

The following assumptions are used in the VIU calculation, in accordance with the requirements of IAS 36:
- Discount rate: 12.1%
- Projected terminal growth rate: 2%

Discount rate
The discount rate was calculated by reference to a series of internal indicators combined with certain identifiable and available sector specific information.

Growth rate
The growth rate is based on management's expectation of the long term average growth prospects for UK GDP after taking into account the broader historic UK economic outlook and trends.

Investment in Virgin Money Unit Trust Managers Limited
Following receipt of all regulatory approvals and conclusion of contractual negotiations, the investments and pensions JV with AAM was completed on 31 July 2019. The Group recognised a gain on sale of £35m within non-interest income (note 2.3) from the disposal of 50% (less one share) of its interest in UTM. Investments in JV are recognised in the consolidated financial statements within other assets.

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 a number of structured entities:

Other controlled entities	Nature of business	Country of incorporation	Registered office	Financial year end
Clydesdale Covered Bonds No. 2 LLP	Acquisition of mortgage loans	England	20 Merrion Way, Leeds, Yorkshire, LS2 8NZ	30 September
Eagle Place Covered Bonds LLP	Acquisition of mortgage loans	England	Jubilee House, Gosforth, Newcastle upon Tyne, NE3 4PL	30 September
Gosforth Funding 2014-1 PLC (in liquidation)	Issuer of securitised notes	England	8 Princes Parade, Liverpool, L3 1QH	31 December
Gosforth Funding 2015-1 PLC (in liquidation)	Issuer of securitised notes	England	8 Princes Parade, Liverpool, L3 1QH	31 December
Gosforth Funding 2016-1 PLC	Issuer of securitised notes	England	Fifth Floor, 100 Wood Street, London, EC2V 7EX	30 September
Gosforth Funding 2016-2 PLC (in liquidation)	Issuer of securitised notes	England	8 Princes Parade, Liverpool, L3 1QH	31 December
Gosforth Funding 2017-1 PLC	Issuer of securitised notes	England	Fifth Floor, 100 Wood Street, London, EC2V 7EX	30 September
Gosforth Funding 2018-1 PLC	Issuer of securitised notes	England	Fifth Floor, 100 Wood Street, London, EC2V 7EX	30 September
Gosforth Holdings 2014-1 Limited (in liquidation)	Holding company	England	8 Princes Parade, Liverpool, L3 1QH	31 December
Gosforth Holdings 2015-1 Limited (in liquidation)	Holding company	England	8 Princes Parade, Liverpool, L3 1QH	31 December
Gosforth Holdings 2016-1 Limited	Holding company	England	Fifth Floor, 100 Wood Street, London, EC2V 7EX	30 September
Gosforth Holdings 2016-2 Limited (in liquidation)	Holding company	England	8 Princes Parade, Liverpool, L3 1QH	31 December
Gosforth Holdings 2017-1 Limited	Holding company	England	Fifth Floor, 100 Wood Street, London, EC2V 7EX	30 September
Gosforth Holdings 2018-1 Limited	Holding company	England	Fifth Floor, 100 Wood Street, London, EC2V 7EX	30 September
Gosforth Mortgages Trustee 2014-1 Limited (in liquidation)	Trust	England	8 Princes Parade, Liverpool, L3 1QH	31 December
Gosforth Mortgages Trustee 2015-1 Limited (in liquidation)	Trust	England	8 Princes Parade, Liverpool, L3 1QH	31 December
Gosforth Mortgages Trustee 2016-1 Limited	Trust	England	Fifth Floor, 100 Wood Street, London, EC2V 7EX	30 September
Gosforth Mortgages Trustee 2016-2 Limited (in liquidation)	Trust	England	8 Princes Parade, Liverpool, L3 1QH	31 December
Gosforth Mortgages Trustee 2017-1 Limited	Trust	England	Fifth Floor, 100 Wood Street, London, EC2V 7EX	30 September
Gosforth Mortgages Trustee 2018-1 Limited	Trust	England	Fifth Floor, 100 Wood Street, London, EC2V 7EX	30 September
Lanark Funding Limited	Funding company	England	Third Floor, Suite 2, 11-12 St James's Square, London, SW1Y 4LB	30 September
Lanark Holdings Limited	Holding company	England	Third Floor, Suite 2, 11-12 St James's Square, London, SW1Y 4LB	30 September

6.2 Bank investments in controlled entities (continued)

Other controlled entities (continued)	Nature of business	Country of incorporation	Registered office	Financial year end
Lanark Master Issuer PLC	Issuer of securitised notes	England	Third Floor, Suite 2, 11-12 St James's Square, London, SW1Y 4LB	30 September
Lanark Trustees Limited	Mortgages trustee	England	Third Floor, Suite 2, 11-12 St James's Square, London, SW1Y 4LB	30 September
Lannraig Funding Limited	Funding company	England	1 Bartholomew Lane, London, EC2N 2AX	30 September
Lannraig Holdings Limited	Holding company	England	1 Bartholomew Lane, London, EC2N 2AX	30 September
Lannraig Master Issuer PLC	Issuer of securitised notes	England	1 Bartholomew Lane, London, EC2N 2AX	30 September
Lannraig Trustees Limited	Mortgages trustee	Jersey	44 Esplanade, St Helier, Jersey, JE4 9WG Channel Islands	30 September
Red Grey Square Funding LLP	Security provider	England	1 Bartholomew Lane, London, EC2N 2AX	30 September

Details of the Group's interests in consolidated structured entities associated with securitisation and covered bond arrangements are set out in note 3.3.

The Group also has a participating interest in the following undertakings as either an associate (A) or a joint venture (JV):

Name of undertaking	Status	% of share class held by immediate Parent Company (or by the Group where this varies)	Registered office address (UK unless stated otherwise)	Financial year end
Eagle Place Covered Bonds Finance Limited	A	20%	1 Bartholomew Lane, London, EC2N 2AX	31 December
Salary Finance Loans Limited	JV	50%	One Hammersmith Broadway, London, W6 9DL	31 December
Virgin Money Unit Trust Managers Limited(1)	JV	50% and 1 share	Jubilee House, Gosforth, Newcastle Upon Tyne, NE3 4PL	31 December

(1) Virgin Money Unit Trust Managers Limited owns 100% of the share capital of Virgin Money Nominees Limited, a dormant company registered at Jubilee House, Gosforth, Newcastle upon Tyne, NE3 4PL.

6.3 FSMA Part VII transfer of trade and assets from Virgin Money PLC to Clydesdale Bank PLC

On 26 September 2019, at a hearing in the Court of Session in Edinburgh, the Court approved a banking business transfer scheme under Part VII of FSMA. The scheme effective date was 21 October 2019 and, in accordance with the court approval, on this date the business of Virgin Money PLC was transferred to the Bank for a cash consideration of £10m. The transfer of the trade and assets is a business transfer under common control and has no impact on the consolidated financial results. The total assets and total liabilities transferred were £49bn and £47bn respectively.

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 RWAs.
Total capital ratio	Total capital resources divided by RWAs at a given date.
CRD IV Leverage ratio	This is a regulatory standard ratio proposed by 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.
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
On 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, as management consider that this presents more comparable results year-on-year. These items are all significant and are typically one-off in nature. Additional detail is provided below where considered necessary to further explain the rationale for their exclusion from underlying performance, in particular for new items in the current year or recurring non-underlying items:

Item	**2020 £m**	2019 £m	Reason for exclusion from the Group's current underlying performance
Integration and transformation costs	**(139)**	(149)	These are part of the Group's publicised three-year integration plan following the acquisition of Virgin Money Holdings (UK) PLC and comprise a number of one-off expenses that are required to realise the anticipated cost synergies. Also included are one-off costs to support transformation. This programme will improve our digital capability and consequently enable super straightforward efficiency. Costs are expected to be restructuring in nature.
Acquisition accounting unwinds	**(113)**	(87)	This consists principally of the unwind of the IFRS 3 fair value adjustments created on the acquisition of Virgin Money Holdings (UK) PLC in October 2018 (£96m charge) and the IFRS 9 impairment impact in 2020 on acquired assets (£6m charge) with other smaller items amounting to £11m. These represent either one-off adjustments or are the scheduled reversals of the accounting adjustments that arose following the fair value exercise required by IFRS 3. These will continue to be treated as non-underlying adjustments over the expected three to five-year period until they have been fully reversed.
Legacy conduct	**(26)**	(433)	These costs are historical in nature and are not indicative of the Group's current practices.
Other:			
SME transformation	**(11)**	(30)	These costs are significant and relate to the Group's transformation of its Business banking propositions and encompass process re-engineering and customer journey improvements required to support customers migrating under the RBS incentivised switching proposition, and certain costs in respect of government backed schemes.
UTM transition costs	**(8)**	(1)	These are UTM's transformation costs for build of the new proposition, including costs towards the build of a new platform for administration and servicing. The costs are one-off in nature as part of the transition to the new JV proposition.
Intangible asset write-off	**-**	(127)	The charge for the software write-off is significant and has arisen in respect of software assets which are no longer considered to be of value relative to the Group's strategy following the acquisition of Virgin Money Holdings (UK) PLC.
Mortgage EIR adjustments	**-**	80	The alignment of accounting practices is a one-off exercise arising from the acquisition
Consent solicitation	**-**	22	A one-off gain relating to the change in obligor of senior debt from Virgin Money Holdings (UK) PLC to CYBG on 20 August 2019.
Gain on sale of UTM	**-**	35	A one-off gain recognised on the disposal of 50% (less one share) of UTM.
GMP equalisation cost	**-**	(11)	A one-off charge for GMP equalisation in the Group's defined benefit scheme.
Legacy restructuring and separation	**-**	(5)	These legacy costs were significant in prior years and related to the Sustain programme, and demerger from NAB, both of which completed in the current year.
Gain on disposal of VocaLink	**-**	4	
Total other	**(19)**	(33)	

Main Glossary

Term	Definition
Additional Tier 1 **(AT1)**	Securities that are considered AT1 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.
Bank	Clydesdale Bank PLC.
Basel II	The capital adequacy framework issued by the Basel Committee on Banking Supervision (BCBS) in June 2004.
Basel III	Reforms issued by the BCBS in December 2017 with subsequent revision.
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 Virgin Money UK PLC Board or the Clydesdale Bank PLC Board as appropriate.
Bounce back loan scheme **(BBLS)**	A scheme implemented by the UK Government to provide financial support to businesses across the UK that are losing revenue, and seeing their cashflow disrupted as a result of COVID-19, and that can benefit from £50,000 or less in finance.
Business 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.
carbon related assets	Assets tied to the energy and utilities sectors under the Global Industry Classification Standard (mapped to internal industry classifications), excluding water utilities and independent power and renewable electricity producer industries.
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.
cash and cash equivalents	For the purposes of the statement of cash flows, cash and cash equivalents comprise cash and non-mandatory deposits with central banks and amounts due from other banks with a maturity of less than three months
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	Virgin Money UK PLC and its controlled entities following the acquisition of Virgin Money Holdings (UK) PLC.
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 risk	The risk of treating customers unfairly and/or delivering inappropriate outcomes resulting in customer detriment, regulatory fines, compensation, redress costs and reputational damage.
Coronavirus business interruption loan scheme **(CBILS)**	A scheme implemented by the UK Government to provide financial support to smaller businesses across the UK that are losing revenue, and seeing their cashflow disrupted, as a result of COVID-19.
Coronavirus large business interruption loan scheme **(CLBILS)**	A scheme implemented by the UK Government to provide financial support to mid-sized and larger businesses across the UK that are suffering disruption to their cashflow due to lost or deferred revenues as a result of COVID-19.
counterparty	The other party that participates in a financial transaction, with every transaction requiring a counterparty in order for the transaction to complete.
Coverage ratio	Impairment allowance as at the year end shown as a percentage of gross loans and advances as at the year end.
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 CRD 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 conversion factor **(CCF)**	CCFs are used in determining the EAD in relation to a credit risk exposure. The CCF is an estimate of the proportion of undrawn and off-balance sheet commitments expected to be drawn down at the point of default.

Main Glossary (continued)

Credit impaired financial asset	A financial asset that is in default or has an individually assessed provision. This is also referred to as a 'Stage 3' impairment loss and subject to a lifetime ECL calculation. The Group considers 90 DPD as a backstop in determining whether a financial asset is credit impaired.
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.
Credit risk mitigation **(CRM)**	Techniques to reduce the potential loss in the event that a customer (borrower or counterparty) becomes unable to meet its obligations. This may include the taking of financial or physical security, the assignment of receivables or the use of credit derivatives, guarantees, credit insurance, set-off or netting.
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.
days past due **(DPD)**	The number of days a facility has borrowing in excess of an agreed or expired limit or, where facilities are subject to a regular repayment schedule, contractual payments are not fully up to date.
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	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 **(EIR)**	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.
Exposure at default **(EAD)**	The estimate of the amount that the customer will owe at the time of default.
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.
forbearance	The term generally applied to the facilities provided or changes to facilities provided to assist borrowers 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.
IFRS 9	The financial instrument accounting standard which was adopted by the Group with effect from 1 October 2018.
impairment allowances	An ECL provision held on the balance sheet for financial assets calculated in accordance with IFRS 9. The impairment allowance is calculated as either a 12-month or a lifetime ECL.
impairment losses	The ECLs calculated in accordance with IFRS 9 and recognised in the income statement with the carrying value of the financial asset reduced by creating an impairment allowance. Impairment losses are calculated as either a 12-month or lifetime ECL.
Internal Capital Adequacy Assessment Process **(ICAAP)**	The Group's assessment of the levels of capital that it needs to hold through an examination of its risk profile from regulatory and economic capital viewpoints.
Internal Liquidity Adequacy Assessment Process **(ILAAP)**	The Group's assessment and management of balance sheet risks relating to funding and liquidity.
Internal Ratings-Based approach **(IRB)**	A method of calculating credit risk capital requirements using internal, rather than supervisory, estimates of risk parameters.
investment grade	The highest possible range of credit ratings, from 'AAA' to 'BBB', as measured by external credit rating agencies.

Main Glossary (continued)

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.
Lifetime ECL	The ECL calculation performed on financial assets where a SICR since origination has been identified. This can be either a 'Stage 2' or 'Stage 3' impairment loss depending on whether the financial asset is credit impaired.
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 given default **(LGD)**	The estimate of the loss that the Group will suffer if the customer defaults (incorporating the effect of any collateral held).
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.
Personal lending	Lending to individuals rather than institutions and excludes mortgage lending which is reported separately.
PPI redress	Includes PPI customer redress and all associated costs excluding fines.
probability of default **(PD)**	The probability that a customer will default over either the next 12 months or lifetime of the account.
regulatory capital	The capital which the Group holds, determined in accordance with rules established by the PRA.
residential mortgage-backed securities **(RMBS)**	Securities that represent interests in groups or pools of underlying mortgages. Investors in these securities have the right to cash received from future mortgage payments (interest and principal).
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.
Significant increase in credit risk **(SICR)**	The assessment performed on financial assets at the reporting date to determine whether a 12-month or lifetime ECL calculation is required. Qualitative and quantitative triggers are assessed in determining whether there has been a SICR since origination. The Group considers 30 DPD as a backstop in determining whether a SICR since origination has occurred.
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.

Main Glossary (continued)

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	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 UK PLC
Virgin Money Holdings	Virgin Money Holdings (UK) PLC

Abbreviations

AAM	Aberdeen Asset Management PLC
ACS	Annual cyclical scenario
FPC	Financial Policy Committee
AIRB	Advanced internal ratings based
ALCO	Assets and Liability Committee
AT1	Additional Tier 1
BBL	Bounce back loan
BBLS	Bounce back loan scheme
BCBS	Basel Committee on Banking Supervision
BoE	Bank of England
bps	Basis points
CBIL	Coronavirus business interruption loan
CBILS	Coronavirus business interruption loan scheme
CCF	Credit Conversion Factor
CCyB	Countercyclical Capital Buffer
CET1	Common Equity Tier 1 Capital
CLBILS	Coronavirus large business interruption loan scheme
COVID-19	Corona Virus Disease 2019
CPI	Consumer Price Index
CRD	Capital Requirements Directive
CRM	Credit risk mitigation
CRR	Capital Requirements Regulation
CSRBB	Credit spread risk in the banking book
DEP	Deferred Equity Plan
DPD	Days past due
EAD	Exposure at default
EBA	European Banking Authority
ECL	Expected credit loss
EIR	Effective interest rate
ESG	Enterprise, Social and Governance
FCA	Financial Conduct Authority
FIRB	Foundation internal ratings based
FRC	Financial Reporting Council
FSMA	Financial Services and Markets Act 2000
FTE	Full time equivalent
FVOCI	Fair value through other comprehensive income
FVTPL	Fair value through profit or loss
GDP	Gross Domestic Product
GMP	Guaranteed Minimum Pension
G-SII	Global Systemically Important Institution
HMT	Her Majesty's Treasury
HPI	House Price Index
HQLA	High-Quality Liquid Asset
IAS	International Accounting Standard
IASB	International Accounting Standards Board
IPO	Initial Public Offering
IRB	Internal ratings based
ISDA	International Swaps and Derivatives Association
KMP	Key management personnel
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
MGC	Model Governance Committee
MREL	Minimum Requirement for Own Funds and Eligible Liabilities
NAB	National Australia Bank Limited
NIM	Net interest margin
NSFR	Net stable funding ratio
OLAR	Overall liquidity adequacy rule
PD	Probability of Default
PMA	Post model adjustment
POCI	Purchased or originated credit impaired
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
SICR	Significant increase in credit risk
SIP	Share Incentive Plan
SME	Small or medium sized enterprises
SONIA	Sterling Over Night Index Average
SRB	Systemic Risk Buffer
SVR	Standard variable rate
TCFD	Taskforce for Climate-related Financial Disclosures
TFS	Term Funding Scheme
TFSME	Term Funding Scheme with additional incentives for SMEs
VAA	Virgin Atlantic Airways Limited
VIU	Value in use
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.

	2020
	UK
Average FTE employees (number)	**8,256**
Total operating income (£m)	**1,435**
Loss before tax (£m)	**173**
Corporation tax paid (£m)	**12**
Public subsidies received (£m)	**-**
Return on assets (%)	**(0.2)%**

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.

Website www.virginmoneyukplc.com/investor-relations/results-and-reporting/financial-results/.

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Forward-looking statements

The information in this document may include forward-looking statements, which are based on assumptions, expectations, valuations, targets, estimates, forecasts and projections about future events. These can be identified by the use of words such as ‘expects’, ‘aims’, ‘targets’, ‘seeks’, ‘anticipates’, ‘plans’, ‘intends’, ‘prospects’, ‘outlooks’, ‘projects’, ‘forecasts’, ‘believes’, ‘estimates’, ‘potential’, ‘possible’, and similar words or phrases. These forward-looking statements, as well as those included in any other material discussed at any presentation, are subject to risks, uncertainties and assumptions about the Group and its securities, investments and the environment in which it operates, including, among other things, the development of its business and strategy, any acquisitions, combinations, disposals or other corporate activity undertaken by the Group (including but not limited to the integration of the business of Virgin Money Holdings (UK) PLC and its subsidiaries into the Group), trends in its operating industry, changes to customer behaviours and covenant, macroeconomic and/or geo-political factors, the repercussions of the outbreak of coronaviruses (including but not limited to the COVID-19 outbreak), changes to its Board and/or employee composition, exposures to terrorist activity, IT system failures, cyber crime, fraud and pension scheme liabilities, changes to law and/or the policies and practices of the Bank of England, the Financial Conduct Authority and/or other regulatory and governmental bodies, inflation, deflation, interest rates, exchange rates, changes in the liquidity, capital, funding and/or asset position and/or credit ratings of the Group future capital expenditures and acquisitions the repercussions of the UK’s referendum vote to leave the European Union, the UK’s exit from the EU (including any change to the UK’s currency), Eurozone instability, and any referendum on Scottish independence.

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

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