Annual report and consolidated financial statements

Clydesdale Bank PLC

For the year ended 30 September 2021

Company Number: SC001111

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Contents

Overview

Clydesdale Bank PLC (‘the Bank’), together with its subsidiary undertakings (which together comprise ‘the Group’), operate under the Clydesdale Bank, Yorkshire Bank and Virgin Money brands. It offers a range of banking services for both retail and business customers through retail stores, 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 2021.

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 194.

Officers and professional advisers

Chairman	David Bennett
Senior Independent Non-Executive Director	Tim Wade
Independent Non-Executive Directors	Paul Coby Geeta Gopalan Darren Pope Elena Novokreschenova (appointed 22 March 2021)
Non-Executive Director	Amy Stirling
Executive Director	David Duffy Clifford Abrahams (appointed 8 March 2021)
Group Company Secretary	Lorna McMillan
Group General Counsel and Purpose Officer	James Peirson
Registered office	30 St Vincent Place Glasgow G1 2HL
Independent auditors	Ernst & Young LLP 25 Churchill Place Canary Wharf London E14 5EY

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 2021.

Principal activities

The Group operates a full service UK-focused retail and commercial banking business under the brand names 'Clydesdale Bank', 'Yorkshire Bank' 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	**2021 £m**	2020 £m
Customer loans	**71,990**	72,443
Other financial assets	**15,035**	15,608
Other non-financial assets	**2,191**	2,256
Total assets	**89,216**	90,307
Customer deposits	**(66,870)**	(67,511)
Wholesale funding	**(13,609)**	(14,224)
Other liabilities	**(3,155)**	(3,582)
Total liabilities	**(83,634)**	(85,317)
Ordinary shareholders' equity	**(4,910)**	(4,318)
Additional Tier 1 (AT1) equity	**(672)**	(672)
Equity	**(5,582)**	(4,990)
Total liabilities and equity	**(89,216)**	(90,307)

Summary income statement – underlying and statutory basis[(1)] **for the year ended 30 September**	**2021 £m**	2020 £m
Net interest income	**1,415**	1,352
Non-interest income	**155**	187
Total operating income	**1,570**	1,539
Total operating and administrative expenses	**(901)**	(914)
Operating profit before impairment losses	**669**	625
Impairment credit/(losses) on credit exposures	**131**	(501)
Underlying profit on ordinary activities before tax	**800**	124
Integration and transformation costs	**(146)**	(139)
Acquisition accounting unwinds	**(88)**	(113)
Legacy conduct	**(76)**	(26)
Other items	**(74)**	(19)
Statutory profit/(loss) on ordinary activities before tax	**416**	(173)
Tax credit/(expense)	**116**	(18)
Statutory profit/(loss) attributable to equity holders	**532**	(191)

(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 187.

Business review (continued)

The Group has continued to make good progress delivering its strategy and benefitted from an improving economic backdrop. The Group has delivered strong financial results with improved performance and momentum on most key metrics. A recovery in income, reduced costs, a significant reduction in the level of expected credit loss (ECL) provisions and robust common equity tier 1 (CET1) accretion, all leave the bank well placed to accelerate its digital strategy and deliver profitable growth.

Well managed balance sheet

The Group managed balances prudently through the year, given the uncertain environment and overall lending finished 1% lower at £72.0bn. Unsecured balances performed strongly, particularly in the second half, with balances growing 4% in the year against a market that contracted, as the resilience of our book and our strong digital propositions allowed us to continue to take market share. Deposit balances reduced 1% to £66.9bn and we continued to focus on improving the mix of our deposit base and reducing our cost of funds. Over the course of FY21, there was a 29% reduction in more expensive term deposits and a 19% increase in lower-cost relationship deposits. This provided an important underpin to the Group's improving momentum in total operating income.

Significant improvement in impairments

Impairments were significantly improved compared to last year as the Group recognised a £131m impairment credit (2020: £501m charge) given the improving economic outlook and continuing robust asset quality. We remain vigilant as Government support is removed and have maintained coverage levels of 70bps (2020: 103bps), well above pre-pandemic levels.

Return to statutory profit

The Group made a statutory profit before tax of £416m (2020: loss before tax of £173m) after deducting £384m of exceptional costs (2020: £297m). Overall income improved 2% on the prior year driven by stronger net interest income more than offsetting a weaker non-interest income performance. Operating costs were 1% lower than the prior year as the improvement in underlying costs was partially offset by higher conduct charges in relation to the finalisation of the Group's Payment Protection Insurance (PPI) programme and one-off charges recognised in the year following a reassessment of the Group's practices on the capitalisation of work in progress (WIP) balances against the backdrop of the new digital first strategy and the move to an agile project delivery.

Robust capital, liquidity and funding position

The Group has maintained a robust capital postion with a transitional CET1 ratio of 14.9%. The Group therefore retains a significant CET1 management buffer in excess of its Capital Requirements Directive IV (CRD IV) minimum CET1 requirement of 5.7%.

Funding and liquidity

The Group has maintained a strong funding and liquidity position and has no reliance on short-term wholesale funding. The Group's liquidity surplus continues to comfortably exceed our regulatory minimum and internal risk appetite, with a Liquidity Coverage Ratio (LCR) of 151% as at 30 September 2021 (2020:140%). Net stable funding ratio (NSFR) was 134% at 30 September 2020 (2020: 131%).

Outlook

With an improving economic backdrop, the Group has a strong opportunity through its strategy to simplify the bank and accelerate growth aspirations. The Board believes that the strategy is the right one and with a strong 2021 performance as a foundation, the Group is well positioned to deliver profitable growth, in a cost effective and sustainable way that supports all stakeholders, and disrupt the status quo.

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.

Governance

Our commitment to good governance has continued to underpin our strategic delivery and ensures we continue to challenge our assumptions and risks. Details of s.172 compliance can be found on pages 96 to 102.

Reconciliation of statutory to underlying results

The statutory basis presented within this section reflects the Group's results as reported in the financial statements. The underlying basis reflects the Group's financial performance prepared on an underlying basis as presented to the CEO, Executive Leadership Team and Board and exclude certain items that are part of the statutory results. The table below reconciles the statutory results to the underlying results, and full details on the adjusted items to the underlying results are included on page 187:

2021 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	**1,360**	**-**	**55**	**-**	**-**	**1,415**
Non-interest income	**127**	**-**	**23**	**-**	**5**	**155**
Total operating income	**1,487**	**-**	**78**	**-**	**5**	**1,570**
Total operating and administrative expenses before impairment credit	**(1,202)**	**146**	**10**	**76**	**69**	**(901)**
Operating profit before impairment credit	**285**	**146**	**88**	**76**	**74**	**669**
Impairment credit on credit exposures	**131**	**-**	**-**	**-**	**-**	**131**
Profit on ordinary activities before tax	**416**	**146**	**88**	**76**	**74**	**800**

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

Strategic report (continued)

Principal risks and mitigating actions

The Group's principal risks are those which 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 the same as those outlined in the Annual Report and Accounts 2020.

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

Principal risks	Key mitigating actions	Future focus
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 frameworks and policies. • The Group carries out 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 prepared regularly to assess the adequacy of the Group's impairment provisions and the impact on risk-weighted assets (RWA) and capital.	• The Group remains focused on continued and timely support for customers and horizon-scanning in relation to expected events and outcomes given the ever-changing external environment. • Group Credit Risk will put in place all necessary measures to ensure readiness for any potential economic downturn and consequent customer support.
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), strategic funding plans and recovery planning. • The Group completes an annual Internal Capital Adequacy Assessment Process (ICAAP) which formally assesses 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. The Group is now also a participant in the Bank of England's (BoE) Solvency Stress Test (SST). • Board-approved risk appetite measures ensure funding and liquidity levels are monitored and managed in accordance with internal and regulatory requirements, 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. Pension Risk is overseen by the Asset and Liability Committee (ALCO) and is considered in detail as part of the ICAAP and ongoing reports are provided to the Boards' Risk Committee. • Regular tracking of prudential regulations maintains a focus on the evolving landscape with oversight from ALCO.	• The Group's focus is to manage the balance sheet through the uncertain economic environment as the UK economy recovers from COVID-19, as well as managing the residual disruption created by the UK's exit from the EU. This is combined with an ongoing landscape of regulatory change. • The economic environment creates uncertainty with interest rates, which presents potential for both adverse operational impacts and for continued pressure on margins. There will be ongoing focus on how to mitigate these effects. • The Prudential Regulation Authority's (PRA) timeline for implementing Basel 3.1 has been extended and a consultation paper is now due in 2022. This will be a particular area of focus for us to understand potential impacts on capital requirements across, for example, operational and credit risks.

Strategic report (continued)

Principal risks and mitigating actions (continued)

Principal risks	Key mitigating actions	Future focus
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 and is subject to oversight by the Model Governance Committee. Examples of how the Board is kept informed on model risk include the Risk Appetite Statement (RAS), reports from the Chief Risk Officer and model monitoring reports. • 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.	• Model changes will be required relating to the application of new regulatory requirements for mortgages, definitions of default and for financial risks from climate change. The continued investment in Risk's operations during 2021 have included a focus on models. • The impact on models from the unwinding of government support measures during the pandemic is being closely monitored. Expert judgement will continue to be used to supplement model outcomes in line with thorough governance processes.
Regulatory and compliance risk is the risk failing to comply with relevant laws and regulatory requirements, not keeping regulators informed of relevant issues, not responding effectively to information requests, 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 reporting and development of Regulatory and compliance risk appetite measures to the Executive Risk Committee and the Board. • There is ongoing proactive and coordinated engagement with key regulators. • Formal monitoring of compliance is managed through focused oversight, regular reporting to the Executive Risk Committee and Board Risk Committee.	• The Group will continue to respond to regulatory change and associated requirements for systems and processes across the banking industry as a whole. It will seek to comply with all regulations as they evolve, and as customer expectations continue to develop. • The Group will continue its implementations of major regulatory changes, including transition from London Interbank Offered Rate (LIBOR) and Payment Services Directive 2 (PSD2).
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. • There is ongoing reporting and development of conduct risk appetite measures to the Executive Risk Committee and the Board. • The Group continually assesses evolving conduct regulations, customer expectations, and product and proposition development to ensure it continues to put the customer first. • A risk-based assurance framework is in place which monitors compliance with regulation and assesses customer outcomes.	• The Group remains focused on seeking to ensure that customers remain supported and that current and future products and services meet conduct standards and regulators' expectations. • Development will continue in the Group's capabilities to support customers impacted by COVID-19 and vulnerable customer groups more generally, and in response to Financial Conduct Authority (FCA) guidance and its development of a new Consumer Duty.

Strategic report (continued)

Principal risks and mitigating actions (continued)

Principal risks	Key mitigating actions	Future focus
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. • A change management framework is in place to govern the execution and safe delivery of business change. • 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.	• Continued focus on management of resilience risks arising from the increasing change portfolio. • Enhanced supplier management to safeguard the provision, enablement and delivery of critical processes through third parties.
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 risk 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 through 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.	• Ongoing investment in existing platforms across both heritage technology estates will be a key area of focus, in order to maintain resilience until duplication of systems and data centres is removed. • The ability to deliver new and enhanced digital services using agile development and cloud technologies will come into focus as we strive to bring innovation and disruption to the banking sector.

Strategic report (continued)

Principal risks and mitigating actions (continued)

Principal risks	Key mitigating actions	Future focus
Financial crime and fraud 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 financial crime and fraud risk framework, with clearly defined policy statements and standards to protect our customers and the Group. • There is ongoing reporting and development of financial crime and fraud risk appetite measures to the Executive Risk Committee and the Board. • 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.	• The Group will continue to develop its capabilities to mitigate financial crime in an external environment where digitisation is increasing quickly and threats continue to evolve. • Supporting our digitisation strategy, investment will continue in the Group's anti-money laundering systems platforms and fraud prevention (including Confirmation of Payee) capabilities to protect our customers.
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. • 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 work streams focused on supporting the Group's digital-led strategy, placing customers' interest at the centre of all aspects of change.	• The Strategic and Financial Plan retains a focus on optimising the Group's efficiency, with emphasis on supporting the change governance framework, to deliver positive outcomes for our customers. • The Group will continue to manage risks associated with COVID-19 and stands ready to execute further customer support arrangements if required. • The continued enhancement of our strategic risk framework is a priority for the Group.
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.	• Focus will remain on potential health, safety and well-being impacts of working environments implemented in response to COVID-19. • Embedding the Group's Purpose continues to be a priority as it leads to better customer service, greater colleague engagement, higher standards of conduct and enhanced business performance. • The Group's Remuneration Committee continues to explore remuneration design to balance incentivisation and motivation with appropriate risk management.

Strategic report (continued)

Principal risks and mitigating actions (continued)

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 93.

Climate risk

Climate risk is not a standalone principal risk but manifests through existing principal risk types. The Group is exposed to physical and transition risks arising from climate change. Further information can be found on page 93 as well as page 218 of the Task Force on Climate-related Financial (TCFD) report in the Group's 2021 Annual Report and Accounts.

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 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 Risk Management Framework (RMF), and are subject to regular review across senior governance forums.

Amendments have been made to the emerging risk classifications reported in the Group's 2020 Annual Report and Accounts. Two emerging risks have been renamed and repositioned:

- Technology and cyber risk has been renamed Resilience risk and repositioned to focus on the increasing importance attached to systems resilience; and
- Critical infrastructure has been renamed Third-party risk and repositioned in recognition of the operational risks arising from the Group's dependencies on third parties.

New ways of working and changing skill requirements is a new emerging risk, recognising the internal and external changes to workforce dynamics brought about by COVID-19.

Strategic report (continued)

External emerging risks

Emerging risks	Description	Mitigating actions
Political and economic risk	There continues to be significant uncertainty linked to the UK and Global economic outlook, with key macroeconomic variables, such as gross domestic product (GDP), unemployment, interest rates and the house price index (HPI), remaining subject to potential change depending on a complex mix of outcomes. Significant government intervention and support throughout the pandemic has led to higher levels of corporate and government indebtedness and uncertainty remains over how this will unwind. Political risks remain, in particular linked to the potential for a Scottish independence referendum.	• The Group continues to monitor economic and political developments in light of the ongoing uncertainty, considering potential consequences for its customers, products, operating model and strategy. • The Group actively monitors its credit portfolios and undertakes robust internal analysis to identify sectors that may come under stress as a result of an economic slowdown in the UK. • Internal and regulatory stress testing is undertaken to demonstrate the Group's financial resilience under a range of severe but plausible economic scenarios.
Regulatory change	The Group remains subject to high levels of oversight and a complex programme of regulatory change from a number of different bodies. The regulatory landscape continues to evolve, with the requirement to respond to ongoing prudential and conduct driven initiatives, as well as reviews, investigations and redress projects, the outcomes of which are all difficult to predict. There is uncertainty surrounding changes to the UK–EU legal and regulatory framework post-Brexit.	• The Group continues to monitor emerging regulatory initiatives to identify potential impacts on its business model and to 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.
Climate risk	While climate risk is treated as a cross-cutting risk within the Group's RMF, it is also treated as an emerging risk given it is a new and evolving area, and to acknowledge the uncertainty around the exact nature and impact of climate change on the Group's strategy, performance and operating model. Climate-related risks arising from physical risks and the transition to a low-carbon economy may pose significant and complex horizon risks. Further detail on the Group's approach to managing financial risks from climate change is included on page 93 and within the TCFD report on pages 218 to 234 of the Group's 2021 Annual Report and Accounts.	• The Group continues to work to understand potential risks and impacts, exploring different climate pathways, to determine how they can be appropriately monitored and managed. • Work continues to build our capability and enhance our policies and processes to ensure these risks are identified, measured, monitored and managed. • The Group's sustainability aspirations and commitments will also play a pivotal role in managing transition risk while supporting our customers to play their part.
Third-party risk	The Group's digitisation strategy is leading to more significant dependencies on services provided by third parties, which are required to maintain day-to-day operations without interruption. As our digitisation strategy progresses, it will be important to assess the levels of reliance which will be placed on these suppliers. This is an emerging risk which is separate from existing supplier relationships in place, as managed through the Group's third-party RMF.	• Impact assessments for important business services are carried out to evaluate operational resilience and to identify and mitigate third-party dependency risks. • Stress testing and self-assessments are carried out to identify any vulnerabilities in operational resilience.

Internal emerging risks

Emerging risks	Description	Mitigating actions
Data stewardship	The Group's digitisation strategy, coupled with the changing regulatory requirements and advancements in technology, such as the increasing use of Cloud solutions or Big Data for analysis purposes, means there is a growing importance attached to the effective and ethical use, governance and protection of data. Failure to effectively mitigate data management risks could result in unethical decisions, regulatory breaches, poor customer outcomes, mistrust and loss of value to the Group.	• The Group has a data management framework governing the creation, storage, distribution, usage and retirement of data. This framework also encompasses data ethics. • The Group continues to invest in data management capabilities alongside the introduction of new technologies and services. • New and existing data management regulations are continuously assessed with proactive action taken to ensure compliance.
Resilience risk	The rapid pace of technological change, coupled with increasing digital demands from customers for the access and use of our products and services, means there is an increasing demand on systems' resilience and our people. Safeguarding resilience is of critical importance, as failure could result in colleagues or customers being unable to provide or receive fundamental banking services. The resilience of systems security, payment and overall technology solutions are subject to a range of threats. Fast-moving global cyber-risk challenges, including those driven by large nation states, continue to pose risks to the security and resilience of Company and government systems.	• The Group undertakes extensive scenario planning to assess potential dependencies in end-to-end systems processing. • 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 important business services. • 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.
New ways of working and changing skill requirements	COVID-19 has introduced new ways of working which are affecting colleague support, culture, and retention. Remote working may break the link between workforce location and job location, which could impact skills availability but also allow the Group to recruit more widely. Changing labour market dynamics, including higher levels of job vacancies, are creating a resource shortage for certain positions, leading to wage premiums and increasing costs/inflation pressures for businesses and customers. Inflationary pressures and resource scarcity in the economy could adversely impact customer finances, which could in turn affect asset quality.	• The Group's A Life More Virgin colleague proposition aims to address these people risks, through its attractive, progressive initiatives and its ability to offer colleagues increased flexibility and choice. • A number of well-being measures are being taken and are tracked, to ensure our colleagues remain supported and able to work safely. • The Group continuously assesses people-related risks as part of the RMF and its people strategy. • Inflationary pressures in the economy and resource availability in the marketplace are closely monitored, with impacts on our customer base assessed and mitigated as required.

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 its strategy to disrupt the status quo.

Personal accountability is at the heart of this and is enabled through the risk management accountability model, as well as the formal delegation framework. Colleagues are recruited with the core skills, abilities and attitude required for their role. They are provided with training and development to maintain and develop the required levels of competence.

Culture is shaped by many aspects including: Purpose, Values and Behaviours that set a 'Tone from Above; 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 and policies and to build constructive regulatory relationships.

The Group promotes 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 retained its focus on assessment of 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 (RAF) 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 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 Risk 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.

During the year, the Group considers the effectiveness of the Executive Committee governance framework in order to ensure it remains fit for purpose. The following Executive Committees have been established under the authority of the CEO:

Committees	**Risk focus**
Executive Leadership Team	The Executive Leadership Team supports the CEO in leading the Group to be a strong, customer-focused bank for its communities, by focusing on four strategic priorities: pioneering growth; delighting customers and colleagues, being straightforward and efficient; and being disciplined in a sustainable manner.
Executive Risk Committee	The Executive Risk Committee supports the CEO in respect of risk and control accountabilities and serves to provide leadership focus on key risk issues, including: • endorsing the RAS for approval by the Board; • overseeing and challenging the enterprise-wide risk performance and control environment of the Group and business units, including the effective use of policy, frameworks and tools; • monitoring the status of regulatory relationships, the reputation of the Group in relation to its regulators and the changing state of the regulatory landscape, including the impacts for and readiness of the Group for future changes; • monitoring the strength of risk capability and capacity, including risk training and education plans to ensure an effective risk and control framework; and • reviewing and endorsing risk policies, frameworks and tools for use across the Group.
Disclosure Committee	The Disclosure Committee is responsible for ensuring the Group complies with its continuous disclosure obligations for exchanges on which it has equity and debt securities listed.
Purpose Council	The Purpose Council oversees and manages the factors that are critical to being a Purpose-led organisation. The Council maintains focus on agreed objectives, outcomes and benefits, and focuses on removing obstacles in the way of being a Purpose-led organisation.
The Executive Risk Committee is supported by the following committees:	
Credit Risk Committee	The Credit Risk Committee is responsible for ensuring that the credit risk management framework and associated policies remain effective. The Committee has oversight of the quality, composition and concentrations of the credit risk portfolio and recommends strategies to adjust the portfolio to react to changes in market conditions.

Risk report (continued)

Risk governance and oversight (continued)

Committees	Risk focus
Enterprise Conduct Risk Committee	The Enterprise Conduct Risk Committee is responsible for overseeing the management of conduct risk across the Group (including third parties) and taking an enterprise perspective of conduct performance. The Committee also supports the Group in ensuring the right outcomes for customers and will report any material conduct themes or issues for action to the Executive Risk Committee.
Model Governance Committee	The Model Governance Committee supports the Executive Risk Committee and consequently the Board in fulfilling its governance responsibilities for material models and rating systems. The Committee oversees the integration and ongoing use of models across the Group, specifically considering the fitness for purpose, usability and scalability of models.
Reward Risk Adjustment Committee	The Reward Risk Adjustment Committee is responsible for considering and providing feedback to the Board Risk Committee and the Remuneration Committee in relation to risk events which may affect awards of variable pay and therefore ensuring that the Group complies with its regulatory requirements in respect of establishing and maintaining a robust risk adjustment process.
The Executive Leadership Team is supported by the following committees:	
Investments, Projects and Costs Committee	The Investments, Projects and Costs Committee is responsible for overseeing the management of controllable costs across the Group while supporting its growth ambitions, aligned to risk appetite.
ALCO	ALCO is responsible for monitoring the performance of the Group against the Board approved capital and funding plans. The Committee focuses on the Group's financial risks including capital, funding, liquidity and interest rate risk to ensure that the Group's activity complies with regulatory and corporate governance requirements and also delivers Group policy objectives. The impact of pension risk on capital is also assessed by ALCO.
Environment Committee	The primary role of the Environment Committee is to oversee the management of Environmental and Climate Change matters across the Group, directing resources, investment and activity. Environmental and Climate Change matters are a subset of the Group's Environment, Social and Governance (ESG) strategy.
Customer Experience Committee	The primary role of the Customer Experience Committee is to oversee the delivery of the Customer Experience Strategy and the overall holistic customer experience agenda.

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 framework, 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 key risk management principles and 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 financial, operational and compliance controls, to highlight and address any material movement in the effectiveness of those controls since the last assessment. During the year, the assessment process was updated to use risk control self-assessment data extracted directly from the Group's Operational Risk Portal, to drive a more efficient, simple and data driven process.

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 risk that would pose fundamental threats to the viability of the Group's business model.

The Group has participated in the BoE UK-wide SST for the first time during 2021. Results from the stress tests will be used by the Financial Policy Committee (FPC) to assess the stress testing severity required to threaten resilience and test the Group's ability to absorb losses and continue to lend.

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 to 11 of the Strategic report.

COVID-19 impacts on principal risks

COVID-19 continues to impact all of the Group's principal risk types. The range of governmental, regulatory and central bank support measures have created operational, conduct, enforceability and financial risks for the Group. These risks have a variety of implications which are being monitored and managed proactively in line with the Group's RMF.

Risk report (continued)
Credit risk

Credit risk overview

Close monitoring, clear policies and a disciplined approach to credit risk management support the Group's operations and have underpinned its resilience in recently challenging times.

Credit risk is the risk that a borrower or counterparty fails to pay the interest or capital due on a loan or other financial instrument. Credit risk manifests itself in the financial instruments and products that the Group offers and in which it invests and can arise in respect of both on- and off-balance sheet exposures.

Managing credit risk within our asset 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.

In the first full financial year since the onset of COVID-19 the Group remained focused on supporting customers and colleagues through this difficult period. The FY22 RAS continues to consider the impact of COVID-19 ensuring a controlled approach to portfolio management and new lending origination.

Climate risk is an increasingly important component of the broader RMF and we have recognised this through the inclusion of climate-related risk factors within the FY22 RAS. The framework has been updated to embed climate risk considerations across various aspects of customer lending and credit risk management practices. Further detail is provided in the TCFD report, on pages 218 to 234 of the Group's 2021 Annual Report and Accounts.

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) capital calculation for the Mortgage and Business portfolios and account management activity for all portfolios. Further information on the measurement and calculation of ECLs 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, which included participation in the PRA's SST for the first time this year. Stress test scenarios are regularly prepared to assess the adequacy of the Group's impairment provision and the impact on RWA 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.

As highlighted on page 10 of the Strategic report, Political and economic risk is an emerging risk for the Group and includes the future impact of macroeconomic variables which are used in the calculation of the Group's modelled ECL output. Further detail on the Group's use of macroeconomic variables in the year can be found on pages 41 to 43.

Risk report (continued)
Credit risk (continued)

Mitigation

The Group maintains a dynamic approach to credit management and takes appropriate 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 automated credit strategies, individual transactions and asset quality, analysis of the performance of the various credit portfolios, and independent oversight of credit portfolios across the Group. Portfolio monitoring techniques cover such areas as product, industry, 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 mitigating steps taken where required. Credit risk mitigation is also supported, in part, by obtaining collateral and corporate and personal guarantees where appropriate.

The key 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.

Where required, 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 LTV of up to 95%. The Group has maximum percentage LTV limits which depend upon the loan size. Product types such as buy-to-let (BTL) 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, guarantees from borrowers.

Specialist expertise
Credit quality is managed and monitored by skilled teams including, where required, specialists who provide dedicated support for vulnerable customers experiencing financial or other types of difficulties. Credit decisions utilise credit scoring techniques and/or 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. 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.

Controls over rating systems

The Group has a Model Risk Oversight team that sets common minimum standards for risk models and associated rating systems to ensure these 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 rating systems, to ensure ongoing CRR compliance.

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

<u>Derivatives</u>
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.

<u>Master netting agreements</u>
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

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 as security and other credit enhancements includes the following:

<u>Residential mortgages</u>
Residential property is the Group's main source of collateral on mortgage lending and means of mitigating loss in the event of the default 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.

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

<u>Commercial property</u>
Commercial property is the Group's main source of collateral on business lending and means of mitigating loss in the event of default. For the majority of commercial loans, collateral 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.

<u>Non-property related collateral</u>
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. It can also include specific or interlocking guarantees, and loan agreements which include affirmative and negative covenants and, in some instances, guarantees of counterparty obligations.

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

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.

Credit risk (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 including the response to COVID-19 and climate risk.
- RAS measures: Measures are reported and reviewed monthly to ensure they remain relevant and appropriately calibrated. Regular review ensures 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, product, geographical region and industry sector. In addition, single name exposure limits exist to control exposures to a single counterparty. Concentrations are also considered through the RAS process, focusing particularly on the external environment, outlook and comparison against market benchmarks.
- Single large exposure excesses: Excesses on exposures under the delegated commitment authority of the Transactional Credit Committee are reported to the committee where the amount of excess is >£250k (senior Business Credit Risk personnel have delegated authority to manage excesses <£250k). All excess reports include a proposed route to remediation. Exposures are also managed in accordance with the large exposure reporting requirements of the CRR.

Forbearance

Forbearance is considered to exist where customers are experiencing or about to experience financial difficulty and the Group grants a concession on a non-commercial basis. 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.

In dealing with the exceptional challenges posed by COVID-19 and to ensure the appropriate delivery of customer support, a number of concessions were granted in response to the short-term financial consequences for customers in line with regulatory guidance, including for example payment holidays. These measures were not considered to be forbearance, as confirmed by the regulatory guidance, for the purposes of reporting forborne loans at 30 September 2020. The standard approach of classifying such concessions as forbearance has resumed in the current year.

Other measures to support customers

The Debt Respite Scheme came into force on 4 May 2021 and establishes a scheme which gives eligible individuals in England and Wales with problem debt, the right to legal protection from their creditors, including almost all enforcement action, during a period of 'breathing space'. The Breathing Space Regulations do not apply to mortgages, except for arrears which are uncapitalised at the date of the application under the Breathing Space Regulations. In Scotland, eligible individuals are afforded similar legal protection under the Bankruptcy (Scotland) Act 2016.

The Group implemented the changes required by these regulations in advance of the 4 May 2021 implementation date.

Measuring credit risk within our asset portfolios

The Group adopts two approaches in the measurement of credit risk under International Financial Reporting Standard (IFRS) 9:

Individually assessed
A charge is taken to the income statement when an individually assessed provision has been recognised or a direct write-off has been applied to an asset balance. These will be classified as Stage 3.

Collectively assessed
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.

Measuring credit risk within our asset portfolios (continued)

Collectively assessed (continued)

At each reporting date, the Group assesses financial assets measured at amortised cost, as well as loan commitments and financial guarantees, 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.

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.

The calculated model 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) since initial recognition.
Stage 2	Lifetime	A loan that has experienced a SICR since initial recognition but is not yet deemed to be credit-impaired.
Stage 3	Lifetime	A loan that is credit-impaired.

In addition, 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 any changes to its credit quality. POCI financial assets are included 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 the PD since origination. Absent any specific SICR factors, the Group operates a 30 days past due (DPD) back-stop for classification as Stage 2 assets, and 90 DPD for Stage 3 assets. Forborne exposures can be classed as either Stage 2 or Stage 3 depending on the type of forbearance programme that has been applied to the customer.

The SICR criteria and triggers are parameters within the ECL calculation process and, as such, are considered under the same governance pathway as the Group's IFRS 9 models. This means that any changes to the triggers are initially submitted to and endorsed by the Credit Model Technical Forum with formal approval provided by the Model Governance Committee.

The Credit Risk Committee provide oversight on the adequacy of ECL provisioning with reviews and robust challenge of the calculation and management judgement recommendations. This includes the rationale behind the inclusion of PMAs, the basis on which these are calculated and the proposed timeline for their release.

The Boards' Audit Committee provides a further layer of oversight to the calculation and measurement of ECL with reviews and robust challenge of all calculated outcomes and management judgements.

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

The approach to calculating credit losses differs between the accounting and regulatory frameworks that the Group reports under, with the most significant difference being that the concept of SICR, which moves exposures from a 12-month to a lifetime ECL calculation in the accounting framework, does not exist under the regulatory framework (either Standardised or IRB). The approach to staging under IFRS 9 is also not applicable under regulatory credit loss reporting.

Both frameworks calculate credit losses under a PD x LGD x EAD approach, with the regulatory IRB approach assessing these in the next 12 months whereas the accounting framework under IFRS 9 requires these to be assessed with a forward-looking view with a lifetime loss calculated where appropriate. Credit losses are only supplemented by management judgements in the form of PMAs, where required, under the accounting framework.

Both the accounting and regulatory definitions of default are aligned with default being triggered at 90 days past due, with the exception of the heritage Virgin Money mortgage models, which apply a 180 days past due regulatory default trigger under existing approved permissions. The definition of default will be fully aligned to 90 days past due when the regulatory models are updated in line with hybrid model adoption.

The Group aligns the regulatory cure periods for forborne exposures in its IFRS 9 staging criteria at a minimum period of either 24 or 36 months depending on the forbearance programme utilised. Where exposures are classified as Stages 2 or 3 as a result of not being in a forbearance programme, these can cure when the relevant staging trigger is removed and no longer applicable.

Risk report (continued)
Credit risk (continued)

Group credit risk exposures

The Group is exposed to credit risk across all of its financial asset classes, however its principal exposure to credit risk arises on customer lending balances. Given the relative significance of customer lending exposures to the Group's overall credit risk position the disclosures within the following pages of the risk report are principally focused on customer lending.

The Group is also exposed to credit risk on its other banking and treasury-related activities. £7.9bn of cash is held with the BoE (2020: £7.2bn), and balances with other banks are all held with senior investment grade counterparties. No material ECL provisions are currently held for these exposures, with all other banking and treasury related financial assets being classed as Stage 1 financial assets under IFRS 9.

The table below shows the Group's maximum exposure to credit risk on its financial assets, contingent liabilities and credit-related commitments.

Maximum exposure to credit risk on financial assets, contingent liabilities and credit-related commitments (audited)

2021	Gross loans and advances to customers £m	Contingent liabilities and credit-related commitments £m	Total £m
Mortgages	**58,441**	**2,845**	**61,286**
Personal	**5,770**	**10,507**	**16,277**
Business	**8,338**	**3,769**	**12,107**
Total	**72,549**	**17,121**	**89,670**
Impairment provisions held on credit exposures(1)	**(496)**	**(8)**	**(504)**
Fair value hedge adjustment	**(179)**	**-**	**(179)**
Maximum credit risk exposure on lending assets	**71,874**	**17,113**	**88,987**
Cash and balances with central banks			**9,711**
Financial instruments at FVOCI			**4,352**
Due from other banks			**800**
Other financial assets at fair value			**149**
Due from related entities			**4**
Derivative financial assets			**140**
Maximum credit risk exposure on all financial assets(2)			**104,143**

2020			
Mortgage	58,652	3,088	61,740
Personal	5,550	9,674	15,224
Business	8,721	4,108	12,829
Total	72,923	16,870	89,793
Impairment provisions held on credit exposures(1)	(735)	-	(735)
Fair value hedge adjustment	240	-	240
Maximum credit risk exposure on lending assets	72,428	16,870	89,298
Cash and balances with central banks			9,107
Financial instruments at FVOCI			5,080
Due from other banks			927
Other financial assets at fair value			191
Due from related entities			11
Derivative financial assets			318
Maximum credit risk exposure on all financial assets(2)			104,932

(1) The provision of £504m in the current year includes £8m for off-balance sheet exposures. A change to the accounting presentation was made in the year, with the on-balance sheet ECL continuing to be reflected in loans and advances to customers (note 3.1) and the off-balance sheet ECL now separately disclosed as part of the provision for liabilities and charges balance in note 3.14. The off-balance sheet provision, which relates to credit-related commitments, was £7m at 30 September 2020; the prior period comparatives have not been restated. All tables and ratios that follow are calculated using the combined on- and off-balance sheet ECL, which is consistent for all periods reported.

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

Group credit highlights (audited)

In addition to the balance sheet position on the previous page, key metrics of relevance for an understanding of the Group's credit risk position are as follows.

	2021 £m	2020 £m
Impairment (credit)/charge on credit exposures		
Mortgage lending	**(44)**	95
Personal lending	**(32)**	223
Business lending	**(55)**	183
Total Group impairment (credit)/charge[1]	**(131)**	501
Key asset quality ratios		
Underlying impairment (credit)/charge[2] to average customer loans (cost of risk)	**(0.18%)**	0.68%
% Loans in Stage 2	**14.09%**	17.70%
% Loans in Stage 3	**1.32%**	1.19%
Total book coverage[3]	**0.70%**	1.03%
Stage 2 coverage[3]	**3.02%**	3.66%
Stage 3 coverage[3]	**9.59%**	15.73%

(1) See note 3.2 for further details.
(2) Inclusive of gains/losses on assets held at fair value and elements of fraud loss. In the prior year, this excluded the acquisition accounting impact on impairment losses of £6m.
(3) Excludes the guaranteed element of government-backed loan schemes.

The first full financial year post-pandemic saw relative stability in the lending book, as the Group continued to focus efforts on supporting customers through this challenging period at a time when demand for new origination was more muted. As a result, total gross loans and advances to customers decreased by £0.4bn from £72.9bn to £72.5bn.

Despite the challenging environment, asset quality metrics have on the whole remained positive with no evidence of material deterioration to date. The proportion of Group lending not yet past due at the reporting date remains high at 98.2% (2020: 98.3%). This has been influenced by the extended period of customer support measures plus prudent actions taken by customers, combined with the Group's controlled risk appetite and continued focus on responsible lending decisions.

Steady improvement in wider economic conditions as the year progressed supported a reduction in the Group's impairment provision from £735m at 30 September 2020 to £504m as at 30 September 2021. This reduction was driven mainly by more favourable macroeconomic inputs to the IFRS 9 models which led to the modelled ECL provision falling by £252m in the year. While the post-pandemic outlook is undoubtedly more positive than previously indicated, the Group has nevertheless maintained PMAs of £207m (2020: £186m) to address the residual risk of further deterioration for certain customers as government support is fully withdrawn as currently planned over the coming year. Although broadly stable at a total level year-on-year, there has been a shift in composition of PMAs across the product portfolios, with a reduction in PMAs held for the Mortgage and Personal lending books, offset by the establishment of a targeted PMA for the business lending portfolio. Further detail on the nature of each PMA is provided in the respective product performance section on the following pages.

The reduction in provision in the year has given rise to an impairment credit in the income statement of £131m (2020: charge of £501m), and associated cost of risk for the year of (18)bps (2020: 68bps). The year-on-year reduction in total book coverage from 103bps to 70bps reflects improving economic conditions and underlying asset quality metrics together with a more targeted provisioning approach to more vulnerable business sectors.

The tables below and on the following pages provide information on the staging profile of the Group's customer lending portfolios which are key for understanding the asset quality of the portfolios. Refer to pages 28 to 38 for further commentary explaining movements and trends at a portfolio level:

Gross loans and advances(1) ECL and coverage (audited)

			Personal									
	Mortgages		Cards		Loans and Overdrafts		Combined		Business(2)		Total	
2021	**£m**	**%**	**£m**	**%**	**£m**	**%**	**£m**	**%**	**£m**	**%**	**£m**	**%**
Stage 1	50,596	86.6%	4,100	88.1%	1,048	94.0%	5,148	89.2%	5,672	68.0%	61,416	84.7%
Stage 2 – total	7,192	12.3%	497	10.7%	56	5.0%	553	9.6%	2,431	29.2%	10,176	14.0%
Stage 2: 0 DPD	6,918	11.9%	466	10.1%	46	4.2%	512	8.9%	2,388	28.7%	9,818	13.5%
Stage 2: < 30 DPD	128	0.2%	16	0.3%	5	0.4%	21	0.4%	25	0.3%	174	0.2%
Stage 2: > 30 DPD	146	0.2%	15	0.3%	5	0.4%	20	0.3%	18	0.2%	184	0.3%
Stage 3(3)	653	1.1%	58	1.2%	11	1.0%	69	1.2%	235	2.8%	957	1.3%
	58,441	100.0%	4,655	100.0%	1,115	100.0%	5,770	100.0%	8,338	100.0%	72,549	100.0%
ECLs												
Stage 1	4	4.6%	32	20.0%	9	26.5%	41	21.1%	66	29.6%	111	22.0%
Stage 2 – total	64	73.6%	99	61.9%	19	55.9%	118	60.9%	120	53.8%	302	59.9%
Stage 2: 0 DPD	61	70.2%	82	51.3%	13	38.2%	95	49.0%	120	53.8%	276	54.8%
Stage 2: < 30 DPD	1	1.1%	8	5.0%	2	5.9%	10	5.2%	-	-	11	2.1%
Stage 2: > 30 DPD	2	2.3%	9	5.6%	4	11.8%	13	6.7%	-	-	15	3.0%
Stage 3(3)	19	21.8%	29	18.1%	6	17.6%	35	18.0%	37	16.6%	91	18.1%
	87	100.0%	160	100.0%	34	100.0%	194	100.0%	223	100.0%	504	100.0%
Coverage												
Stage 1		0.01%		0.85%		1.13%		0.91%		1.35%		0.18%
Stage 2 – total		0.88%		22.12%		42.01%		23.92%		5.43%		3.02%
Stage 2: 0 DPD		0.87%		19.51%		33.66%		20.64%		5.48%		2.84%
Stage 2: < 30 DPD		0.85%		58.36%		52.88%		57.27%		1.51%		6.90%
Stage 2: > 30 DPD		1.36%		64.46%		99.65%		73.48%		2.85%		8.99%
Stage 3(3)		2.81%		54.13%		64.02%		55.65%		17.31%		9.59%
		0.15%		3.79%		3.86%		3.80%		3.06%		0.70%

			Personal									
	Mortgages		Cards		Loans and Overdrafts		Combined		Business(2)		Total	
2020	£m	%	£m	%	£m	%	£m	%	£m	%	£m	%
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 – total	8,166	13.9%	519	11.6%	304	28.0%	823	14.8%	3,853	44.2%	12,842	17.6%
Stage 2: 0 DPD	7,826	13.3%	500	11.2%	292	26.9%	792	14.3%	3,823	43.9%	12,441	17.1%
Stage 2: < 30 DPD	150	0.3%	12	0.2%	6	0.5%	18	0.3%	20	0.2%	188	0.2%
Stage 2: > 30 DPD	190	0.3%	7	0.2%	6	0.6%	13	0.2%	10	0.1%	213	0.3%
Stage 3(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 – total	95	72.5%	147	66.2%	47	59.5%	194	64.4%	176	58.1%	465	63.3%
Stage 2: 0 DPD	79	60.3%	133	59.9%	42	53.2%	175	58.1%	175	57.8%	429	58.4%
Stage 2: < 30 DPD	5	3.8%	8	3.6%	2	2.5%	10	3.3%	1	0.3%	16	2.2%
Stage 2: > 30 DPD	11	8.4%	6	2.7%	3	3.8%	9	3.0%	-	-	20	2.7%
Stage 3(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%		1.40%		0.24%
Stage 2 – total		1.17%		30.40%		17.64%		25.81%		4.59%		3.66%
Stage 2: 0 DPD		1.01%		28.76%		16.07%		23.85%		4.60%		3.48%
Stage 2: < 30 DPD		3.43%		70.04%		45.76%		165.97%		2.49%		8.99%
Stage 2: > 30 DPD		5.98%		76.86%		74.28%		75.83%		5.12%		9.73%
Stage 3(3)		4.31%		57.48%		79.43%		62.05%		26.74%		15.74%
		0.23%		5.37%		8.24%		5.91%		3.87%		1.03%

(1) Excludes loans designated at fair value through profit or loss (FVTPL), balances due from customers on acceptances, accrued interest and deferred and unamortised fee income.

(2) Business and total coverage ratio excludes the guaranteed element of government-backed loans.

(3) Stage 3 includes POCI for gross loans and advances of £67m for Mortgages and £2m for Personal (30 September 2020: £86m and £4m respectively); and ECL of £Nil for Mortgages and £2m for Personal (2020: £Nil and (£2m) respectively).

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 being classed as Stage 2:

			Personal									
	Mortgages		**Cards**		**Loans and Overdrafts**		**Combined**		**Business**[(2)]		**Total**	
2021	**£m**	**%**	**£m**	**%**	**£m**	**%**	**£m**	**%**	**£m**	**%**	**£m**	**%**
PD deterioration	**6,100**	**85%**	**300**	**60%**	**48**	**86%**	**348**	**63%**	**1,443**	**59%**	**7,891**	**78%**
Forbearance	**176**	**2%**	**11**	**2%**	**3**	**5%**	**14**	**3%**	**374**	**15%**	**564**	**6%**
AFD or Watch List[(1)]	**11**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**584**	**24%**	**595**	**6%**
> 30 DPD	**146**	**2%**	**15**	**3%**	**5**	**9%**	**20**	**4%**	**18**	**1%**	**184**	**2%**
Other[(2)]	**759**	**11%**	**171**	**35%**	**-**	**-**	**171**	**30%**	**12**	**1%**	**942**	**8%**
	7,192	**100%**	**497**	**100%**	**56**	**100%**	**553**	**100%**	**2,431**	**100%**	**10,176**	**100%**
ECLs												
PD deterioration	**43**	**67%**	**51**	**52%**	**14**	**74%**	**65**	**55%**	**52**	**43%**	**160**	**53%**
Forbearance	**4**	**6%**	**2**	**2%**	**1**	**5%**	**3**	**3%**	**24**	**20%**	**31**	**10%**
AFD or Watch List[(1)]	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**32**	**27%**	**32**	**11%**
> 30 DPD	**2**	**3%**	**9**	**9%**	**4**	**21%**	**13**	**11%**	**-**	**-**	**15**	**5%**
Other[(2)]	**15**	**24%**	**37**	**37%**	**-**	**-**	**37**	**31%**	**12**	**10%**	**64**	**21%**
	64	**100%**	**99**	**100%**	**19**	**100%**	**118**	**100%**	**120**	**100%**	**302**	**100%**

			Personal									
	Mortgages		Cards		Loans and Overdrafts		Combined		Business[(2)]		Total	
2020	£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	-	-	-	-	-	-	-	586	15%	599	5%
> 30 DPD	190	2%	7	1%	6	2%	13	2%	10	-	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)]	-	-	-	-	-	-	-	-	37	21%	37	8%
> 30 DPD	11	12%	6	4%	3	6%	9	5%	-	-	20	4%
Other[(2)]	16	17%	50	34%	-	-	50	25%	5	3%	71	15%
	95	100%	147	100%	47	100%	194	100%	176	100%	465	100%

(1) Approaching Financial Difficulty (AFD) and Watch markers are early warning indicators of Business 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 high indebtedness, county court judgement and previous arrears, 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:

		Gross carrying value[(1)]							
		Stage 1		**Stage 2**		**Stage 3[(2)]**		**Total**	
2021		**£m**	**%**	**£m**	**%**	**£m**	**%**	**£m**	**%**
Mortgages	**PD range**								
Strong	0 – 0.74	**46,984**	**93%**	**4,555**	**63%**	**-**	**-**	**51,539**	**88%**
Good	0.75 – 2.49	**3,313**	**6%**	**1,888**	**27%**	**-**	**-**	**5,201**	**9%**
Satisfactory	2.50 – 99.99	**299**	**1%**	**749**	**10%**	**-**	**-**	**1,048**	**2%**
Default	100	**-**	**-**	**-**	**-**	**653**	**100%**	**653**	**1%**
Total		**50,596**	**100%**	**7,192**	**100%**	**653**	**100%**	**58,441**	**100%**
Personal									
Strong	0 – 2.49	**4,730**	**92%**	**85**	**15%**	**-**	**-**	**4,815**	**83%**
Good	2.50 – 9.99	**411**	**8%**	**325**	**59%**	**-**	**-**	**736**	**13%**
Satisfactory	10.00 – 99.99	**7**	**-**	**143**	**26%**	**-**	**-**	**150**	**3%**
Default	100	**-**	**-**	**-**	**-**	**69**	**100%**	**69**	**1%**
Total		**5,148**	**100%**	**553**	**100%**	**69**	**100%**	**5,770**	**100%**
Business									
Strong	0 – 0.74	**3,298**	**58%**	**505**	**21%**	**-**	**-**	**3,803**	**46%**
Good	0.75 – 9.99	**2,374**	**42%**	**1,821**	**75%**	**-**	**-**	**4,195**	**50%**
Satisfactory	10.00 – 99.99	**-**	**-**	**105**	**4%**	**-**	**-**	**105**	**1%**
Default	100	**-**	**-**	**-**	**-**	**235**	**100%**	**235**	**3%**
Total		**5,672**	**100%**	**2,431**	**100%**	**235**	**100%**	**8,338**	**100%**

		Gross carrying value[(1)]							
		Stage 1		Stage 2		Stage 3[(2)]		Total	
2020		£m	%	£m	%	£m	%	£m	%
Mortgages	**PD range**								
Strong	0 – 0.74	44,038	88%	3,785	46%	-	-	47,823	81%
Good	0.75 – 2.49	5,246	11%	2,879	35%	-	-	8,125	14%
Satisfactory	2.50 – 99.99	686	1%	1,502	19%	-	-	2,188	4%
Default	100	-	-	-	-	516	100%	516	1%
Total		49,970	100%	8,166	100%	516	100%	58,652	100%
Personal									
Strong	0 – 2.49	4,144	89%	183	22%	-	-	4,327	78%
Good	2.50 – 9.99	500	11%	478	58%	-	-	978	18%
Satisfactory	10.00 – 99.99	16	-	162	20%	-	-	178	3%
Default	100	-	-	-	-	67	100%	67	1%
Total		4,660	100%	823	100%	67	100%	5,550	100%
Business									
Strong	0 – 0.74	791	17%	150	4%	-	-	941	11%
Good	0.75 – 9.99	3,674	80%	2,733	71%	-	-	6,407	73%
Satisfactory	10.00 – 99.99	124	3%	970	25%	-	-	1,094	13%
Default	100	-	-	-	-	279	100%	279	3%
Total		4,589	100%	3,853	100%	279	100%	8,721	100%

(1) The information presented in the table excludes the impact of PD neutralisation and Sector stress PMAs on the business portfolio. Refer to narrative disclosures on pages 35 and 36 for more information on the PMAs.

(2) Stage 3 includes POCI of £67m for Mortgages and £2m for Personal (2020: £86m and £4m respectively).

In terms of credit quality, 97% (2020: 95%) of the loan commitments and financial guarantee contracts were classed as either 'Good' or 'Strong' under the Group's internal PD rating scale.

Risk report (continued)
Credit risk (continued)

Movement in gross lending balances and impairment loss allowance (audited)

The following table shows the changes in the loss allowance and gross carrying value of the portfolios. 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 period, thereby incorporating all movements an account has made during the year.

	Stage 1		**Stage 2**		**Stage 3**(1)			
2021	**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 2020	**59,219**	**136**	**12,842**	**465**	**862**	**134**	**72,923**	**735**
Transfers from Stage 1 to Stage 2	**(11,131)**	**(62)**	**11,076**	**389**	**-**	**-**	**(55)**	**327**
Transfers from Stage 2 to Stage 1	**10,397**	**58**	**(10,484)**	**(284)**	**-**	**-**	**(87)**	**(226)**
Transfers to Stage 3	**(115)**	**(1)**	**(623)**	**(91)**	**734**	**108**	**(4)**	**16**
Transfers from Stage 3	**33**	**-**	**217**	**23**	**(253)**	**(25)**	**(3)**	**(2)**
Changes to model methodology	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
New assets originated or purchased(2)	**19,276**	**206**	**1,621**	**158**	**132**	**22**	**21,029**	**386**
Repayments and other movements(3)	**(2,955)**	**(59)**	**(933)**	**(140)**	**(16)**	**(72)**	**(3,904)**	**(271)**
Repaid or derecognised(3)	**(13,308)**	**(167)**	**(3,540)**	**(218)**	**(376)**	**(55)**	**(17,224)**	**(440)**
Write-offs	**-**	**-**	**-**	**-**	**(126)**	**(126)**	**(126)**	**(126)**
Cash recoveries	**-**	**-**	**-**	**-**	**-**	**26**	**-**	**26**
Individually assessed impairment charge	**-**	**-**	**-**	**-**	**-**	**79**	**-**	**79**
Closing balance at 30 September 2021	**61,416**	**111**	**10,176**	**302**	**957**	**91**	**72,549**	**504**

	Stage 1		Stage 2		Stage 3(1)			
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(2)	18,380	96	1,349	90	150	15	19,879	201
Repayments and other movements(3)	(3,454)	67	2,304	150	40	(49)	(1,110)	168
Repaid or derecognised(3)	(13,658)	(53)	(1,747)	(108)	(267)	(63)	(15,672)	(224)
Write-offs	-	-	-	-	(159)	(159)	(159)	(159)
Cash recoveries	-	-	-	-	-	25	-	25
Individually assessed impairment charge	-	-	-	-	-	139	-	139
Closing balance at 30 September 2021	59,219	136	12,842	465	862	134	72,923	735

(1) Stage 3 includes POCI for gross loans and advances of £67m for Mortgages and £2m for Personal (2020: £86m and £4m respectively), and ECL of £Nil for Mortgages and (£2m) for Personal (2020: £Nil and (£2m) respectively).

(2) Includes assets where the term has ended, and a new facility has been provided.

(3) 'Repayments' comprises payments made on customer lending which are not yet fully paid at the reporting date and the customer arrangement remains live at that date. 'Repaid' refers to payments made on customer lending which is either fully repaid or derecognised by the reporting date and the customer arrangement is therefore closed at that date.

In addition to the above on-balance sheet position, the Group also has £17,121m of loan commitments and financial guarantee contracts (2020: £16,870m) of which £16,001m (93.5%) are held under Stage 1, £1,090m in Stage 2 and £30m in Stage 3 (2020: £15,155m (89.8%) held under Stage 1, £1,666m in Stage 2 and £49m in Stage 3). ECLs of £8m (2020: £7m) are included in the table above, of which £2m (2020: £1m) is held under Stage 1 and £6m (2020: £6m) under Stage 2.

Stage migrations in the year drove a net increase in ECL of £115m, lower than the prior year net increase of £237m, reflecting year-on-year improvement in the staging profile consistent with other asset quality metrics. A higher level of customer repayment activity occurred in the current year as customers sought to deleverage as much as possible. Low levels of default were evident across the portfolio.

The contractual amount outstanding on loans and advances that were written off during the reporting period or still subject to enforcement activity was £2.6m (2020: £4.1m). The Group has not purchased any lending assets in the year (2020: none). Further information on staging profile is provided at a portfolio level in the respective portfolio performance section on the following pages.

Risk report (continued)
Credit risk (continued)

Mortgage credit performance

The table below presents key information which is important for understanding the asset quality of the Group's Mortgage portfolio and should be read in conjunction with the supplementary data presented in the following pages of this section.

Breakdown of Mortgage portfolio

2021	**Gross lending £m**	**Modelled ECL £m**	**PMA £m**	**Total ECL £m**	**Net lending £m**	**Coverage %**	**Average LTV %**
Residential – capital repayment	**35,192**	**19**	**21**	**40**	**35,152**	**0.10**	**57.2%**
Residential – interest only	**8,341**	**6**	**2**	**8**	**8,333**	**0.10**	**47.2%**
BTL	**14,908**	**8**	**31**	**39**	**14,869**	**0.24**	**54.8%**
Total Mortgage portfolio	**58,441**	**33**	**54**	**87**	**58,354**	**0.15**	**55.3%**
2020							
Residential – capital repayment	36,125	36	51	87	36,038	0.22	59.4%
Residential – interest only	7,940	9	13	22	7,918	0.27	49.4%
BTL	14,587	11	11	22	14,565	0.12	56.0%
Total Mortgage portfolio	58,652	56	75	131	58,521	0.23	57.3%

The Mortgage portfolio has shown continued strength and resilience, with gross lending relatively stable year-on-year at £58bn. Of this, 98.4% of the portfolio was not past due at the reporting date (2020: 98.5%), a continuation of historic trends which reflect the quality of the portfolio which has been built with robust underwriting standards and affordability checks. The relative stability in the book and low LTV mix of the portfolio mirrors conditions in the UK housing market, which recovered well following the easing of government restrictions.

The initial deterioration in the economic environment resulted in the migration of balances from Stage 1 to Stage 2 'not past due' in the prior year; this trend reversed in the current year with a decrease of 1.4% from Stage 2 'not past due' to Stage 1. There was only modest migration to the other categories of Stage 2 or Stage 3.

Typical of our book, the average LTV remained low at 55.3% (2020: 57.3%). While there was a £0.2bn increase in the value of mortgages in forbearance, this has also remained at a relatively low overall level of 1.43% (2020: 1.08%) of the total mortgage book. This has been driven primarily by an increase in mortgages converting to interest only terms for a short-term period, where the Group has sought to engage with and support customers through periods of temporary financial difficulty resulting from COVID-19. Further detail on LTV bandings and forbearance measures is provided on the following pages.

The improving economic outlook has driven more favourable macroeconomic assumptions leading to a reduction in the modelled ECL provision from £56m to £33m at 30 September 2021. Notwithstanding the more encouraging signs of economic recovery on the horizon, certain PMA's have been maintained to address areas of potential vulnerability within the data inputs to the credit models. The most significant of these relate to payment holidays across the Mortgage portfolio of £22m (2020: £43m), and a specific PMA for the BTL book of £28m (2020: £6m).

Government support for customers through payment holidays was vital for a short period in preventing those customers from falling into delinquency as a direct result of COVID-19. The granting of payment holidays does however suppress the level of delinquency that would otherwise have been expected, as such a PMA of £43m was established in the prior year to address this; the PMA has subsequently reduced in the current year reflecting the successful exit from payment holiday arrangements for the majority of impacted customers, with a £22m PMA maintained to address the likelihood of certain customers experiencing financial distress.

The BTL book has seen a slight increase in the year and by its nature is more exposed to customers experiencing rental voids as their tenants are often younger and working in sectors impacted by COVID-19. The increase in the associated PMA from £6m to £28m reflects a more cautious approach on this component of the book and has driven up BTL book coverage from a modest 12bps at 30 September 2020 to a more conservative 24bps at 30 September 2021.

Together with other lower value PMAs of £4m (2020: £26m), this brings the total ECL provision at 30 September 2021 to £87m (2020: £131m). The reduction in provision in the year has given rise to an impairment credit in the income statement of £44m (2020: charge of £95m).

Overall, coverage levels remain substantially ahead of the pre-pandemic level of 7bps, with the reduction in the year from 23bps to 15bps reflecting more favourable macroeconomic assumptions and a re-balancing of PMAs in the context of a high-quality low-LTV portfolio where customers, to date, have proven to be resilient with the vast majority continuing to meet their repayment obligations.

Mortgage credit performance (continued)

Collateral

The quality of the Group's Mortgage portfolio can be considered in terms of the average LTV of the portfolio and the staging of the portfolio, as set out in the following tables:

Average LTV of Mortgage portfolio by staging (audited)

2021	**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%	**19,907**	**39%**	**1**	**2,268**	**32%**	**6**	**274**	**41%**	**2**	**22,449**	**38%**	**9**
50% to 75%	**24,383**	**49%**	**1**	**3,648**	**51%**	**37**	**256**	**39%**	**3**	**28,287**	**49%**	**41**
76% to 80%	**3,123**	**6%**	**1**	**729**	**10%**	**9**	**49**	**8%**	**1**	**3,901**	**7%**	**11**
81% to 85%	**2,346**	**5%**	**1**	**426**	**6%**	**6**	**30**	**5%**	**1**	**2,802**	**5%**	**8**
86% to 90%	**715**	**1%**	**-**	**102**	**1%**	**3**	**17**	**3%**	**1**	**834**	**1%**	**4**
91% to 95%	**79**	**-**	**-**	**7**	**-**	**-**	**8**	**1%**	**1**	**94**	**-**	**1**
96% to 100%	**8**	**-**	**-**	**2**	**-**	**-**	**5**	**1%**	**-**	**15**	**-**	**-**
Greater than 100%	**35**	**-**	**-**	**10**	**-**	**3**	**14**	**2%**	**10**	**59**	**-**	**13**
	50,596	**100%**	**4**	**7,192**	**100%**	**64**	**653**	**100%**	**19**	**58,441**	**100%**	**87**

2020	Stage 1			Stage 2			Stage 3(2)			Total		
LTV(1)	Loans £m	%	ECL £m	Loans £m	%	ECL £m	Loans £m	%	ECL(3) £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	-	-	21	-	1	6	1%	1	83	-	2
Greater than 100%	43	-	1	10	-	1	22	4%	4	75	-	6
	49,970	100%	14	8,166	100%	95	516	100%	22	58,652	100%	131

(1) LTV of the Mortgage portfolio is defined as Mortgage portfolio weighted by balance. The portfolio is indexed using the MIAC Acadametrics indices at a given date.
(2) Stage 3 includes £67m (2020: £86m) of POCI gross loans and advances.
(3) The comparative has been restated in line with the current year presentation.

The Mortgage portfolio remains very well secured with 86.8% of mortgages, by loan value, having an indexed LTV less than 75% (2020: 82.8%), and an average portfolio LTV of 55.3% (2020: 57.3%). The proportion of mortgages with an LTV greater than 90% has also reduced in the year from 1.9% to 0.3%, evidencing the extent to which property prices have shown resilience during the past year with strong demand and support, for example in the form of the Stamp Duty holiday which was extended through to 30 June 2021.

Mortgage credit performance (continued)

Forbearance (audited)

A key indicator of underlying Mortgage portfolio health is the level of loans subject to forbearance measures. Forbearance can occur when a customer experiences longer-term financial difficulty. In such circumstances, the Group considers the customer's individual circumstances, uses judgement in assessing whether SICR, an impairment or default event has occurred, and then applies tailored forbearance measures in order to support the customer in a route to stability. 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.

The table below summarises the level of forbearance in respect of the Group's Mortgage portfolio at each balance sheet date. All balances subject to forbearance are classed as either Stage 2 or Stage 3 for ECL purposes.

	Total loans and advances subject to forbearance measures			Impairment allowance on loans and advances subject to forbearance measures	
2021	**Number of loans**	**Gross carrying amount £m**	**% of total portfolio**	**Impairment allowance £m**	**Coverage %**
Formal arrangements	**1,115**	**133**	**0.23**	**4.9**	**3.66**
Temporary arrangements	**675**	**100**	**0.17**	**6.8**	**6.81**
Payment arrangement	**1,865**	**176**	**0.30**	**2.3**	**1.30**
Payment holiday(1)	**1,436**	**123**	**0.21**	**0.5**	**0.41**
Interest only conversion	**1,390**	**273**	**0.47**	**1.3**	**0.47**
Term extension	**127**	**12**	**0.02**	**0.1**	**0.57**
Other	**19**	**2**	**0.01**	**-**	**0.68**
Legal	**116**	**11**	**0.02**	**0.3**	**3.09**
Total mortgage forbearance	**6,743**	**830**	**1.43**	**16.2**	**1.95**
2020					
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)	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

(1) In the prior year, payment holidays granted in line with regulation were not classified as forbearance due to the extenuating circumstances arising from COVID-19. The standard approach of classifying payment holidays as forbearance has resumed in the current year.

As at 30 September 2021, forbearance totalled £830m (6,743 customers), an increase from the 30 September 2020 position of £636m (5,621 customers). This represents 1.43% of total mortgage balances (2020: 1.08%) with the year-on-year increase primarily driven by temporary interest only conversion. This concession has been offered to support those customers who, in reaching the end of their payment deferral term, continued to experience short-term financial difficulty or who opted to make a partial payment rather than full payment deferral.

When all other avenues of resolution, including forbearance, have been explored, the Group will take steps to repossess and sell underlying collateral. In the year to 30 September 2021, there were 33 repossessions of which 13 were voluntary (2020: 57 including 21 voluntary). The key driver of the reduction was the possession moratorium, part of the government's measures to support borrowers throughout COVID-19.

Risk report (continued)
Credit risk (continued)

Mortgage credit performance (continued)

IFRS 9 staging (audited)

The Group closely monitors the staging profile of the Mortgage portfolio over time which can be indicative of general trends in book health. Movements in the staging profile of the portfolio in the current and prior year are presented in the tables below.

	Stage 1		Stage 2		Stage 3(1)			
2021	**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 2020	**49,970**	**14**	**8,166**	**95**	**516**	**22**	**58,652**	**131**
Transfers from Stage 1 to Stage 2	**(8,172)**	**(4)**	**8,140**	**113**	**-**	**-**	**(32)**	**109**
Transfers from Stage 2 to Stage 1	**7,479**	**5**	**(7,522)**	**(101)**	**-**	**-**	**(43)**	**(96)**
Transfers to Stage 3	**(64)**	**-**	**(367)**	**(9)**	**429**	**7**	**(2)**	**(2)**
Transfers from Stage 3	**24**	**-**	**108**	**13**	**(137)**	**(4)**	**(5)**	**9**
Changes to model methodology	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
New assets originated or purchased	**9,662**	**2**	**76**	**2**	**2**	**-**	**9,740**	**4**
Repayments and other movements	**(2,141)**	**(11)**	**(405)**	**(36)**	**(38)**	**(3)**	**(2,584)**	**(50)**
Repaid or derecognised	**(6,162)**	**(2)**	**(1,004)**	**(13)**	**(118)**	**(2)**	**(7,284)**	**(17)**
Write-offs	**-**	**-**	**-**	**-**	**(1)**	**(1)**	**(1)**	**(1)**
Cash recoveries	**-**	**-**	**-**	**-**	**-**	**1**	**-**	**1**
Individually assessed impairment charge	**-**	**-**	**-**	**-**	**-**	**(1)**	**-**	**(1)**
Closing balance at 30 September 2021	**50,596**	**4**	**7,192**	**64**	**653**	**19**	**58,441**	**87**

	Stage 1		Stage 2		Stage 3(1)			
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	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 2021	49,970	14	8,166	95	516	22	58,652	131

(1) Stage 3 includes POCI for gross loans and advances of £67m and ECL of £Nil (2020: £86m and £Nil respectively).

The application of more positive economic forecasts has increased the level of mortgage lending classed as Stage 1 to 86.6% (2020: 85.2%), with a corresponding decrease of assets in Stage 2 from 13.9% to 12.3%. Of the Stage 2 category, 11.9% is not yet past due at the balance sheet date (2020: 13.3% not yet past due), but falls into Stage 2 classification due predominantly to PD deterioration. The proportion of mortgages classified as Stage 3 remains modest at 1.1% (2020: 0.9%).

These conditions have also contributed to an increase in assets classed as 'Strong' from 81% at 30 September 2020 to 88% at 30 September 2021, with over 97% (2020: 95%) of the Mortgage portfolio now classed as 'Good' or 'Strong'.

The high proportion of mortgages not yet past due at the balance sheet date of 98.4% (2020: 98.5%) along with the improvement in internal PD ratings and high quality of collateral underpinning the book are key factors supporting the lower level of provision coverage required for this portfolio.

Personal credit performance

The table below presents key information which is important for understanding the asset quality of the Group's Personal lending portfolio and should be read in conjunction with the supplementary data presented in the following pages of this section.

Breakdown of Personal credit portfolio

2021	Gross lending £m	Modelled ECL £m	PMA £m	Total ECL £m	Net lending £m	Coverage %
Credit cards	**4,655**	**142**	**18**	**160**	**4,495**	**3.79**
Personal loans	**1,082**	**14**	**17**	**31**	**1,051**	**3.57**
Overdrafts	**33**	**3**	**-**	**3**	**30**	**11.14**
Total Personal lending portfolio	**5,770**	**159**	**35**	**194**	**5,576**	**3.80**
2020						
Credit cards	4,464	165	57	222	4,242	5.37
Personal loans	1,047	20	52	72	975	7.81
Overdrafts	39	5	2	7	32	20.09
Total Personal lending portfolio	5,550	190	111	301	5,249	5.91

As with the Mortgage portfolio, overall lending in the Unsecured portfolio remained relatively stable year-on-year following a period of stagnation in the consumer market as a result of COVID-19. However, there was a 4% increase in credit cards year-on-year as consumer spending activity returned to more normal levels with the easing of government restrictions.

The quality of the Unsecured portfolio remains high, with 98.1% in each of the personal loans and credit cards portfolios in Stage 1 or Stage 2 not past due (2020: 98.2%), and a modest amount of 1.2% of each portfolio in Stage 3 (2020: 1.4%). The level and type of government support measures, furlough and temporary payment holidays influenced the low level of forbearance measures granted to customers, which was 0.75% of the portfolio at 30 September 2021 (2020: 0.67%).

Underpinning the asset quality of the Personal loan portfolio is the fact that c.50% has been written under the tighter credit conditions introduced at the start of COVID-19. As a result of these sound credit practices 83% of the portfolio (2020: 78%) is rated in the highest PD category of 'Strong', with a minimal amount of lending classed as being in default. This has been borne out with a movement of c.6% of balances from Stage 2 to Stage 1 year-on-year.

A refresh of macroeconomic assumptions to reflect the improving economic outlook has driven a reduction in the modelled ECL provision from £190m at 30 September 2020 to £159m at 30 September 2021. This has been accompanied by a reduction of £76m in the PMA from £111m to £35m reflecting greater confidence in economic assumptions and the ability to hold more targeted PMAs to address specific risk factors. The most significant component of PMA held in respect of the Unsecured portfolio at 30 September 2021 is payment holidays of £13m (2020: £23m). The remainder of the PMA covers factors such as model alignment for upcoming definition of default changes, debt sale and PD neutralisation, with the latter established to effectively counteract the modelled PDs which are lower than they were at the outset of COVID-19, a position which is considered to be temporary; this element of PMA will unwind as PDs return to a more normalised level.

As a result, the total ECL provision at 30 September 2021 is £194m (2020: £301m), with the reduction in provision in the year giving rise to an impairment credit in the income statement of £32m (2020: charge of £223m).

Across the whole Unsecured portfolio, the reduction in coverage to 380bps (2020: 591bps) reflects the high quality, including the typically higher affluence credit card customer base where the lending position has focused on mature, higher earners who are homeowners and have shown greater resilience through COVID-19. Coverage is now broadly back to pre-COVID-19 levels, with improved book quality largely offsetting the potential for asset quality deterioration in a downturn.

Personal credit performance (continued)

Forbearance (audited)

The table below summarises the level of forbearance in respect of the Group's Personal lending portfolios at each balance sheet date. All balances subject to forbearance are classed as either Stage 2 or Stage 3 for ECL purposes.

	Total loans and advances subject to forbearance measures			Impairment allowance on loans and advances subject to forbearance measures	
2021	**Number of loans**	**Gross carrying amount £m**	**% of total portfolio**	**Impairment allowance £m**	**Coverage %**
Credit cards arrangements	**7,718**	**32**	**0.73%**	**15.0**	**47.39%**
Loans arrangements	**1,174**	**6**	**0.78%**	**3.3**	**49.61%**
Overdraft arrangement	**280**	**1**	**2.55%**	**0.4**	**51.89%**
Total Personal lending forbearance(1)	**9,172**	**39**	**0.75%**	**18.7**	**47.86%**
2020					
Credit cards arrangements	6,309	27	0.63%	12.5	47.23%
Loans arrangements	1,385	7	0.82%	3.2	42.42%
Overdraft arrangement	398	1	2.48%	0.3	26.39%
Total Personal lending forbearance(1)	8,092	35	0.67%	16.0	45.63%

(1) In the prior year, payment holidays granted in line with regulation were not classified as forbearance due to the extenuating circumstances arising from COVID-19. The standard approach of classifying payment holidays as forbearance has resumed in the current year.

As at 30 September 2021, credit cards forbearance totalled £32m (7,718 customers), an increase from the 30 September 2020 position of £27m (6,309 customers). This represents the 0.73% of total credit cards balances (2020: 0.63%). The increase in credit cards forbearance is the result of payment arrangements being extended to customers who have come to the end of their payment holiday term and require additional short-term support, which has triggered a move into forbearance this year. The level of impairment coverage on forborne loans is broadly flat at 47.4% from 47.2% at 30 September 2020 reflecting a more prudent approach to ECL. Limited forbearance is exercised in relation to Personal loans and overdrafts, with a modest reduction to £7m (0.85%) of the loans and overdrafts portfolio from £8m (0.88%) at 30 September 2020.

Personal credit performance (continued)

IFRS 9 staging (audited)

The Group closely monitors the staging profile of its Personal lending portfolio over time which can be indicative of general trends in book health. Movements in the staging profile of the portfolio in the current and prior year are presented in the tables below:

2021	Stage 1 Gross loans £m	Stage 1 ECL £m	Stage 2 Gross loans £m	Stage 2 ECL £m	Stage 3[(1)] Gross loans £m	Stage 3[(1)] ECL £m	Total gross loans £m	Total provisions £m
Opening balance at 1 October 2020	**4,660**	**70**	**823**	**194**	**67**	**37**	**5,550**	**301**
Transfers from Stage 1 to Stage 2	**(954)**	**(32)**	**951**	**209**	**-**	**-**	**(3)**	**177**
Transfers from Stage 2 to Stage 1	**859**	**21**	**(890)**	**(113)**	**-**	**-**	**(31)**	**(92)**
Transfers to Stage 3	**(19)**	**(1)**	**(100)**	**(68)**	**119**	**80**	**-**	**11**
Transfers from Stage 3	**2**	**-**	**3**	**2**	**(5)**	**(5)**	**-**	**(3)**
Changes to model methodology	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
New assets originated or purchased	**1,319**	**17**	**38**	**6**	**1**	**-**	**1,358**	**23**
Repayments and other movements	**(493)**	**(28)**	**(217)**	**(98)**	**15**	**(52)**	**(695)**	**(178)**
Repaid or derecognised	**(226)**	**(6)**	**(55)**	**(14)**	**(29)**	**(25)**	**(310)**	**(45)**
Write-offs	**-**	**-**	**-**	**-**	**(99)**	**(99)**	**(99)**	**(99)**
Cash recoveries	**-**	**-**	**-**	**-**	**-**	**24**	**-**	**24**
Individually assessed impairment charge	**-**	**-**	**-**	**-**	**-**	**75**	**-**	**75**
Closing balance at 30 September 2021	**5,148**	**41**	**553**	**118**	**69**	**35**	**5,770**	**194**

2020	Stage 1 Gross loans £m	Stage 1 ECL £m	Stage 2 Gross loans £m	Stage 2 ECL £m	Stage 3[(1)] Gross loans £m	Stage 3[(1)] 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

(1) Stage 3 includes POCI for gross loans and advances of £2m (30 September 2020: £4m); and ECL of £2m (30 September 2020: (£2m)).

The balance of Personal lending in Stage 2 reduced by 5.2% to 9.6% (2020: 14.8%), driven by technical changes to the SICR criteria for credit cards and to a model change for Personal loans. This resulted in a corresponding increase in Stage 1 from 84.0% to 89% while Stage 3 Personal lending remains modest and stable at 1.2% (2020: 1.2%).

Business credit performance

The table below presents key information which is important for understanding the asset quality of the Group's Business lending portfolio and should be read in conjunction with the supplementary data presented in the following pages of this section.

Breakdown of Business credit portfolio

2021	Gross lending £m	Government[(1)] £m	Total gross £m	Modelled ECL £m	PMA £m	Total ECL £m	Net lending £m	Coverage[(2)] %
Agriculture	**1,361**	**80**	**1,441**	**7**	**5**	**12**	**1,429**	**0.89**
Business services	**943**	**337**	**1,280**	**21**	**27**	**48**	**1,232**	**4.82**
Commercial Real Estate	**667**	**13**	**680**	**4**	**3**	**7**	**673**	**1.00**
Government, health and education	**1,031**	**73**	**1,104**	**7**	**10**	**17**	**1,087**	**1.62**
Hospitality	**563**	**105**	**668**	**6**	**7**	**13**	**655**	**2.29**
Manufacturing	**556**	**144**	**700**	**22**	**21**	**43**	**657**	**6.93**
Resources	**95**	**8**	**103**	**3**	**4**	**7**	**96**	**6.85**
Retail and wholesale trade	**623**	**248**	**871**	**14**	**14**	**28**	**843**	**4.13**
Transport and storage	**300**	**80**	**380**	**4**	**4**	**8**	**372**	**2.50**
Other	**881**	**230**	**1,111**	**17**	**23**	**40**	**1,071**	**4.42**
Total Business portfolio	**7,020**	**1,318**	**8,338**	**105**	**118**	**223**	**8,115**	**3.06**
2020								
Agriculture	1,456	70	1,526	27	-	27	1,499	2.00
Business services	1,056	280	1,336	50	-	50	1,286	4.44
Commercial Real Estate	801	12	813	38	-	38	775	4.78
Government, health and education	1,082	65	1,147	30	-	30	1,117	2.75
Hospitality	575	97	672	17	-	17	655	2.78
Manufacturing	637	132	769	44	-	44	725	6.35
Resources	94	9	103	6	-	6	97	6.00
Retail and wholesale trade	714	232	946	40	-	40	906	5.48
Transport and storage	314	62	376	21	-	21	355	6.21
Other	829	204	1,033	30	-	30	1,003	3.35
Total Business portfolio	7,558	1,163	8,721	303	-	303	8,418	3.87

(1) Government includes all lending provided to business customers under UK Government schemes including Bounce back loan scheme (BBLS), Coronavirus business interruption loan scheme (CBILS), Coronavirus large business interruption loan scheme (CLBILS) and Recovery loan scheme (RLS). When onboarding, some new borrowers for BBLS loans were coded as business services; a portion of these may be reclassified over time.

(2) Coverage ratio excludes the guaranteed element of government-backed loan schemes.

The Group preserved concentrations across its Business portfolio throughout COVID-19 with a bias towards sectors less vulnerable to cyclical economic impacts, such as agriculture and government, health and education, which together represented 31% of the portfolio at 30 September 2021 (2020: 31%). Legacy lending to hospitality, the most exposed sector throughout COVID-19, remained stable year-on-year at only 8% of the portfolio and remains a sector where the Group's appetite to lend is limited. The focus of the past 12 months was on supporting customers through their COVID-19 journey, ensuring customers likely to experience difficulty were identified and engaged early. Muted demand for new origination resulted in a decrease in gross lending of £0.3bn year-on-year. These actions, along with the spread of the book and government support, ensured the portfolio was sufficiently resilient to withstand the short-term shocks from COVID-19.

The Group continued to lend under the UK Government-backed loan schemes, which were launched in 2020 in order to support customers through COVID-19. The initial schemes (BBLs, CBILS, CLBILS) were replaced in April 2021 by the RLS, which is set to remain open for applications until 30 June 2022.

Lending under the government schemes increased from £1.1bn to £1.4bn in the first half of the year, and subsequently started to reduce in the second half as initial loans were repaid, ending at £1.3bn at 30 September 2021. Aligned to sectors most impacted by COVID-19, the majority of these loans (55% year-on-year) were extended to customers in the business services, manufacturing and retail sectors, which accounted for £0.7bn at 30 September 2021 (2020: £0.6bn).

Risk report (continued)
Credit risk (continued)

Business credit performance (continued)

Asset quality has remained stable; customers have sought to address the challenges they have faced which, combined with government and Group support, has resulted in a portfolio outcome better than had been expected. The combination of customer outcomes and improving economic forecasts results in a significant increase in Stage 1 loans from 52.6% to 68.0% year-on-year, with a corresponding reduction in Stage 2 loans. Total balances in Stage 1 and Stage 2 not past due is c.£8.1bn representing 96.7% of the portfolio (2020: £8.4bn representing 96.5% of the portfolio). Of the Stage 2 loans, 96% were rated 'Strong' or 'Good' (2020: 84%). Stage 3 loans decreased marginally. Government interventions, including the loan schemes, meant that there was a reduced requirement for granting of forbearance; low levels were maintained with only 5.82% of the total portfolio being forborne at 30 September 2021 (2020: 5.92%).

As with the Group's other lending portfolios, the improving economic outlook has driven more favourable macro assumptions leading to a significant reduction in the modelled ECL provision from £303m at 30 September 2020 to £105m at 30 September 2021. The Group has recognised targeted PMAs for PD neutralisation (£34m) and sector stress (£80m), with a further £4m for other minor factors. This reduction in total provision has driven an impairment credit in the income statement of £55m (2020: charge of £183m).

As with Personal lending, a PD neutralisation PMA of £34m has been established and will unwind as PDs return to a more normalised level. The sector stress PMA of £80m has been established to recognise the inherent risk of certain sectors more susceptible to volatility as they emerge from the pandemic, where the Group expects some level of difficulty to emerge as government and other support measures unwind. For the sector stress PMA, a targeted PD stress has been applied to selected sectors and sub-sectors to replicate the level of challenge the Group expects could happen as trading cycles recommence and activities normalise without downgrading the risk grades of the underlying customers.

Overall, portfolio coverage remains prudent at 306bps (2020: 387bps), reflecting the high quality of the book and little evidence of deterioration in asset quality to date. A cautious position has been maintained through a more targeted approach to PMAs, with coverage over those sectors most susceptible to a downturn when government and other support measures are ultimately withdrawn, remaining elevated.

Risk report (continued)
Credit risk (continued)

Business credit performance (continued)

Forbearance (audited)

Forbearance is considered to exist where customers are experiencing or about to experience financial difficulty and the Group grants a concession 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.

	Total loans and advances subject to forbearance measures			Impairment allowance on loans and advances subject to forbearance measures	
2021	**Number of loans**	**Gross carrying amount £m**	**% of total portfolio**	**Impairment allowance £m**	**Coverage %**
Term extension	**188**	**196**	**2.27%**	**10.2**	**5.19%**
Payment holiday(1)	**86**	**130**	**1.51%**	**17.6**	**13.48%**
Reduction in contracted interest rate	**1**	**1**	**0.01%**	**-**	**0.02%**
Alternative forms of payment	**1**	**13**	**0.15%**	**5.6**	**43.14%**
Debt forgiveness	**2**	**4**	**0.04%**	**-**	**0.67%**
Refinancing	**10**	**3**	**0.04%**	**0.2**	**7.21%**
Covenant breach/reset/waiver	**44**	**155**	**1.80%**	**8.2**	**5.27%**
Total Business forbearance	**332**	**502**	**5.82%**	**41.8**	**8.31%**
2020					
Term extension	199	211	2.31%	27.5	13.05%
Payment holiday(1)	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%

(1) In the prior year, payment holidays granted in line with regulation were not classified as forbearance due to the extenuating circumstances arising from COVID-19. The standard approach of classifying payment holidays as forbearance has resumed in the current year.

Business portfolio forbearance has reduced from £539m (368 customers) at 30 September 2020 to £502m (332 customers) at 30 September 2021. 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 5.82% (2020: 5.92%) with impairment coverage, in line with actions taken on ECLs, also reducing to 8.31% (2020: 14.30%). The majority of forbearance arrangements relate to term extensions allowing customers a longer term to repay their obligations in full than initially contracted.

Customers within the forbearance portfolio have received £31m of COVID-19 related support loans: £6m CLBIL, £18m CBIL and £5m BBL and £2m RLS.

The table includes a portfolio of financial assets at fair value. The gross value of fair value loans subject to forbearance as at 30 September 2021 is £5.3m (2020: £7m), representing 0.06% of the total business portfolio (2020: 0.08%). The credit risk adjustment on these amounts totalled £0.1m (2020: £0.7m). Coverage is 2.32% (2020: 9.77%).

Business credit performance (continued)

IFRS 9 staging (audited)

The Group closely monitors the staging profile of its Business lending portfolio over time which can be indicative of general trends in book health. Movements in the staging profile of the portfolio in the current and prior year are presented in the tables below.

2021	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 2020	**4,589**	**52**	**3,853**	**176**	**279**	**75**	**8,721**	**303**
Transfers from Stage 1 to Stage 2	**(2,005)**	**(26)**	**1,985**	**67**	**-**	**-**	**(20)**	**41**
Transfers from Stage 2 to Stage 1	**2,059**	**32**	**(2,072)**	**(70)**	**-**	**-**	**(13)**	**(38)**
Transfers to Stage 3	**(32)**	**-**	**(156)**	**(14)**	**186**	**21**	**(2)**	**7**
Transfers from Stage 3	**7**	**-**	**106**	**8**	**(111)**	**(16)**	**2**	**(8)**
Changes to model methodology	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
New assets originated or purchased	**8,295**	**187**	**1,507**	**150**	**129**	**22**	**9,931**	**359**
Repayments and other movements	**(321)**	**(20)**	**(311)**	**(6)**	**7**	**(17)**	**(625)**	**(43)**
Repaid or derecognised	**(6,920)**	**(159)**	**(2,481)**	**(191)**	**(229)**	**(28)**	**(9,630)**	**(378)**
Write-offs	**-**	**-**	**-**	**-**	**(26)**	**(26)**	**(26)**	**(26)**
Cash recoveries	**-**	**-**	**-**	**-**	**-**	**1**	**-**	**1**
Individually assessed impairment charge	**-**	**-**	**-**	**-**	**-**	**5**	**-**	**5**
Closing balance at 30 September 2021	**5,672**	**66**	**2,431**	**120**	**235**	**37**	**8,338**	**223**

2020	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	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

The application of more positive economic forecasts has increased the level of Business lending classed as Stage 1 to 68.0% (2020: 52.6%), with a corresponding decrease of 15% in Stage 2 to 29.2% (2020: 44.2%). The proportion of the portfolio in Stage 2 does remain heightened, reflective of the Group's prudent approach. As at 30 September 2021, 59% of balances in Stage 2 are associated with a deterioration in PD (2020: 75%). Business loans in Stage 3 remain modest with a slight reduction in the year to 2.8% (2020: 3.2%).

The PDs for Business lending combine both internal ratings information and forward-looking economic forecasts. The positive economic forecasts, which included a modest GDP rise in 2021 and a stronger recovery, are the material drivers of the PD and stage migrations in the year to 30 September 2021. The improvements in PD and staging have not been driven to any material extent by the lack of observed impairment through either internal downgrades or the emergence of arrears or defaults. Model changes within the Business portfolio have driven a retiming of expected default risk, with higher short-term default rates but lower cumulative default expectations. This has led to an increase in the proportion of assets classed as 'Strong' to 46% (2020: 11%), with assets classed as 'Good' correspondingly decreasing to 50% (2020: 73%). 96% of the business portfolio is categorised as 'Strong' or 'Good' (2020: 84%).

Risk report (continued)
Credit risk (continued)

Other credit risks

Non-property related collateral (audited)

The following table shows the total non-property collateral held at 30 September 2021 in terms of cash, guarantees (guarantees are predominantly in relation to the government-backed COVID-19 loans) and netting. The exposure amount shown below is the total gross exposure (net of credit provisions) 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.

2021	**Cash £m**	**Guarantee £m**	**Netting £m**	**Debt securities £m**	**Other physical collateral £m**	**Receivables £m**	**Total £m**	**Exposure £m**
Financial assets at amortised cost								
Loans and advances to customers								
Business	**9**	**1,235**	**202**	**-**	**442**	**507**	**2,395**	**2,621**
Cash and balances with central banks	**5,894**	**-**	**-**	**-**	**-**	**-**	**5,894**	**8,093**
Due from other banks	**-**	**-**	**-**	**287**	**-**	**-**	**287**	**331**
Total	**5,903**	**1,235**	**202**	**287**	**442**	**507**	**8,576**	**11,045**
Of which: Stage 3								
Loans and advances to customers								
Business	**-**	**34**	**-**	**-**	**4**	**9**	**47**	**46**

2020								
Financial assets at amortised cost								
Loans and advances to customers								
Business	9	1,098	230	-	487	648	2,472	2,772
Cash and balances with central banks	5,409	-	-	-	-	-	5,409	7,421
Due from other banks	-	-	-	295	-	-	295	360
Total	5,418	1,098	230	295	487	648	8,176	10,553
Of which: Stage 3								
Loans and advances to customers								
Business	-	5	-	-	13	18	36	41

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 2021 (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 in 2020, the Group moved to recognise asset finance and invoice finance collateral, being other physical collateral and receivables respectively, as being eligible collateral from a credit risk mitigation 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.

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.

Other credit risks (continued)

Offsetting of financial assets and liabilities (audited)

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 International Accounting Standard (IAS) 32. The table excludes financial instruments not subject to offset and that are formally 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.

				Net amounts not offset on the balance sheet		
2021	Gross amounts £m	Gross amounts offset on balance sheet £m	Net amounts presented on balance sheet[1] £m	Subject to master netting agreements £m	Cash collateral pledged/ received £m	Net amount £m
Assets						
Derivative financial instruments[2]	**413**	**(273)**	**140**	**(76)**	**(1)**	**63**
Liabilities						
Derivative financial instruments[2]	**678**	**(469)**	**209**	**(76)**	**(50)**	**83**
2020						
Assets						
Derivative financial instruments[2]	423	(105)	318	(127)	(12)	179
Liabilities						
Derivative financial instruments[2]	1,063	(813)	250	(127)	(83)	40

(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 has pledged securities collateral in respect of derivative transactions subject to master netting agreements of £274m (2020: £522m), which is not presented separately as collateral on the balance sheet.

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

Risk report (continued)
Credit risk (continued)

Macroeconomic assumptions, scenarios and weightings

The Group's ECL allowance as at 30 September 2021 was £504m (2020: £735m).

Macroeconomic assumptions

The Group engages Oxford Economics to provide a wide range of future macroeconomic assumptions which are 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 drivers as the most significant inputs for IFRS 9 modelling purposes: UK GDP growth, inflation, house prices, base rates, and unemployment rates. The external data provided is assessed and reviewed on a quarterly basis to ensure appropriateness and relevance to the ECL calculation, with more frequent updates provided as and when the circumstances require them. Further adjustments supplement the modelled output when it is considered that not all the risks identified in a product segment have been accurately reflected within the models or for other situations where it is not possible to provide a modelled outcome.

As the UK economy continues to recover from the impact of COVID-19, the outlook is more optimistic than it was at this point in 2020 as businesses open up again and the public begins to transition back to spending patterns and behaviours as observed pre-pandemic. Against this environment, the Group has continued to assess the possible IFRS 9 economic scenarios to select appropriate forecasts and weightings. The selection of scenarios and the appropriate weighting to apply are considered and debated by an internal review panel each quarter with final proposed recommendations for use in the IFRS 9 models made to ALCO for formal approval. The three scenarios selected, together with the weightings applied, have been updated to reflect the current economic environment and are:

Scenario (audited)	**2021 (%)**	2020 (%)
Upside	**15**	5
Base	**50**	50
Downside	**35**	45

The Group continued to select three scenarios and apply a 50% weighting to the base scenario. There is a 10% shift in the weightings from the Downside scenario towards the Upside scenario in the period reflecting a more optimistic view of the Upside scenario over the short term as a result of the updated macroeconomic assumptions.

Upside (15%)[1]

- GDP declined by 6.1% in the first quarter of 2021 (Q1 2021 v Q1 2020) before rising steeply in Q2 2021 and settling to pre-crisis levels by Q3 2021, with overall year-on-year growth in 2021 forecast at 8.1% and rising slightly to 8.8% in 2022 before reverting to more modest increases over the remainder of the forecast horizon period.
- Inflation rises steeply to 4.1% by Q2 2022 from a low base of 0.6% at Q1 2021 and reverts to pre-COVID-19 levels from Q1 2024 for the remaining forecast period.
- BoE base rate rises are anticipated in the latter half of 2021 and expected to continue throughout 2022 and 2023 and reach 1.1% in Q1 2023. These rises continue gradually over the remaining forecast horizon reaching 1.8% in Q4 2025.
- HPI stagnates with little movement between Q3 2021 and Q3 2022 but then increases in each quarter until the end of the forecast period. Overall, HPI sees Q4 v Q4 growth of 8.2% in 2021 declining to 0.8% in 2022 before rising sharply again to 5.2% in 2023 which is maintained through 2024.
- Unemployment peaks in Q4 2020, at 5.2%, and is forecast to recover to 3.8% by the end of 2022. From then, there is no significant movement over the following years, reaching 3.9% in Q1 2023 and remaining there until Q1 2024 before steadily and modestly declining over the remainder of the forecast horizon period and hitting 3.6% in Q3 2025.

Base (50%)

- GDP contracted by 6.1% in the first quarter of 2021 (Q1 2021 v Q1 2020) before recovering sharply in Q2 2021 and settling at higher than average for the remainder of 2021, with overall year-on-year growth in 2021 forecast at 7.3%, and modestly retracting to 6.7% in 2022. GDP settles over the remaining forecast period to pre-COVID-19 levels.
- Inflation rises steeply to 3.4% by Q4 2021 from a low base of 0.6% at Q1 2021 and reverts to pre-COVID-19 levels from Q2 2023 for the remaining forecast period.
- BoE base rates remain flat at 0.1% for the majority of the forecast period and start to rise slowly from 2024 reaching 0.7% by Q4 2025.
- HPI sees a steady decline between Q3 2021 to Q3 2023 but then rebounds slowly in each quarter after this until the end of the forecast period to finish higher than it was in 2020. Overall, HPI sees Q4 v Q4 year-on-year growth of just 5.0% in 2021 which regresses to (1.6%) in 2022 and reverts to positive growth in each of the remaining forecast years.
- Unemployment peaks at over 4.9% in two quarters in 2021 before beginning to fall steadily over the remaining forecast period. By the end of 2025 the rate is sitting at 3.8% which is at a similar level to those seen pre-COVID-19.

(1) The time periods referenced in this section relate to calendar years unless otherwise stated.

Risk report (continued)
Credit risk (continued)

Macroeconomic assumptions (continued)

Downside (35%)

- GDP drops sharply from 22.2% (Q2 2021 v Q2 2020) to just 2.6% by the end of 2021 (Q4 2021 v Q4 2020) and remains sluggish over the remaining forecast period. The overall year-on-year growth of 4.4% in 2021 drops to 2.4% by 2022 and falls further to just 1.0% by 2024 recovering to 2.5% in 2025.
- Inflation hits 2.0% in two quarters in 2021, decreasing to just 0.1% by Q4 2022 and then steadily rising each quarter to a high of 2.4% in Q3 2024 before regressing back to below pre-COVID-19 levels by the end of 2025.
- The BoE base rate is cut to -0.5% by the end of Q2 2022 and remains there for the next few years finishing at -0.3% at Q4 2025.
- HPI falls steadily and deeply from Q2 2021 to Q3 2024 but then experiences modest increases in each quarter until the end of the forecast period but finishes well below the levels experienced in 2020. Overall, HPI sees a Q4 v Q4 decline of (2.9%) in 2021 worsening to (15.2%) in 2022 and remaining negative until 2025.
- Unemployment peaks at 6.9% in Q3 2023 and remains at over 6.0% for the remainder of the forecast period. Overall, unemployment averages at 5.6% in 2021 rising to 6.8% for both 2023 and 2024 before falling modestly to 6.4% in 2025.

Base case – 2021 v 2020 (audited)

The following table shows how the Group's base case assumptions have changed from those used at 30 September 2020:

Year	Assumption	2020 %	2021 %	2022 %	2023 %	2024 %	2025 %
	Base rate		0.1	0.1	0.1	0.3	0.5
	Unemployment		4.8	4.6	4.3	4.0	3.9
2021	GDP		7.3	6.7	2.1	1.5	1.5
	Inflation		2.1	2.7	1.9	1.8	1.8
	HPI		5.0	(1.6)	0.6	2.7	3.9
	Base rate	0.2	0.1	0.1	0.2	0.3	
	Unemployment	6.1	7.8	6.3	6.3	6.0	
2020	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	

The base case macroeconomic estimates and assumptions used at 30 September 2020 reflected the forward-looking view which was particularly uncertain as a result of COVID-19 and the stage the UK economy was in at that time. The impact of the further lockdown measures introduced in Q4 2020 together with the successful vaccine roll-out programme has resulted in much more positive base case assumptions for the current year and the forecast period with significant reductions in unemployment levels and improved GDP over the short term.

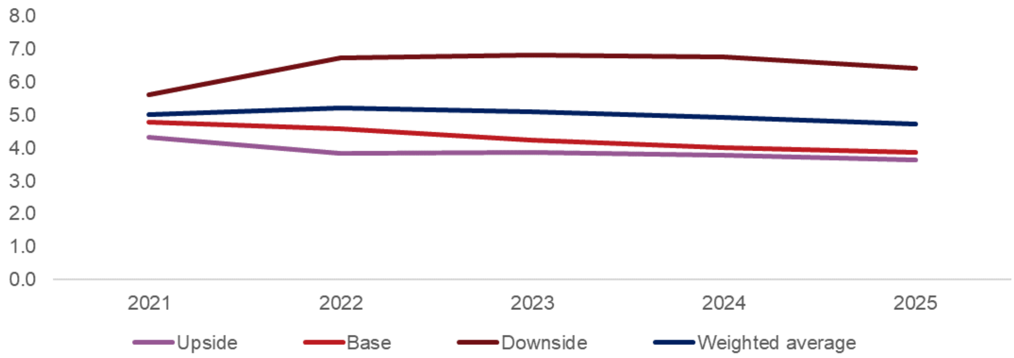
Five-year simple averages for the most sensitive inputs of unemployment, GDP and HPI (audited)

2021	Unemployment %	GDP %	HPI %
Upside	**3.9**	**4.6**	**4.6**
Base	**4.3**	**3.8**	**2.1**
Downside	**6.5**	**2.1**	**(5.8)**
2020			
Upside	4.4	1.3	1.7
Base	6.5	0.5	(1.6)
Downside	7.4	(0.4)	(6.2)

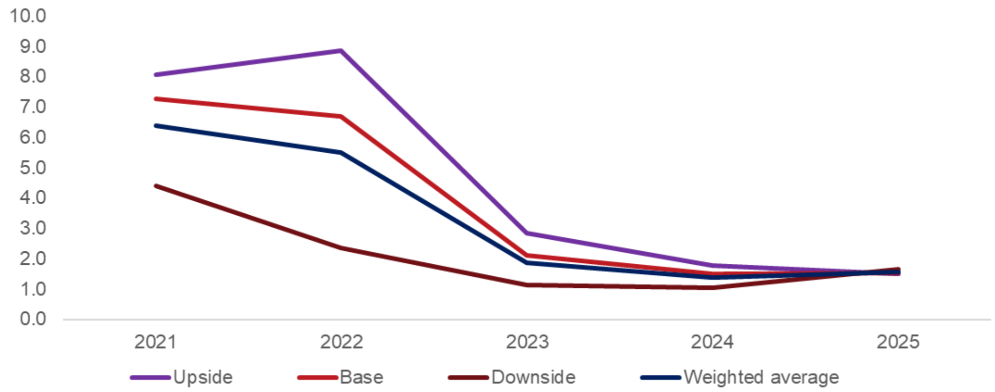
Macroeconomic assumptions (continued)

Graphical illustrations of the above key inputs over the five-year forecast period are:

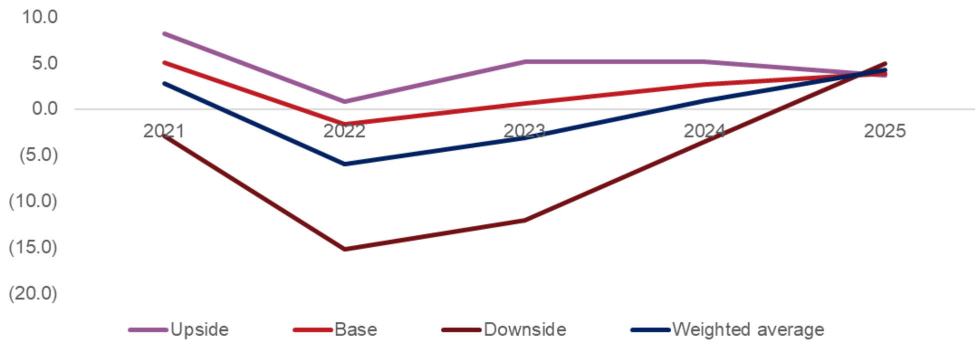
Unemployment (simple average):



GDP (year-on-year movement):



HPI (Q4 v Q4 movement):



The full range of the key macroeconomic assumptions is included in the table on page 47.

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:

2021 (audited)	**Probability Weighted[1] £m**	**Upside £m**	**Base £m**	**Downside £m**
Mortgages	**24**	**16**	**19**	**37**
Personal of which:	**159**	**155**	**155**	**167**
Cards	*142*	*139*	*139*	*147*
Personal loans and overdrafts	*17*	*16*	*16*	*20*
Business	**83**	**47**	**61**	**127**
Total	**266**	**218**	**235**	**331**

(1) In addition to the probability weighted modelled provision shown in the table, the Group holds £207m relative to PMAs (2020: £186m) and £31m of individually assessed provision (2020: £53m).

2020 (audited)	Probability Weighted £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

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 46.

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

Mortgages: Unemployment and HPI
Personal: Unemployment
Business: Unemployment, HPI, GDP and interest rates

In addition to assessing the ECL impact of applying a 100% weighting to each of the three chosen scenarios, the Group has also considered what the effect of changes to a few key economic inputs would make to the modelled ECL output.

The Group considers that the unemployment rate and HPI are the inputs that would have the most significant and sensitive ECL impact and has assessed how these would change the ECL across the relevant portfolios, with the reported output assessed against the base case. All changes have been implemented as immediate effects seen within the first year of the base case scenario, persisting throughout the scenario.

The use of estimates (continued)

The following table discloses the ECL impact of HPI changes on the Group's Mortgage and Business lending:

(Audited)	2021 £m
Mortgages +10%	**(2)**
Business +10%	**(2)**
Mortgages -10%	**3**
Business -10%	**3**

Unemployment is a key input that affects all of the Group's lending categories and the following table highlights the ECL impact of a one percent change in the unemployment rate:

(Audited)	2021 £m
Mortgages +1%	**1**
Personal +1%	**4**
Business +1%	**6**
Mortgages -1%	**(1)**
Personal -1%	**(4)**
Business -1%	**(4)**

Altering the basis of how the changes are reflected would produce different results, with a sharper rise or decline in unemployment having a much more material ECL impact.

While the above sensitivities provide a view of how the ECL would be impacted based on these single changes, such changes would not ordinarily occur in isolation and the economic inputs used are linked within each chosen scenario.

The use of judgement

SICR

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.

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 implemented an approach with the required SICR threshold trigger varying on a portfolio and product basis according to the origination PD.

The table below illustrates this with reference to the Group's business, credit card and Mortgage portfolios. In each case the illustration is of the PD threshold based on a 5-year full lifetime PD (not the annualised equivalent). The business example reflects the thresholds appropriate for term lending.

Risk report (continued)
Credit risk (continued)

The use of judgement (continued)

The table below illustrates this with reference to the Group's portfolios:

(Audited)		Origination PD	SICR Trigger
Business	Low origination lifetime PD	2.00%	5.69%
	High origination lifetime PD	10.00%	17.69%
Credit cards	Low origination lifetime PD	2.00%	22.34%
	High origination lifetime PD	10.00%	25.52%
Business	Low origination lifetime PD	2.00%	6.03%
	High origination lifetime PD	10.00%	16.70%

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

(Audited)	**2021 £m**	2020 £m
A 10% movement in the mortgage portfolio from Stage 1 to Stage 2[(1)]	**+6**	+16
A 10% movement in the credit card portfolio from Stage 1 to Stage 2[(1)]	**+69**	+76
A 10% movement in the business portfolio from Stage 1 to Stage 2[(1)]	**+13**	+16
A PD stress which increases PDs upwards by 20% for all portfolios	**+94**	+151

(1) The comparative has been restated in line with current year presentation.

Definition of default

The PD of a credit exposure is a key input to the measurement of the ECL allowance. Default under Stage 3 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.

PMAs

At 30 September 2021, £207m of PMAs (2020: £186m) are included within the balance sheet ECL provision of £504m (2020: £735m).

These are management judgements which impact the ECL provision by increasing the collectively assessed modelled output where not all of the known risks identified in a particular product segment have been accurately reflected within the models and are described in more detail below:

Mortgages: the potential future impact of the wind-down in payment holidays continues to remain a significant unknown and customer behaviours continue to be monitored and assessed for indications of deterioration. The Group monitored the level of ECL held on BTL mortgages in the year due to uncertainty around how landlords will react to this and how the portfolio will perform post the withdrawal of UK Government support measures in terms of both their own position and that of their tenants.

Personal: as with Mortgages, the future performance of customers who previously had payment holidays remains a significant factor along with the potential impact on the sale or future recovery value of Unsecured written-off debt, which has fluctuated in the current environment. In addition to these, further adjustments were made to estimate the impact of the alignment of the definition of default on credit cards, which is in the process of changing, and to re-base origination PDs. The reduced reliance on PMAs is primarily a result of the improvements in the macroeconomic outlook from September 2020.

Business: the introduction of the PMA for the Business portfolio is a consequence of the improvements in the macroeconomic assumptions used at 30 September 2021 compared to the previous year, with the Group adopting a cautious approach as the UK begins to emerge from the pandemic. The government measures put in place for businesses throughout COVID-19 have resulted in a significant decrease in corporate insolvency levels compared to long-term UK trends, with concerns on how businesses will adapt once the economy fully reopens. The Group considers that certain sectors within its Business portfolio require additional ECL to more adequately reflect the strains observed and expected in those sectors that are not fully captured in the modelled output. This also includes a modest adjustment to address technical model corrections.

The use of judgement (continued)

The impact of PMAs on the Group's ECL allowance and coverage ratios is as follows:

(Audited)	Mortgages	Personal	Business	Total
2021	**£54m**	**£35m**	**£118m**	**£207m**
% of total ECL	**61%**	**19%**	**52%**	**41%**
Coverage – total	**0.14%**	**3.93%**	**3.16%**	**0.71%**
Coverage – total ex PMAs	**0.06%**	**2.89%**	**1.28%**	**0.41%**
2020	£75m	£111m	-	£186m
% of total ECL	57%	37%	-	25%
Coverage – total	0.23%	5.91%	3.91%	1.03%
Coverage – total ex PMAs	0.10%	3.73%	3.91%	0.77%

PMAs are primarily directed towards Stages 1 and 2 and are discussed in more detail in the divisional commentary on pages 28 to 38.

The Group assesses and reviews the need for and quantification of PMAs on a quarterly basis, with the CFO recommending the level of PMAs on a divisional basis to the Board Audit Committee twice a year at each external reporting period. The Group has strengthened the governance around PMAs in the year with the Model Risk Oversight and Group Credit Oversight teams reviewing the methodology supporting material PMAs and presenting their findings to the Board Audit Committee.

In the absence of significant events that might impact ECLs going forward, the Group expects the current level of PMAs to materially reduce over the next 18-24 months.

Risk report (continued)
Credit risk (continued)

Macroeconomic assumptions (audited)

The annual macroeconomic assumptions used over the five-year forecast period in the scenarios and their weighted averages are[(1)]:

2021

Scenario	VMUK weighting	Economic measure[(2)]	**2021 %**	**2022 %**	**2023 %**	**2024 %**	**2025 %**
Upside	20%	Base rate	**0.2**	**0.6**	**1.2**	**1.5**	**1.6**
		Unemployment	**4.3**	**3.8**	**3.9**	**3.8**	**3.6**
		GDP	**8.1**	**8.8**	**2.8**	**1.8**	**1.5**
		Inflation	**2.4**	**3.7**	**2.5**	**1.6**	**1.8**
		HPI	**8.2**	**0.8**	**5.2**	**5.2**	**3.6**
Base	50%	Base rate	**0.1**	**0.1**	**0.1**	**0.3**	**0.5**
		Unemployment	**4.8**	**4.6**	**4.3**	**4.0**	**3.9**
		GDP	**7.3**	**6.7**	**2.1**	**1.5**	**1.5**
		Inflation	**2.1**	**2.7**	**1.9**	**1.8**	**1.8**
		HPI	**5.0**	**(1.6)**	**0.6**	**2.7**	**3.9**
Downside	30%	Base rate	**(0.0)**	**(0.5)**	**(0.5)**	**(0.5)**	**(0.3)**
		Unemployment	**5.6**	**6.7**	**6.8**	**6.8**	**6.4**
		GDP	**4.4**	**2.4**	**1.1**	**1.0**	**1.7**
		Inflation	**1.5**	**0.7**	**0.8**	**2.2**	**1.7**
		HPI	**(2.9)**	**(15.2)**	**(12.1)**	**(3.5)**	**4.9**
Weighted average		Base rate	**0.1**	**0.0**	**0.1**	**0.2**	**0.4**
		Unemployment	**5.0**	**5.2**	**5.1**	**4.9**	**4.7**
		GDP	**6.4**	**5.5**	**1.9**	**1.4**	**1.6**
		Inflation	**2.0**	**2.1**	**1.6**	**1.9**	**1.8**
		HPI	**2.7**	**(6.0)**	**(3.2)**	**0.9**	**4.2**

2020

Scenario	VMUK weighting	Economic measure[(2)]	2020 %	2021 %	2022 %	2023 %	2024 %
Upside	20%	Base rate	0.2	0.1	0.1	0.2	0.4
		Unemployment	5.5	5.1	3.9	3.7	3.6
		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	50%	Base rate	0.2	0.1	0.1	0.2	0.3
		Unemployment	6.1	7.8	6.3	6.3	6.0
		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
Downside	30%	Base rate	0.2	(0.5)	(0.5)	(0.3)	(0.3)
		Unemployment	6.7	10.0	7.2	6.8	6.5
		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
Weighted average		Base rate	0.2	(0.2)	(0.2)	(0.1)	0.0
		Unemployment	6.3	8.6	6.6	6.4	6.1
		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.
(2) The percentages shown for base rate, unemployment and inflation are averages. GDP is the year-on-year movement, with HPI the Q4 v Q4 movement.

Risk report (continued)
Financial risk

Risk report (continued)
Financial risk (continued)

Financial risk covers several categories of risk which impact the way 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.

CET1 ratio	Loan to deposit ratio	Liquidity coverage ratio
14.9%	108%	151%

Risk appetite

The primary objective for the management of financial risks is to control the risk profile within approved risk limits in order 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 MREL. Measures for funding and liquidity risks consider the structure of the balance sheet, the Group's overall funding profile and compliance with the regulatory LCR and NSFR requirements. 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 market 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 and future contributions.

Capital risk

Capital is held by the Group to cover inherent risks in a normal and stressed operating environment, to protect unsecured creditors and investors and to support the Group's long-term strategy of pioneering growth. Capital risk is the risk that the Group has or forecasts insufficient capital and other loss-absorbing debt instruments to operate effectively, including meeting minimum regulatory requirements, operating within Board approved risk appetite and supporting its strategic goals.

Measurement

The Group manages capital in accordance with prudential rules issued by the PRA and the FCA, which are implemented through the CRD IV CRR regulatory framework. Pillar 1 capital requirements are calculated in respect of credit risk, operational risk, market risk, counterparty credit risk and credit valuation adjustments. The capital requirements are calculated using the following approaches:

- Retail mortgages: IRB
- Business lending: FIRB
- Specialised lending: IRB slotting; and
- All other portfolios: Standardised approach, via either sequential IRB implementation or Permanent Partial Use.

A rigorous approach is taken to assessing risks that are not adequately covered by Pillar 1. 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 documented in the Group's ICAAP which is subject to review, challenge and approval by the Board. The outputs from the ICAAP and regulatory stress testing are used to inform minimum capital targets and risk appetite, ensuring survivability above peak-to-trough stress movements.

Capital risk (continued)

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, expected loss 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, some of which can lead to uncertainty on eventual outcomes. In order to mitigate this risk, the Group actively monitors emerging regulatory change, assesses the impact and puts plans in place to respond and address.

<u>COVID-19 regulatory capital developments</u>

Following the BoE's announcements in 2020 regarding supervisory and prudential policy measures to address the challenges of COVID-19, the timescales for implementing updates relating to definition of default, mortgage Hybrid PD and LGD were extended and the Group no longer expects the adoption of hybrid mortgage models in FY22.

The Group continues to apply relevant relief measures introduced by regulatory and supervisory bodies to help address and alleviate various COVID-19 driven financial impacts. These include amendments to the CRR introduced by the 'Quick Fix' package in June 2020, which introduced a number of beneficial modifications, including changes to IFRS 9 transitional arrangements for capital and the accelerated implementation of revised small and medium enterprises (SME) supporting factors under CRR II.

<u>IRB approach to UK mortgage risk weights</u>

In July 2021, the PRA issued a policy statement in response to the consultation setting out proposals to introduce certain floors in respect of the IRB approach to UK mortgage risk weights. In response to the feedback the PRA received, including useful quantitative data that enabled the PRA to better gauge the distribution of risk weights across mortgage exposures, the PRA made two changes to the draft policy: it will not introduce the proposed 7% minimum risk weight expectation on individual UK mortgage exposures; and mortgage exposures classified as in default will be excluded from the 10% minimum risk weight expectation.

Instead, the PRA will consider the calibration of the incoming PD and LGD parameter floors for mortgages as part of the PRA's Basel 3.1 implementation.

<u>UK implementation of Basel Standards</u>

In July 2021, the PRA published Policy Statement 17/21 which provided feedback to the Consultation Paper 5/21 with the same title: 'Implementation of Basel standards' with the publication of Policy Statement 22/21 in October containing final rules. The policy statements cover a range of areas including: definition of capital; market risk; collective investment undertakings; counterparty credit risk; operational risk; large exposures; LCR; NSFR; reporting; and disclosure. These standards will be effective in the UK from 1 January 2022.

Policy Statement 22/21 confirms the PRA's treatment to fully deduct software assets from CET1 capital, applicable from 1 January 2022. This is a reversal of the preferential treatment permitted under the CRR Quick Fix which came into force from December 2020 whereby the CET1 deduction was replaced with a simple approach based on a prudential amortisation of software assets calibrated over a maximum period of three years. The PRA's view is that intangible assets are not sufficiently loss absorbent on a going concern basis to warrant recognition as CET1 capital.

Risk report (continued)
Financial risk (continued)

Capital risk (continued)

Basel 3.1
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 due to be subject to a transition period from 2023 to 2028. There are a number of areas within Basel 3.1 subject to national discretion and choice. The PRA is due to release a Consultation Paper on UK implementation in the second half of 2022 with the final reforms now not expected to be introduced until after March 2023. Uncertainties therefore remain for a number of topics that will be subject to revisions under Basel 3.1. In response the Group has undertaken an assessment across a range of scenarios for potential outcomes to assist with planning.

Solvency Stress Test
The Group participated in the BoE UK-wide SST for the first time during 2021 and is due to receive the outcome in December 2021. Results from the stress tests, which are due to be published by the BoE by the end of 2021, will be used by the FPC to assess the stress severity required to threaten resilience and test the Group's ability to absorb losses and continue to lend.

UK Leverage Ratio Framework
In June 2021 the FPC and PRA published consultations (Consultation Paper 14/21) on their proposed changes to the UK leverage ratio framework with feedback and final policy published in October (Policy Statement 21/21). The changes, effective from 1 January 2022, will simplify the framework with the Group being subject to the UK leverage ratio only rather than the two leverage ratio definitions that currently exist. The Group exceeds the 3.25% leverage ratio requirements.

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 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 retention of profit over time, which may be increased by: income growth and cost cutting; raising new equity, for example via 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 its lending strategy.

Capital optimisation remains a key strategic priority, ensuring the Group manages the quantity and quality of resources efficiently while meeting internal targets, stress testing requirements and maintaining regulatory compliance. 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 Board approves the capital risk appetite annually, defining minimum levels of capital across a range of capital ratios and measurements. The internal appetite ensures the Group operates above minimum regulatory requirements with reporting conducted through ALCO, Board and Executive Risk Committee. The capital plan, which assesses capital adequacy on a forward-looking basis, is also approved by the Board annually. The annual planning process is supported by rolling forecasting which is reported to ALCO monthly. This ensures that performance trends are reviewed and that there is transparency of the impact on capital ratios, risk appetite and the future outlook. As part of the monthly forecasting process, ALCO reviews scenario analysis, considering adverse impacts to economic conditions and modelling sensitivities, including changes to regulation.

Risk report (continued)
Financial risk (continued)

Capital risk (continued)

Capital resources

The Group's capital resources position as at 30 September 2021 is summarised below:

Regulatory capital[1]	2021 £m	2020 £m
Statutory total equity	**5,582**	4,990
CET1 capital: Regulatory adjustments[2]		
AT1 capital instruments	**(672)**	(672)
Defined benefit pension fund assets	**(551)**	(470)
Prudent valuation adjustment	**(5)**	(6)
Intangible assets	**(208)**	(477)
Goodwill	**(11)**	(11)
Deferred tax asset relying on future profitability[3]	**(388)**	(215)
Cash flow hedge reserve	**(10)**	80
AT1 coupon accrual	**(14)**	(21)
Foreseeable dividend on ordinary shares	**(254)**	-
IFRS 9 transitional adjustments	**134**	310
Total regulatory adjustments to CET1	**(1,979)**	(1,482)
Total CET1 capital	**3,603**	3,508
AT1 capital		
AT1 capital instruments	**672**	672
Total AT1 capital	**672**	672
Total Tier 1 capital	**4,275**	4,180
Tier 2 capital		
Subordinated debt	**1,019**	749
Total Tier 2 capital	**1,019**	749
Total regulatory capital	**5,294**	4,929

(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.
(3) Includes deferred tax on losses in relation to Virgin Money Unit Trust Managers Limited (UTM) which is proportionately consolidated under prudential rules.

Capital risk (continued)

Regulatory capital flow of funds[1]	**2021** **£m**	2020 £m
CET1 capital[2]		
CET1 capital at 1 October	**3,508**	3,462
Retained earnings and other reserves (including special purpose entities)	**502**	(97)
Prudent valuation adjustment	**1**	(1)
Amendment to software asset deduction rules[3]	**151**	-
Intangible assets	**118**	24
Deferred tax asset relying on future profitability	**(173)**	35
Defined benefit pension fund assets	**(81)**	(213)
AT1 foreseeable distribution	**7**	-
Foreseeable dividend on ordinary shares	**(254)**	-
Excess expected losses	**-**	88
IFRS 9 transitional adjustments	**(176)**	210
Total CET1 capital at 30 September	**3,603**	3,508
AT1 capital		
AT1 capital at 1 October	**672**	672
Total AT1 capital at 30 September	**672**	672
Total Tier 1 capital at 30 September	**4,275**	4,180
Tier 2 capital		
Tier 2 capital at 1 October	**749**	723
Capital instruments issued: subordinated debt	**298**	472
Capital instruments purchased: subordinated debt	**(30)**	(446)
Amortisation of issue costs	**2**	-
Total Tier 2 capital at 30 September	**1,019**	749
Total capital	**5,294**	4,929

(1) Data in the table is reported under CRD IV on a fully loaded basis with IFRS 9 transitional arrangements applied.
(2) CET1 capital is comprised of shares issued and related share premium, retained earnings and other reserves less specified regulatory adjustments.
(3) Regulatory capital is calculated in line with current rules which incorporate the amendments introduced by the CRR Quick Fix in December 2020, which apply the CET1 software asset deduction on a prudential amortisation basis over a period of three years. The PRA confirmed in the year that this relief will be removed with effect from 1 January 2022.

The Group's CET1 capital increased by £95m in the year, primarily due to increases in retained earnings and other reserves of £502m (driven mainly by statutory profit after tax of £532m), a reduction in intangible assets of £118m and the beneficial effect of the CRR Quick Fix amendments in relation to software assets of £151m. These increases were offset by an increase of £173m in the deferred tax recognised on tax losses carried forward and an increase in the defined benefit fund pension asset of £81m. The reduction in IFRS 9 provisions recognised in the year reduced the transitional relief available by £176m and the net increase in distributions on ordinary shares and AT1 notes reduced CET1 by a further £247m.

The Group issued £300m Tier 2 Capital Notes (£298m net of costs of £2m) in May 2021, which after the redemption of £30m of Notes issued in 2016, increased Tier 2 capital by £270m.

Risk report (continued)
Financial risk (continued)

Capital risk (continued)

Risk Weighted Assets

	2021			2020		
Minimum capital requirements	**Exposure £m**	**RWA £m**	**Minimum capital requirement £m**	Exposure £m	RWA £m	Minimum capital requirement £m
Retail mortgages	**61,146**	**10,010**	**801**	61,548	9,484	759
Business lending	**11,668**	**6,038**	**483**	12,302	6,714	537
Other retail lending	**16,201**	**4,311**	**345**	15,160	4,151	332
Other lending	**15,462**	**326**	**25**	15,703	320	29
Other[1]	**756**	**835**	**67**	740	794	61
Total credit risk RWA	**105,233**	**21,520**	**1,721**	105,453	21,463	1,718
Credit valuation adjustment		**103**	**8**		175	14
Operational risk		**2,466**	**197**		2,567	205
Counterparty credit risk		**105**	**8**		179	14
Total RWA	**105,233**	**24,194**	**1,934**	105,453	24,384	1,951

1) The items included in the Other exposure class that attract a capital charge include items in the course of collection, fixed assets, intangible assets on software less than three years old, prepayments, other debtors and deferred tax assets that are not deducted.

	2021					2020				
RWA movements	**IRB RWA £m**	**STD RWA £m**	**Other RWA £m**	**Total £m**	**Minimum capital requirement £m**	IRB RWA £m	STD RWA £m	Other RWA £m	Total £m	Minimum capital requirement £m
Opening RWA	**15,845**	**5,618**	**2,921**	**24,384**	**1,951**	15,721	6,398	3,052	25,171	2,014
Asset size	**(553)**	**157**	**-**	**(396)**	**(32)**	(270)	(78)	-	(348)	(29)
Asset quality	**(644)**	**19**	**-**	**(625)**	**(50)**	332	(158)	-	174	14
Model updates[1]	**1,086**	**-**	**-**	**1,086**	**87**	297	-	-	297	24
Methodology and policy	**(36)**	**151**	**-**	**115**	**9**	(704)	(48)	-	(752)	(60)
IRB accreditation	**-**	**-**	**-**	**-**	**-**	457	(473)	-	(16)	(1)
Other[2]	**-**	**(123)**	**(247)**	**(370)**	**(31)**	12	(23)	(131)	(142)	(11)
Closing RWA	**15,698**	**5,822**	**2,674**	**24,194**	**1,934**	15,845	5,618	2,921	24,384	1,951

(1) Model updates include the mortgage quarterly PD calibrations.
(2) 'Other' includes operational risk, credit valuation adjustment and counterparty credit risk.

RWA reduced c.£0.2bn (1%) to £24.2bn primarily due to the impact of business effective maturity methodology changes in the period and as lending volumes remained stable.

In the table above, methodology and policy movement is largely driven by the inclusion of a £151m RWA uplift in relation to the CRR Quick Fix amendments in respect of intangible assets, which became effective from December 2020 reporting.

In addition, the migration of the heritage Virgin Money HPI from Markit to MIAC Acadametrics, which now aligns the source of the indexation across both heritages, resulted in a £161m RWA uplift in February 2021. Offsetting this was the move to using effective maturity within the FIRB calculations, which resulted in a £197m reduction in RWA (previously only residual maturity had been used). This was implemented in November 2020 following PRA approval.

Model updates includes a £344m uplift in RWA specific to COVID-19 related PMAs and a net £742m uplift specific to PD recalibrations.

Risk report (continued)
Financial risk (continued)

Capital risk (continued)

IFRS 9 transitional arrangements

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

	2021 (£m)	
Available capital (amounts)	**IFRS 9 Transitional basis**	**IFRS 9 Fully loaded basis**
CET1 capital	**3,603**	**3,469**
Tier 1 capital	**4,275**	**4,141**
Total capital	**5,294**	**5,197**
RWA (amounts)		
Total RWA	**24,194**	**24,118**
Capital ratios		
CET1 (as a percentage of RWA)	**14.9%**	**14.4%**
Tier 1 (as a percentage of RWA)	**17.7%**	**17.2%**
Total capital (as a percentage of RWA)	**21.9%**	**21.5%**
Leverage ratio		
Leverage ratio total exposure measure	**84,293**	**84,159**
CRD IV leverage ratio	**5.1%**	**4.9%**
UK leverage ratio	**5.1%**	**5.0%**

Transitional arrangements in CRR mean the regulatory capital impact of ECL is being phased in over time. Following the CRR Quick Fix amendments package, which applied from 27 June 2020, relevant provisions raised from 1 January 2020 through to 2024 have a CET1 add-back percentage of 100% in 2021, reducing to 75% in 2022, 50% in 2023 and 25% in 2024.

At 30 September 2021, £134m of IFRS 9 transitional adjustments (2020: £310m) have been applied to the Group's capital position in accordance with CRR: £10m of static and £124m of dynamic adjustments (2020: £12m static and £298m dynamic).

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.

	2021	
Minimum Requirements	**CET1**	**Total Capital**
Pillar 1[(1)]	**4.5%**	**8.0%**
Pillar 2A	**2.2%**	**3.9%**
Total Capital Requirement	**6.7%**	**11.9%**
Capital conservation buffer	**2.5%**	**2.5%**
UK countercyclical capital buffer	**0.0%**	**0.0%**
Total (excluding PRA buffer)[(2)]	**9.2%**	**14.4%**

(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) 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 of 5.7% (equivalent to £1,373m) over its CRD IV minimum CET1 requirement of 9.2%. The Group's total capital Pillar 2A requirement has reduced from 4.4% at September 2020 to 3.9% at September 2021 following revisions made by the PRA during the year. Subsequent to the year end, in October 2021, further revisions were made to the Group's Pillar 2A requirement, reducing the total requirement further to 3.1%, with the CET1 requirement similarly reducing from 2.2% to 1.7%.

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, 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 will be set between 1% and 2% in a standard risk environment. On 11 March 2020, as part of a package of measures to support the economy from the impact of COVID-19, the FPC announced a reduction in the UK CCyB to 0% with immediate effect. During July 2021 the FPC provided guidance to maintain the 0% rate until at least December 2021. As any increases to CCyB are usually subject to a twelve month implementation period, any subsequent increase would not take effect until the end of 2022 at the earliest.

Currently, the Group does not meet the criteria for designation as a systemically important institution, or the threshold for systemic risk: therefore, the Group is not subject to either a G-SII buffer or SRB.

MREL

Under the Bank Recovery and Resolution Directive the Group is required to hold additional loss-absorbing instruments to support an effective resolution. The MREL establishes a minimum amount of equity and eligible debt to recapitalise the Bank. An analysis of the Group's current MREL position is provided below:

MREL position	**2021 £m**	2020 £m
Total capital resources[1]	**5,294**	4,929
Eligible senior unsecured securities issued by Clydesdale Bank PLC[2]	**2,408**	2,002
Total MREL resources	**7,702**	6,931
Risk-weighted assets	**24,194**	24,384
MREL ratio	**31.8%**	28.4%

(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 January 2021, the BoE published industry interim and end-state MREL that will apply to the Group.

In 2021, the Group is subject to a binding interim MREL requirement of 18% of RWA, or 20.5% of RWA when including its combined buffer requirements. From 1 January 2022, the Group expects to have to meet an end-state MREL requirement of 22.2% of RWA, or 24.7% of RWA when including its combined buffer requirements.

Following further issuance over the period, the Group's IFRS 9 transitional MREL ratio improved to 31.8% as at 30 September 2021 (2020: 28.4%). This represents prudent headroom of 7.2% or c.£1.7bn over the Group's expected 1 January 2022 MREL Requirement.

Capital risk (continued)

Dividend

The Board has recommended a final dividend for the financial year ended 30 September 2021 of 0.12p per share.

Leverage

Leverage ratio	2021 £m	2020 £m
Total Tier 1 capital for the leverage ratio		
Total CET1 capital	**3,603**	3,508
AT1 capital	**672**	672
Total Tier 1 capital	**4,275**	4,180
Exposures for the leverage ratio		
Total assets as per published financial statements	**89,216**	90,307
Adjustment for off-balance sheet items	**2,884**	2,892
Adjustment for derivative financial instruments	**91**	81
Adjustment for securities financing transactions	**2,235**	2,072
Adjustment for qualifying central bank claims	**(9,094)**	(8,088)
Other adjustments	**(1,039)**	(789)
Leverage ratio exposure	**84,293**	86,475
CRD IV leverage ratio(1)	**5.1%**	4.8%
UK leverage ratio(2)	**5.1%**	4.9%
Average UK leverage ratio exposure(3)	**83,206**	85,712
Average UK leverage ratio(3)	**4.7%**	4.6%

(1) IFRS 9 transitional capital arrangements have been applied to the CRD IV leverage ratio calculation.

(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.

The UK leverage ratio framework is relevant to PRA regulated banks and building societies with consolidated retail deposits equal to or greater than £50bn. The Group exceeds this threshold and accordingly the average UK leverage ratio exposure and average UK leverage ratio are disclosed.

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

The leverage ratio is the ratio of Tier 1 capital to total 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 5.1% (2020: 4.8%) exceeds the Basel Committee's proposed minimum of 3% and the Group's UK leverage ratio of 5.1% (2020: 4.9%) exceeds the UK minimum ratio of 3.25%.

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

Risk report (continued)
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 ensures future balance sheet growth is sustainable.

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 supported by the Group's ongoing wholesale funding programmes, medium-term secured funding issuance (e.g. the Group's securitisation programmes), Regulated Covered Bonds and unsecured medium-term notes. The Group also has access to and has drawn against the BoE TFS and Term Funding Scheme with additional incentives for SMEs (TFSME), both schemes introduced to support the UK through periods of instability.

Funding risk exposures arise from an unsustainable or undiversified funding base creating an inability to maintain or raise sufficient funds within necessary time periods, for example, a reliance on short-term wholesale deposits. The risk may result in deviation from funding strategy, negatively impact market or customer perception, increase the acquisition cost of new funds or reduce lending capacity, thereby adversely impacting financial performance and stability.

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 requirement 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 which reflect both regulatory requirements, as a minimum, and the Group's own view on risk sensitivities. The Group RAS is supported by 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 the quantum, diversity and operational capability 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 is managed in accordance with the ILAAP, which is approved by the Board. 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.

The Treasury function is responsible for the development and execution of strategy subject to oversight from the Risk function and monthly review at 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.

Monitoring

Liquidity is monitored and measured daily by the Group, with reporting 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 the Group's 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.

Funding and liquidity risk (continued)

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 and bilateral relationships 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 had access to funding via the TFS. Following its launch in April 2020, the Group has also been able to access additional funding from 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. Throughout 2021, the Group repaid a significant proportion of outstanding TFS amounts and has a strategy in place to repay the full amount comfortably in advance of the maturity date, funded by a combination of customer deposits, public market issuance and TFSME drawings.

The funding plan includes an assessment of the Group's capacity for raising funds across a wide range of primary funding sources, thereby mitigating funding risk. Refinancing risks are carefully managed and are subject to controls overseen by ALCO. The Group's funding plan includes TFSME repayment profiles designed to manage refinancing risk within a suitably prudent time frame.

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 time frame and defines a management committee to manage the action plan and return the balance sheet structure within appetite.

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

Sources of funding (audited)

The table below provides an overview of the Group's sources of funding as at 30 September 2021:

	2021 £m	2020 £m
Total assets	**89,216**	90,307
Less: Other liabilities(1)	**(6,504)**	(6,205)
Funding requirement	**82,712**	84,102
Funded by:		
Customer deposits	**66,971**	67,710
Debt securities in issue	**4,241**	5,933
Due to other banks	**5,918**	5,469
of which:		
Secured loans	**5,896**	*5,397*
Transaction balances with other banks	**-**	*15*
Deposits with other banks	**22**	*57*
Equity	**5,582**	4,990
Total funding	**82,712**	84,102

(1) Other liabilities include derivative financial instruments, amounts due to related entities, deferred tax liabilities, provisions for liabilities and charges, 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 lending growth. At 30 September 2021, the Group had a funding requirement of £82,712m (2020: £84,102m) with the majority being used to support loans and advances to customers.

Funding and liquidity risk (continued)

Customer deposits
The majority of the Group's funding requirement was met by customer deposits of £66,971m (30 September 2020: £67,710m). Customer deposits are comprised of interest bearing deposits, term deposits and non-interest bearing demand deposits from a range of sources including Personal and Business customers. The managed decrease in customer deposits of £739m in the year is consistent with the reduced funding requirement.

Equity
Equity of £5,582m (2020: £4,990m) 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.

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 LCR moved from 140% to 151% during the year and remains comfortably above regulatory and internal risk appetite.

Liquidity coverage ratio (audited)	**2021** **£m**	2020 £m
Eligible liquidity buffer	**10,996**	10,675
Net stress outflows	**7,289**	7,609
Surplus	**3,707**	3,066
Liquidity coverage ratio	**151%**	140%

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 defined through a series of internal stress tests across a range of time horizons and stress conditions. 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).

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 franchise 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 2021, the Group held eligible liquid assets well in excess of 100% of net stress outflows and Pillar 2 liquidity requirements, as defined through internal risk appetite.

Funding and liquidity risk (continued)

Liquid asset portfolio[1] (audited)	2021 £m	2020 £m	Change %	Average 2021 £m	Average 2020 £m
Level 1					
Cash and balances with central banks	**7,060**	6,255	**12.9**	**7,232**	6,430
UK Government treasury bills and gilts	**771**	1,232	**(37.4)**	**779**	1,301
Other debt securities	**3,239**	3,262	**(0.7)**	**3,296**	3,186
Total level 1	**11,070**	10,749	**3.0**	**11,307**	10,917
Level 2[2]	**23**	29	**(20.7)**	**24**	33
Total LCR eligible assets	**11,093**	10,778	**2.9**	**11,331**	10,950

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

Cash and balances with central banks of £9,711m, as per note 3.4, includes: £2,333m of assets that are encumbered to support the issuance of Scottish bank notes (excluding notes not in circulation) and to support payments systems; £257m of mandatory central bank deposits; and £58m excluded from LCR to cover operating expenses.

Financial assets at FVOCI of £4,352m, as per note 3.7, include: £586m of encumbered UK Government treasury bills and gilts, £312m of which is encumbered to support Operational Continuity in Resolution.

The introduction of a binding NSFR is due to be implemented in the UK on 1 January 2022. Based on current interpretations of European regulatory requirements and guidance, the ratio as at 30 September 2021 is 134% (2020: 131%).

Encumbered assets

The Group manages the level of asset encumbrance to ensure appropriate volumes of assets are maintained to support future planned and potential stressed funding requirements. Encumbrance limits are set in the Group RAS and calibrated to ensure that after a stress scenario is applied, 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 and TFSME schemes, 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.

Funding and liquidity risk (continued)

Encumbered assets by asset category (audited)

	Assets encumbered with non-central bank counterparties					Other assets				
					Positioned at the central bank (including encumbered)	Assets not positioned at the central bank				
2021	**Covered bonds £m**	**Securiti-sations £m**	**Other £m**	**Total £m**	**Positioned at the central bank (including encumbered) £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	**2,618**	**4,970**	**-**	**7,588**	**14,108**	**30,175**	**17,417**	**2,719**	**64,419**	**72,007**
Cash and balances with central banks	**-**	**-**	**-**	**-**	**2,827**	**6,884**	**-**	**-**	**9,711**	**9,711**
Due from other banks	**352**	**310**	**76**	**738**	**-**	**-**	**62**	**-**	**62**	**800**
Derivative financial instruments	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**140**	**140**	**140**
Financial instruments at FVOCI	**-**	**-**	**586**	**586**	**-**	**3,766**	**-**	**-**	**3,766**	**4,352**
Other assets	**-**	**-**	**296**	**296**	**-**	**-**	**266**	**1,644**	**1,910**	**2,206**
Total	**2,970**	**5,280**	**958**	**9,208**	**16,935**	**40,825**	**17,745**	**4,503**	**80,008**	**89,216**

	Assets encumbered with non-central bank counterparties					Other assets				
						Assets not positioned at the central bank				
2020	Covered bonds £m	Securiti-sations £m	Other £m	Total £m	Positioned at the central bank (including encumbered) £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 FVOCI	-	-	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

Risk report (continued)
Financial risk (continued)

Funding and liquidity risk (continued)

The Group's total non-central bank asset encumbrance decreased by £3,186m to £9,208m as at 30 September 2021. This was primarily due to a reduction in residential mortgage-backed securities (RMBS) funding. Current levels of encumbrance include the impact of use of TFS and TFSME schemes which are subject to a repayment profile to manage refinancing risk.

Assets and liabilities by maturity (audited)

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. The majority of customer deposits are repayable on demand or at short notice on a contractual basis, with behavioural maturities typically longer than their contractual maturity. 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	Call	3 months or less	3 to 12 months	1 to 5 years	Over 5 years	No specified maturity[1]	Total
30 September 2021	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Assets							
Financial assets at amortised cost							
Loans and advances to customers	**766**	**1,966**	**1,051**	**6,652**	**56,812**	**4,627**	**71,874**
Cash and balances with central banks	**8,337**	**-**	**-**	**-**	**-**	**1,374**	**9,711**
Due from other banks	**800**	-	-	-	-	-	**800**
Financial assets at FVTPL							
Loans and advances to customers	**-**	**3**	**12**	**44**	**74**	**-**	**133**
Derivative financial instruments	**1**	**8**	**21**	**102**	**8**	**-**	**140**
Other financial assets at fair value	**-**	**-**	**-**	**-**	**-**	**16**	**16**
Due from related entities	**-**	**4**	-	-	-	-	**4**
Financial assets at FVOCI	**-**	**35**	**448**	**2,176**	**1,693**	**-**	**4,352**
Other assets	**-**	**14**	**189**	**2**	**1**	**1,980**	**2,186**
Total assets	**9,904**	**2,030**	**1,721**	**8,976**	**58,588**	**7,997**	**89,216**
Liabilities							
Financial liabilities at amortised cost							
Customer deposits	**49,477**	**4,079**	**9,327**	**4,088**	**-**	**-**	**66,971**
Debt securities in issue	**-**	**118**	**1,141**	**2,982**	**-**	**-**	**4,241**
Due to other banks	**18**	**2**	**1,248**	**4,650**	**-**	**-**	**5,918**
Financial liabilities at FVTPL							
Derivative financial instruments	**1**	**5**	**38**	**94**	**71**	**-**	**209**
Due to related entities	**23**	**28**	**-**	**3,399**	**-**	**-**	**3,450**
Other liabilities	**2,104**	**52**	**82**	**65**	**70**	**472**	**2,845**
Total liabilities	**51,623**	**4,284**	**11,836**	**15,278**	**141**	**472**	**83,634**
Off balance sheet items							
Financial guarantees	**-**	**20**	**21**	**15**	**45**	**-**	**101**
Other credit commitments	**17,020**	**-**	**-**	**-**	**-**	**-**	**17,020**
Total off-balance sheet items	**17,020**	**20**	**21**	**15**	**45**	**-**	**17,121**

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

Funding and liquidity risk (continued)

Group 30 September 2020- Restated	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[2]	785	1,794	1,037	7,052	57,333	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 FVTPL							
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 FVOCI	-	732	251	2,318	1,779	-	5,080
Other assets	-	32	322	2	1	1,888	2,245
Total assets	9,149	2,696	1,741	9,513	59,332	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 FVTPL							
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.
2) The contractual maturity profile for Loans and advances to customers in the prior year incorrectly included £4,873m of balances within the 'less than 5 years' category which had a maturity of over 5 years at that date. These have been reclassified in the current year to the relevant ageing categories, which has resulted in a reduction in amounts due at 30 September 2020 of the following: 3 months or less - £264m; 3 to 12 months - £783m; 1 to 5 years - £3,826m.

Risk report (continued)
Financial risk (continued)

Funding and liquidity risk (continued)

Assets and liabilities by maturity (continued)

Bank 30 September 2021	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	**766**	**1,959**	**1,040**	**6,578**	**55,952**	**4,627**	**70,922**
Cash and balances with central banks	**8,337**	**-**	**-**	**-**	**-**	**1,374**	**9,711**
Due from other banks	**146**	**-**	**-**	**-**	**-**	**-**	**146**
Financial assets at FVTPL							
Loans and advances to customers	**-**	**3**	**12**	**44**	**74**	**-**	**133**
Derivative financial instruments	**1**	**8**	**21**	**49**	**8**	**-**	**87**
Other financial assets at fair value	**-**	**-**	**-**	**-**	-	**1**	**1**
Due from related entities	**895**	**11**	**104**	-	-	**89**	**1,099**
Financial assets at FVOCI	**-**	**35**	**448**	**2,176**	**1,693**	**-**	**4,352**
Other assets	**-**	**16**	**194**	**2**	**1**	**2,015**	**2,228**
Total assets	**10,145**	**2,032**	1,819	**8,849**	**57,728**	**8,106**	**88,679**
Liabilities							
Financial liabilities at amortised cost							
Customer deposits	**49,477**	**4,079**	**9,327**	**4,088**	-	-	**66,971**
Debt securities in issue	**-**	**10**	**-**	**1,812**	-	-	**1,822**
Due to other banks	**18**	**2**	**1,248**	**4,650**	-	-	**5,918**
Financial liabilities at FVTPL							
Derivative financial instruments	**1**	**5**	**25**	**58**	**71**	**-**	**160**
Due to related entities	**453**	**78**	**430**	**4,524**	**-**	**-**	**5,485**
Other liabilities	**2,104**	**52**	**83**	**65**	**70**	**471**	**2,845**
Total liabilities	**52,053**	**4,226**	**11,113**	**15,197**	**141**	**471**	**83,201**
Off balance sheet items							
Financial guarantees	**-**	**20**	**21**	**15**	**45**	**-**	**101**
Other credit commitments	**16,960**	**-**	**-**	**-**	**-**	**-**	**16,960**
Total off-balance sheet items	**16,960**	**20**	**21**	**15**	**45**	**-**	**17,061**

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

Funding and liquidity risk (continued)

Assets and liabilities by maturity (continued)

Bank 30 September 2020- Restated	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[2]	785	1,787	1,029	6,969	56,439	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 FVTPL							
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 FVOCI	-	732	251	2,318	1,779	-	5,080
Other assets	-	33	325	2	1	1,953	2,314
Total assets	9,471	2,578	1,706	9,419	58,342	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 FVTPL							
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.
(2) The contractual maturity profile for Loans and advances to customers in the prior year incorrectly included £4,873m of balances within the 'less than 5 years' category which had a maturity of over 5 years at that date. These have been reclassified in the current year to the relevant ageing categories, which has resulted in a reduction in amounts due at 30 September 2020 of the following: 3 months or less - £264m; 3 to 12 months - £783m; 1 to 5 years - £3,826m.

Risk report (continued)
Financial risk (continued)

Funding and liquidity risk (continued)

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

Group 2021	Call £m	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	No specified maturity £m	Total £m
Liabilities							
Financial liabilities at amortised cost							
Customer deposits	**49,477**	**4,104**	**9,403**	**4,127**	**-**	**-**	**67,111**
Debt securities in issue	**-**	**115**	**1,193**	**3,108**	**-**	**-**	**4,416**
Due to other banks	**18**	**2**	**1,258**	**4,756**	**-**	**-**	**6,034**
Financial liabilities at FVTPL							
Trading derivative liabilities	**-**	**16**	**38**	**31**	**20**	**-**	**105**
Hedging derivative liabilities							**-**
Contractual amounts payable	**-**	**5**	**244**	**1,750**	**25**	**-**	**2,024**
Contractual amounts receivable	**-**	**(9)**	**(199)**	**(1,614)**	**-**	**-**	**(1,822)**
Due to related entities	**23**	**33**	**91**	**3,780**	**-**	**-**	**3,927**
All other financial liabilities	**2,104**	**52**	**82**	**65**	**70**	**472**	**2,845**
Total liabilities	**51,622**	**4,318**	**12,110**	**16,003**	**115**	**472**	**84,640**

Group 2020	Call £m	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	No specified maturity £m	Total £m
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 FVTPL							
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

Risk report (continued)
Financial risk (continued)

Funding and liquidity risk (continued)

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

Bank 2021	Call £m	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	No specified maturity £m	Total £m
Liabilities							
Financial liabilities at amortised cost							
Customer deposits	49,477	4,104	9,403	4,127	-	-	67,111
Debt securities in issue	-	1	37	1,958	-	-	1,996
Due to other banks	18	2	1,258	4,756	-	-	6,034
Financial liabilities at FVTPL							
Customer deposits	-	16	38	31	20	-	105
Hedging derivative liabilities							
Contractual amounts payable	-	5	244	1,750	25	-	2,024
Contractual amounts receivable	-	(9)	(199)	(1,614)	-	-	(1,822)
Due to related entities	453	154	1,284	6,888	-	-	8,779
All other financial liabilities	2,104	52	83	65	70	471	2,845
Total liabilities	52,052	4,325	12,148	17,961	115	471	87,072

Bank 2020	Call £m	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	No specified maturity £m	Total £m
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 FVTPL							
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

The balances in the cash flow tables above will not agree directly to the balances in the balance sheets or the assets and liabilities by maturity table presented above, as the table incorporates all cash flows, on an undiscounted basis, related to both principal and future coupon payments.

Funding and liquidity risk (continued)

Analysis of debt securities in issue by residual maturity

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

	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	Total at 30 Sep 2021 £m	Total at 30 Sep 2020 £m
Covered bonds	10	-	1,842	-	1,852	1,928
Securitisation	108	1,141	1,140	-	2,389	4,005
Total debt securities in issue	118	1,141	2,982	-	4,241	5,933

External credit ratings

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

Material risk for the Group	Outlook as at 30 Sep 2021(1)	As at 30 Sep 2021	As at 30 Sep 2020
Virgin Money UK PLC			
Moody's	**Stable**	**Baa2**	Baa3
Fitch	**Stable**	**BBB+**	BBB+
Standard & Poor's	**Stable**	**BBB-**	BBB-
Clydesdale Bank PLC			
Moody's(2)	**Stable**	**Baa1**	Baa1
Fitch	**Stable**	**A-**	A-
Standard & Poor's	**Stable**	**A-**	BBB+

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

In January 2021, Standard & Poor's affirmed Virgin Money UK PLC's ratings and upgraded the long-term rating of Clydesdale Bank PLC by one notch to A-. The upgrade reflects the Group's improved additional loss-absorbing capacity following Virgin Money UK PLC's MREL issuance, which provides additional protection for Clydesdale Bank's senior creditors in resolution and now exceeds Standard & Poor's threshold for an additional notch of benefit.

In June 2021, Standard & Poor's revised the outlook on Virgin Money UK PLC's and Clydesdale Bank PLC's long-term ratings to 'Stable' from 'Negative', reflecting their stabilising view of the UK economy coupled with the Group's improving asset quality outlook, conservative risk appetite and robust provisioning.

In July 2021, Fitch affirmed the long-term ratings of Virgin Money UK PLC and Clydesdale Bank PLC and revised their outlook to 'Stable' from 'Negative'. This followed the revision in Fitch's outlook on the UK's AA- long-term rating to 'Stable', reflecting their improved expectations for the UK's economic recovery and subsequent reduction in downside risk to the Group's asset quality, capitalisation and strategic execution.

In July 2021, Moody's upgraded Virgin Money UK PLC's long-term rating to Baa2 from Baa3 following revisions to their Advanced Loss Given Failure framework. At the same time Moody's reaffirmed the 'Stable' outlook on all of Clydesdale Bank PLC's and Virgin Money UK PLC's ratings.

As at 23 November 2021, there have been no other changes to the Group's long-term credit ratings or outlooks since the report date.

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.

Exposure

The Group's principal exposure comes from structural interest rate risk. It comprises the sensitivity of the Group's current and future NII 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.

Outlook

Although current higher term rates suggest that the probability of a negative official Bank rate appears to have reduced, the BoE continues to require financial institutions to be operationally ready to implement such a policy step in a way that does not adversely affect the safety and soundness of firms. The PRA continues to assess the operational readiness of firms in the event of negative rates being deployed as a monetary policy tool to support the economy, and has confirmed the Group's readiness, following the documentation of an executable and tested solution.

Measurement

Interest Rate Risk in the Banking Book (IRRBB) is measured, monitored, and managed from both an internal management and regulatory perspective. The RMF incorporates both market valuation and earnings-based approaches. In accordance with the Group IRRBB policy standard, risk measurement techniques include: basis point sensitivity, NII sensitivity, VaR, 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;
- NII 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.

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

Market risk (continued)

Mitigation

Market risks are overseen by ALCO with delegation for day-to-day management given to Treasury, who use 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.

The Group uses derivative financial instruments to manage interest rate and foreign currency risk within approved limits. The Group elects to apply hedge accounting for the majority of its risk management activity that uses derivatives. Certain derivatives are designated as either fair value hedge or cash flow hedge:

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 within note 3.6 to 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. However, for cash flow hedges that were previously designated in respect of LIBOR linked hedged items, the Group had to apply available reliefs such that the Group can now view the variable cash flows as being SONIA linked rather than LIBOR (as LIBOR is being replaced, the original expectations of LIBOR cash flows are no longer expected to occur). The fair value of derivatives is disclosed within note 3.6 to the Group's consolidated financial statements.

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.

	Group			
	Duration risk VaR		**Credit spread**(1)	
	2021	2020	**2021**	2020
Value at Risk (audited)	**£m**	£m	**£m**	£m
As at 30 September	**2**	2	**45**	49
Average value during the year	**2**	2	**48**	36
Minimum value during the year	**1**	1	**45**	23
Maximum value during the year	**3**	2	**52**	49

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

Net interest income (audited)

Earnings sensitivity measures calculate the change in NII over a 12-month period resulting from an instantaneous and parallel change in interest rates, +/- 25 basis point shocks represents the primary NII sensitivity assessed internally, though a range of scenarios are assessed on a monthly basis.

	2021	2020
12 months NII sensitivity	**£m**	£m
+ 25 basis point parallel shift	**30**	76
- 25 basis point parallel shift	**(23)**	(67)

The significant reduction in reported sensitivity year on year reflects the impact of reinstating the structural hedge during the year. The sensitivities disclosed reflect the expected mechanical response to a movement in rates and represent a prudent outcome. The sensitivities are indicative only and should not be viewed as a forecast.

Risk report (continued)
Financial risk (continued)

Market risk (continued)

Net interest income (audited) (continued)

The key assumptions and limitations are outlined below:

- the sensitivities are calculated based on a static balance sheet and it is assumed there is no change to margins on reinvestment of maturing fixed rate products;
- there are no changes to basis spreads with the rate change passed on in full to all interest rate bases;
- administered rate products receive a full rate pass on in the rate fall scenario, subject to internal product floor assumptions. In the rate rise scenario administered products receive a rate pass on in line with internal scenario specific pass on assumptions;
- additional commercial pricing responses and management actions are not included; and
- while in practice hedging strategy would be reviewed in light of changing market conditions, the sensitivities assume no changes over the 12-month period.

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:

	2021 £m	2020 £m	**Interest rate duration**	**Optionality**	**Basis**	**Credit Spread**	**Foreign Exchange**
Assets							
Financial assets at amortised cost							
Loans and advances to customers	**71,874**	72,428	●	●	●		●
Cash and balances with central banks	**9,711**	9,107	●		●		
Due from other banks	**800**	927	●		●		●
Financial assets at FVTPL							
Loans and advances to customers	**133**	190	●	●	●		●
Derivative financial instruments	**140**	318	●		●		●
Other financial assets	**16**	1	●				●
Financial instruments at FVOCI	**4,352**	5,080	●		●	●	●
Other assets	**2,190**	2,256	●				●
Total assets	**89,216**	90,307					

Liabilities							
Financial liabilities at amortised cost							
Customer deposits	**66,971**	67,710	●	●	●		●
Debt securities in issue	**4,241**	5,933	●		●		●
Due to other banks	**5,918**	5,469	●		●		●
Financial liabilities at FVTPL							
Derivative financial instruments	**209**	250	●		●		●
Other liabilities	**6,295**	5,955	●				●
Total liabilities	**83,634**	85,317					

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 2021, the Group reinstated structural hedging. The structural hedging programme lengthened 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 Group Annual Report and Accounts.

Group 2021	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	**3,978**	**12,397**	**14,199**	**39,732**	**1,568**	**-**	**71,874**
Cash and balances with central banks	**8,182**	**12**	**37**	**196**	**-**	**1,284**	**9,711**
Due from other banks	**538**	**262**	**-**	**-**	**-**	**-**	**800**
Financial assets at FVTPL							
Loans and advances to customers	**-**	**83**	**8**	**20**	**22**	**-**	**133**
Derivative financial instruments	**-**	**-**	**-**	**-**	**-**	**140**	**140**
Due from related entities	**4**	**-**	**-**	**-**	**-**	**-**	**4**
Financial instruments at FVOCI	**1,147**	**537**	**228**	**1,172**	**1,268**	**-**	**4,352**
Other assets	**-**	**38**	**113**	**604**	**-**	**1,447**	**2,202**
Total assets	**13,849**	**13,329**	**14,585**	**41,724**	**2,858**	**2,871**	**89,216**
Liabilities							
Financial liabilities at amortised cost							
Customer deposits	**4,619**	**27,599**	**11,877**	**22,874**	**2**	**-**	**66,971**
Debt securities in issue	**2,341**	**272**	**198**	**1,430**	**-**	**-**	**4,241**
Due to other banks	**5,918**	**-**	**-**	**-**	**-**	**-**	**5,918**
Financial liabilities at FVTPL							
Derivative financial instruments	**-**	**-**	**-**	**-**	**-**	**209**	**209**
Due to related entities	**-**		**-**	**3,450**	**-**	**-**	**3,450**
Other liabilities	**-**	**-**	**-**	**-**	**-**	**2,845**	**2,845**
Equity	**1,062**	**191**	**573**	**3,756**	**-**	**-**	**5,582**
Total liabilities and equity	**13,940**	**28,062**	**12,648**	**31,510**	**2**	**3,054**	**89,216**
Off balance sheet items							
Notional value of derivatives managing interest rate sensitivity	**21,786**	**(1,891)**	**(7,089)**	**(10,415)**	**(2,391)**	**-**	**-**
Total interest rate gap	**21,695**	**(16,624)**	**(5,152)**	**(201)**	**465**	**(183)**	**-**
Cumulative interest rate gap	**21,695**	**5,071**	**(81)**	**(282)**	**183**	**-**	**-**

Risk report (continued)
Financial risk (continued)

Market risk (continued)

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

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 FVTPL							
Loans and advances to customers	-	119	10	29	32	-	190
Derivative financial instruments	-	-	-	-	-	318	318
Due from related entities	11	-	-	-	-	-	11
Financial instruments at FVOCI	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 FVTPL							
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	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)

Bank 2021	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	**3,978**	**11,445**	**14,199**	**39,732**	**1,568**	**-**	**70,922**
Cash and balances with central banks	**8,182**	**12**	**37**	**196**	**-**	**1,284**	**9,711**
Due from other banks	**146**	**-**	**-**	**-**	**-**	**-**	**146**
Financial assets at FVTPL							
Loans and advances to customers	**-**	**83**	**8**	**20**	**22**	**-**	**133**
Derivative financial instruments	**-**	**-**	**-**	**-**	**-**	**87**	**87**
Due from related entities	**-**	**1,099**	**-**	**-**	**-**	**-**	**1,099**
Financial instruments at FVOCI	**1,147**	**537**	**228**	**1,172**	**1,268**	**-**	**4,352**
Other assets	**-**	**38**	**113**	**604**	**-**	**1,424**	**2,179**
Investment in related entities	**50**	**-**	**-**	**-**	**-**	**-**	**50**
Total assets	**13,503**	**13,214**	**14,585**	**41,724**	**2,858**	**2,795**	**88,679**
Liabilities							
Financial liabilities at amortised cost							
Customer deposits	**4,619**	**27,599**	**11,877**	**22,874**	**2**	**-**	**66,971**
Debt securities in issue	**589**	**-**	**-**	**1,233**	**-**	**-**	**1,822**
Due to other banks	**5,918**	**-**	**-**	**-**	**-**	**-**	**5,918**
Financial liabilities at FVTPL							
Derivative financial instruments	**-**	**-**	**-**	**-**	**-**	**160**	**160**
Due to related entities	**1,368**	**272**	**198**	**3,647**	**-**	**-**	**5,485**
Other liabilities	**-**	**-**	**-**	**-**	**-**	**2,845**	**2,845**
Equity	**958**	**191**	**573**	**3,756**	**-**	**-**	**5,478**
Total liabilities and equity	**13,452**	**28,062**	**12,648**	**31,510**	**2**	**3,005**	**88,679**
Off balance sheet items							
Notional value of derivatives managing interest rate	**21,786**	**(1,891)**	**(7,089)**	**(10,415)**	**(2,391)**	**-**	**-**
Total interest rate gap	**21,837**	**(16,739)**	**(5,152)**	**(201)**	**465**	**(210)**	**-**
Cumulative interest rate gap	**21,837**	**5,098**	**(54)**	**(255)**	**210**	**-**	**-**

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 FVTPL							
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 FVOCI	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 FVTPL							
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)	-	-

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. Work to decommission LIBOR has involved ceasing the issuance of new LIBOR lending, 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.

As at 30 September 2021, all market-facing derivative flows are executed against the SONIA. The strategy to proactively transition the back-book of transactions is underway with the focus on Business lending customer transactions. The Group is considering options for the transition of the 'Tough Legacy' cohort (existing LIBOR-referencing contracts that parties are unable to convert to a non-LIBOR rate before the end of 2021) and the associated operational plan. This is, however, subject to the outcome that is pending from the FCA consultation that is due by the end of 2021.

The Group has early adopted the Interest Rate Benchmark Reform - Phase 2 (Amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16) issued in August 2020. This introduced amendments to IFRS, addressing some of the financial reporting issues arising from changes to contractual cash flows or hedging relationships which result from interest rate benchmark reform. The Group has adopted the Phase 2 amendments from 1 October 2020. See note 1.10 for further details.

Financial instruments that have yet to transition to alternative benchmark rates are summarised below:

Amounts yet to transition (audited)

2021	Non derivative financial assets - carrying value(1)(2) £m	Non derivative financial liabilities - carrying value(5) £m	Derivatives - nominal amount(1)(3) £m
GBP LIBOR	**2,037**	**-**	**4,754**
Other(4)	**157**	**-**	**-**
Cross currency swaps			
GBP LIBOR to USD LIBOR			**95**
Total	**2,194**	**-**	**4,849**

(1) Excludes exposures that are expected to expire or mature before the Interbank Offered Rate (IBOR) ceases.
(2) Gross carrying amount excluding allowances for ECLs.
(3) The IBOR exposures for derivative nominal amounts include loan commitments.
(4) Comprises financial instruments referencing other IBOR rates yet to transition to alternative benchmark rates (Euro, USD, AUD, CHF).
(5) In addition to the financial liabilities included in the table, at 30 September 2021 £742m issued Covered Bonds were fixed rate with an option to convert to GBP LIBOR if not redeemed on the scheduled maturity date in June 2026. The option to convert was transitioned to SONIA on 22 October 2021. Also at 30 September 2021, Gosforth 2018-1 notes in issue of £788m were still based on LIBOR, but following a successful consent solicitation earlier in the year, the notes will convert to SONIA effective from 25 February 2022.

The Group maintains engagement with the BoE's Working Group on Sterling Risk Free Reference Rates and other industry forums. The programme ensures that the risks of being unable to offer products with suitable reference rates will be mitigated and that full consideration is given to the other risks, including legal, conduct, financial and operational risks, that may arise. While no material changes to the Group's risk management strategy are expected, the programme will continuously monitor progress and amend the approach accordingly.

Pension risk

The Group operates a defined benefit pension scheme, the Yorkshire and Clydesdale Bank Pension Scheme (the Scheme). 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 (for example an insurer) or once all individual member benefits have been honoured.

Pension risk (continued)

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 as a result 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 3.10 of the Group's consolidated financial statements. The fair value of the assets was £4.6bn as at 30 September 2021 (2020: £4.7bn).

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 (retail price index(RPI)/Consumer Price Index (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.

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 increasing the levels of inflation, interest rate hedging and several member benefit reforms, culminating in closure to future accrual for most members. Following a review of the use of equity options that give protection from severe falls in equity values, it was agreed in 2021 that this protection would be allowed to unwind. This is the result of a review that considered the falling proportion of the Scheme's assets that are held in equities, the continued direction to reduce the allocation of equities within the Scheme and the protection given by the overall funding position of the Scheme. The current equity options will mature in the period to September 2022. The Bank retains the ability to reinstate the use of equity options should it be considered prudent to do so.

Risk report (continued)
Financial risk (continued)

Pension risk (continued)

Mitigation (continued)

In addition, the Group has signed a contingent security arrangement to provide the Trustee with protection to partially mitigate the risk of adverse changes impacting the Scheme's assets or liabilities. This arrangement also provided security for the Group's obligations under a Recovery Plan, however all payments subject to that Plan have now been made. Further information is shown within note 3.10 to the Group's consolidated financial statements.

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 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 management 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 can 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. RAS metrics focus on model effectiveness and whether the model validation processes and procedures are managed within the timelines required by the model risk management policy, and on the outcomes of validations on the Group's most material models. Model risk appetite is reported regularly to both Board Risk Committee and the Model Governance Committee (MGC). The escalation of material model issues from MGC can be made to ERC and Board Risk Committee if appropriate.

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.

The Group model inventory contains a comprehensive set of information on all models and the associated exposures 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 Group and, therefore, there is interaction between model risk and a number of the Group's principal risk categories, for example credit rsk.

Measurement

The Board delegates authority 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 Board Risk Committee and MGC and the level of risk is assessed through RAS.

The Group Chief Risk Officer has been identified as the appropriate Significant Influence Function role in line with the requirements set out. As such the Chief Risk Officer performs periodic review and annual attestation against regulatory expectations, to ensure that the Group remains compliant with all relevant requirements on an ongoing basis.

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 management policy standard defines model risk management roles and responsibilities. Specifically, it sets out that the model owner has the responsibility of attesting to the compliance of the model risk management policy standard requirements on an annual basis, including that the model is implemented correctly, or advising of exemptions.

The Model Risk Oversight function conducts model validations prior to model implementation, when a new model is developed or changed, and on a periodic basis.

The function assists with identifying model deficiency and raises mitigating actions. If significant model deficiencies and/or errors are identified during the validation process, the relevant model approval authority will 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.

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 is 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 the framework used to manage model risk. The frequency and level of model monitoring required is detailed within Group model monitoring frameworks.

Risk report (continued)

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 information requests 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 year's 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 for implementation within the required timescales with due consideration for mitigation of potential customer harm. 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. This is expected to continue to increase as the country emerges from the pandemic.

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 regulatory and compliance risk to the Executive Risk Committee, the Board 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 PSD2;
- 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

Regulatory and compliance risk is considered by all three lines of defence as part of their oversight and assurance activities. A risk assurance plan, approved by the Board Risk Committee on an annual basis, independently assesses areas of the control framework underpinning compliance with laws and regulations.

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 harm, 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, including those risks arising as the bank and its customers transition to digital channels, and with the significant changes in customer journeys and behaviours brought into focus during the pandemic.

The Group continues to remediate a small number of legacy conduct issues.

Measurement

Conduct risks are measured against a defined set of Board-approved risk appetite metrics, which are focused on the main areas of regulatory attention such as complaints, vulnerable customers, quality of advice and treatment of customers in financial difficulty. The metrics align to the way in which we manage our business units and product suites. 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 conduct risk appetite measures to the Executive Risk Committee, the Board 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 through relevant governance fora;
- analysis of customer experience 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.

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 impact core business processes.

Business units are responsible for the day-to-day management of operational risk, with oversight from the Risk 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 risks associated with a failure to execute and deliver change that could result in an inability to meet our strategic objectives, including failing to meet our customer, regulator, colleague, or shareholder expectations, at a Group and local management level. *How this risk is managed* - The Group uses a single integrated change governance framework which covers all levels of change management to ensure appropriate oversight and decision making across the change portfolio. As part of this, a centralised view of change is maintained 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; the potential cessation of specific activities; the risk of personally identifiable information or Group sensitive data being exposed or exploited; and 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 is enhancing its third-party risk management framework and oversight approach, in order that ongoing performance management and assurance is undertaken, to ensure supplier relationships and the procurement of service providers 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 86% 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.

Operational risk losses by Basel category(1)

	% of total volume		% of total losses	
	2021	2020	**2021**	2020
Business disruption and system failures(2)	1.6%	0.8%	3.7%	45.7%
Clients, products and business practices	1.4%	5.3%	0.9%	2.5%
Damage to physical assets(3)	1.4%	0.3%	1.7%	0.2%
Employee practices and workplace safety	-	–	-	–
Execution, delivery and process management	9.4%	7.3%	24.8%	12.1%
External fraud	86.2%	86.3%	68.9%	39.5%
Internal fraud	-	-	-	-

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

(2) Figures may not match those presented in 2020, as historical loss amounts can change due to recoveries made.

(3) Losses directly attributable to COVID-19, previously classified as 'Damage to physical assets', have now been reclassified as 'Business disruption and system failures', in line with guidance issued by the EBA (21 December 2020).

Mitigation

In delivering its strategic objectives, the Group strives for operational efficiency and accepts that a level of loss may arise from operational failure. Implementing key controls and monitoring, with appropriate escalation and governance, ensures that operational risks are managed, and losses remain within acceptable limits. We operate robust controls over all significant operational risks and ensure these are sufficient to prevent material disruption of our service to customers and/or our business.

Monitoring

The Group has identified, assessed and monitors 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 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 Group's 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 in 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 for internal or externally provided services.

Risk appetite

Technology risks are measured against a set of defined RAS metrics and reported to Executive and Board Committees. The Group aims to provide a superior level of support and continuity of services to customers and stakeholders on a consistent and uninterrupted basis. However, the Group accepts that this is not always possible and tolerates a level of technology risk associated with internal or external events but will take immediate steps to recover within agreed tolerances and minimise customer disruption.

Exposures

The Group's exposure to technology risk is materially impacted by the need to enhance digital capabilities, simplify our technology estate and mitigate evolving cyber and information security threats. 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. *How this risk is managed* – Our Head of Information Security and Resilience (ISR) 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 significant escalation of external threats, regulatory penalty and resilience need, heavily influenced by COVID-19.
Physical and personal 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 ISR team. Controls are in place to protect physical assets, as well as the security of colleagues and customers.
IT resilience risk	IT resilience is the Group's ability to adapt to disruptions while maintaining continuous operations on critical processes, safeguarding technology and all associated assets in the face of adverse events, chronic disruptions or incremental changes. The Group recognises the significant regulatory focus on resilience as the market becomes more reliant on digital banking, increased remote working, and the use of third-party and cloud solutions. *How this risk is managed* – The Group is well placed to respond to new regulations and standards and develops technology with resilience inbuilt as a principle. A programme of continuous monitoring and maintenance of the currency of the technology estates, alongside disaster recovery testing, helps to minimise the likelihood of system failure. In preparation for an outage, the Group maintains and tests critical end-to-end business recovery and contingency plans.
Data management	Data underpins decision making at all levels of the organisation. Poor-quality data can lead to loss, customer disruption, non-compliance with General Data Protection Regulation (GDPR) and unnecessary rework. *How this risk is managed* - The Group has a data management framework governing the creation, storage, distribution, usage and retirement of data, aligned with GDPR requirements.

Risk report (continued)
Technology risk (continued)

Risk category	
Payment creation, execution and settlement risk	The risk that transactions are not conducted in line with the instructions and parameters of a customer’s payment, trading, clearing, settlement scheme or business requirements. This could lead to delays, inaccuracies, duplicates, failures or rejections as well as system-based restrictions and errors. The payments industry is planning for significant changes to infrastructure and processing protocols over the next 12-24 months, due to the implementation of ISO20022, Real-Time Gross Settlement Renewal and New Payments Architecture. *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 payment risk is managed within appetite, and impact to customers is minimised. All three lines of defence are actively involved in changes being made.

Measurement

The Group has a number of key risk indicators that cover the risk areas outlined above. In addition, Board-approved RAS metrics are monitored and reported monthly, with breaches escalated to the Board. All technology risks are assessed using the RMF 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 risk categories by the Group. 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 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 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 and fraud risk

Financial crime and fraud risk is the risk that the Group's products and services will be used to facilitate financial crime and fraud against the Group, its customers or third parties.

Risk Appetite

Financial crime and fraud 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.

The Group continues to review the external environment for any changes within the industry as well as regulatory or legislative direction, taking action as appropriate.

Exposures

Financial crime and fraud 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.

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 and fraud risk and updated as appropriate. Financial crime and fraud-related risk appetite metrics are monitored and reported to the Board on a monthly basis.

Mitigation

The Group has the following controls and procedures to support mitigation:

- a clearly defined financial crime and fraud 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;
- investment to maintain compliance and 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 and fraud risk (continued)

Monitoring

The financial crime and fraud risk team is responsible for overseeing the effectiveness of the financial crime control framework, financial crime strategy, governance, standard setting, oversight, training and reporting to the competent authorities, Executive Risk Committee and the Board. Matters requiring escalation are reported through ongoing reporting to the Executive Risk Committee and the 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. The effectiveness and performance of these systems are discussed through internal governance and independently tested on a periodic basis.

Risk report (continued)
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, however fails to take account of a change in external circumstances.

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

Driven by COVID-19 recovery and a rebound in economic activity, the RAS has been repositioned, with an overarching focus on expansion, underpinned by a strong control environment, striking a balance between supporting our strategy while keeping the bank compliant and customers safe.

Exposures

The combined impacts from Brexit and COVID-19 continue to create an uncertain outlook for the UK, resulting in a complex risk landscape. The Group has considered this uncertainty and potential challenges as part of the FY22 risk assessment and planning process.

In addition, the Group operates in an increasingly competitive environment, with the pace of change and complexity posing risks to strategic initiatives. Shareholder expectations, customer behaviours and colleague sentiment 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 RAF, is a key means of controlling strategic risk. The RAF 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.

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 proactively 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. 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, 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 Strategic and Financial Plan by the Board and Executive Leadership Team, who react to deviations from targets and modify strategy accordingly.

A formal assessment of the Group's Strategic and Financial Plan, reviewing the Group's current and potential strategic risks, and the impact of strategic decisions and objectives on the Group's risk profile, was undertaken during the year. The findings were reported to the Chair of the Board Risk Committee and the Board, and this process will be carried out annually.

Risk report (continued)

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 diverse 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 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 adversely 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, such as attrition and capability and capacity, 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.

Measurement

The Group has a range of 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 has implications for colleagues and creates 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:* 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, case management; and full business partnering.

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 services to customers as well as the key subject matter experts needed to keep critical functions operating while under duress.

Risk report (continued)
Cross-cutting risks

Climate risk

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

Further detail on how the Group manages climate risk is provided in the TCFD report, on pages 218 to 234 of the Group's 2021 Annual Report and Accounts.

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 under four key pillars: people, technology, third parties and premises, 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. New regulatory requirements on defining Impact Tolerances for critical services will maintain and strengthen focus on recovery objectives. 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; third party and critical outsourcing; and IT resilience.

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 provision of a superior level of support and continuity of services to customers and stakeholders. The management of the technology estate will present additional resilience risk until such time as 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 threat landscape is growing in complexity and volatility and will continue to present risk to the Group's resilience.

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 processes across the Group, focus can be given to those processes and the controls in place, including the management of the technology on which they rely to minimise disruption. A programme of work is in place to remove duplication where it exists in the technology estate, as part of the overall Digital Strategy.

Monitoring

Operational resilience is monitored and reported regularly through Executive and Board Committees. Its underlying components are also monitored through the relevant principal risk reporting 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 2021.

Statement of corporate governance arrangements

The Board of Directors (‘the Board’) strives to ensure good standards of corporate governance are maintained. The Bank is part of the Virgin Money UK PLC Group where Virgin Money UK PLC, as a premium listed holding company, applies the 2018 UK Corporate Governance Code (‘the Code’). As a wholly-owned subsidiary, the Bank is not required to comply with the Code, but looks to apply similar governance arrangements to those described in the Corporate governance report within the Virgin Money UK PLC Annual Report and Accounts. The Bank has therefore adopted its own governance arrangements, which are considered more appropriate in the context of the Bank’s situation than existing recognised codes for private companies. Set out below are the overarching principles which the Bank believes are appropriate to ensure effective decision-making to promote the Bank’s long-term success, and how these principles have been applied during the financial year ended 30 September 2021.

Principle One – Purpose and Leadership – “An effective board develops and promotes the purpose of a company, and ensures that its values, strategy and culture align with that purpose”

The Board is responsible for setting the strategic direction and risk appetite of the Bank and for establishing the Bank’s Purpose and Values, promoting its culture and success, which are aligned to those described in the Virgin Money UK PLC Annual Report and Accounts. The Board is the principal decision-making body for matters of strategic, financial, risk, regulatory or reputational significance. It oversees the delivery of the strategy, ensures the Bank manages risk effectively, monitors financial and operational performance, and ensures that effective succession planning arrangements, remuneration policies and governance arrangements are in place. The Bank’s strategy is discussed further in the Strategic report on pages 2 to 11.

The Board is committed, through our governance framework, to driving Purpose-led decision making and to delivering accountability to our stakeholders. This year accountability for Purpose was strengthened by extending the remit of the General Counsel role to include Purpose and James Peirson now has responsibility for challenging and directing everything we do through a Purpose lens and ensuring Purpose shapes all aspects of our strategy. During the year, the Board took part in a deep dive session on Purpose to discuss the progress made in embedding our Purpose and the action being taken to elevate how we think about ‘Making you happier about money’, keeping it front and centre in all we do and integrating it across every initiative and the decisions we make impacting our customers, colleagues and our communities. This year a new format for Board reporting was introduced which requires every matter that is brought to the Board for approval to clearly draw out the Purpose connection and in Board meetings the Chairman actively encourages Board members to constructively challenge management on why a recommendation is Purpose-driven. More broadly, the Board provides oversight and direction in relation to its Virgin Values-driven culture which aims to empower colleagues to do the right thing for the Bank’s customers. The Board believes that a positive culture and consistent ‘tone from above’ is critical to the Bank’s success. During 2021, the Board continued to regularly assess and monitor cultural progress ensuring it responded to the evolving needs of the Bank’s customers, colleagues and the communities its serves.

Principle Two – Board Composition – “Effective board composition requires an effective chair and a balance of skills, backgrounds, experience and knowledge, with individual directors having sufficient capacity to make a valuable contribution”

The Board comprises the Chairman, two Executive Directors, five independent Non-Executive Directors and one non-independent Non-Executive Director appointed by Virgin Enterprises Limited. The Board reviews the structure, size and composition of the Board and Board Committees on at least an annual basis including the balance of skills, knowledge, experience and diversity. Following the action taken last year to reduce the size of the Board, the Board considers its current size and composition is appropriate to the Bank’s circumstances. The Virgin Money UK PLC Group Board Diversity and Inclusion Policy, which applies to the Bank, confirms that Board appointments are made on the basis of individual competence and merit taking into account the skills, experience, independence and knowledge required, measured against the objective criteria set by the Governance and Nomination Committee for a particular appointment. Additionally, in recruiting Board members, careful consideration is also given to the broader diversity benefits each candidate can bring to overall Board composition. This includes considering a combination of demographics, skills, experience, race, age, gender, educational and professional background and other relevant personal attributes to ensure the Board benefits from a range of perspectives which supports good decision making and avoids the risk of ‘group think’.

The Board undertakes an annual review of its effectiveness, which provides an opportunity to identify ways of improving the efficiency of the Board by maximising strengths and highlighting areas for development. The 2021 evaluation was conducted internally and sought the views of Directors on the same range of topics as those considered the previous year to track trends in performance including Board composition and dynamics; governance and information; strategy; risk management and internal control; succession planning and human resources management; and priorities for change. In addition to a review of the Board’s own effectiveness, there is a review of the effectiveness of the principal Board committees and of Directors individually. The Senior Independent Non-Executive Director leads the review of the Chairman’s performance involving all Non-Executive Directors and taking into account the views of Executive Directors. The Chairman, with the support of the Governance and Nomination Committee leads the Board in acting on the results of the evaluation and by putting in place an action plan to improve Board effectiveness.

Report of the Directors (continued)

Statement of corporate governance arrangements (continued)

Principle Three – Director Responsibilities – "The Board and individual directors should have a clear understanding of their accountability and responsibilities. The Board's policies and procedures should support effective decision-making and independent challenge"

The Directors assume ultimate responsibility for all matters, and along with senior management are committed to maintaining a robust control framework as the foundation for the delivery of good governance, including the effective management of delegation through the Corporate Governance Framework. Policies are also in place in relation to potential conflicts of interest which may arise. All Directors are provided with sufficient resources to undertake their duties and have access to the advice of the Group Company Secretary in relation to the discharge of their duties and matters of governance. In appropriate circumstances, Directors may obtain, at the Group's expense, independent professional advice where they judge it necessary to discharge their responsibilities as Directors.

The Board is supported by its committees which are the Audit Committee, Governance and Nomination Committee, Remuneration Committee and Risk Committee ('Committees'). The Committees make recommendations on matters delegated to them and are managed in the same way meetings of the Board are managed, with open debate encouraged, and adequate time provided for members to consider proposals which are put forward. The Chair of the Board and each Board Committee is responsible, with support from the Group Company Secretary, for the provision to each meeting of accurate and timely information.

The Chairman leads the training and development of the Board and of individual Directors and regularly reviews and agrees with each Director their individual and collective training and development needs taking into account the output from the annual Board evaluation and the evaluation of each Director's own performance. Additionally, Directors take part in collective training as required, for example in relation to their responsibilities as Directors or to address new regulatory or legislative requirements. During the year this included internally facilitated training in relation to the BoE's Resolvability Assessment Framework and externally facilitated training on Board considerations and Director responsibilities on ESG topics particularly climate risk. The Group Company Secretary maintains a training and development log for each Director. For Directors joining the Board, the Chairman ensures that on appointment each Director receives a full, formal and tailored induction which reflects a Director's skills, experience and Board role. Directors who take on new roles (or change roles) during the year participate in an induction programme tailored to their new or changed role. Both Clifford Abrahams and Elena Novokreshchenova, who joined the Board this year undertook a comprehensive, tailored induction programme.

Principle Four– Risk management and internal control – "The Board should promote the long-term sustainable success of the company by establishing oversight for the identification and mitigation of risks"

The Board is responsible for the Bank's systems of internal control. The internal control framework is designed to facilitate effective and efficient operations, ensure a high quality of internal and external reporting, and ensure compliance with applicable laws and regulations. The Directors and management are committed to maintaining a robust control framework as the foundation for the delivery of effective risk management. The effectiveness of the risk management and internal control systems is reviewed regularly by the Risk Committee and the Audit Committee. The Risk Committee is responsible for providing oversight and advice to the Board in relation to current and potential future risk exposures. The Audit Committee assists the Board in discharging its responsibilities with regard to external and internal audit activities and controls including reviewing audit reports, internal controls and risk management systems.

The Board confirms that throughout the year ended 30 September 2021 and up to the date of approval of this Annual Report and Accounts, there have been rigorous processes in place to identify, evaluate and manage the principal risks faced by the Bank, including those that would threaten its business model, future performance, solvency or liquidity, the likelihood of a risk occurring and the costs of control in accordance with the Guidance on Risk Management, Internal Control and Related Financial and Business Reporting published by the Financial Reporting Council (FRC).

Principle Five– Stakeholder engagement – "Directors should foster effective stakeholder relationships aligned to the company's purposes. The Board is responsible for overseeing meaningful engagement with stakeholders, including the workforce, and have regard to that discussion when taking decisions"

Detailed information on how the Bank engages with its stakeholders, and the Board's involvement in overseeing this engagement is set out in the s.172(1) statement on pages 96 to 102.

Profits and appropriations

The Group made a profit before tax for the year ended 30 September 2021 of £416m (2020: loss of £173m). The profit attributable to the shareholders for the year ended 30 September 2021 amounted to £473m (2020: loss of £191m). Interim dividends totalling 0.16p (2020: 0.16p) per ordinary share amounting to £20m (2020: £20m) were paid by the Bank in respect of the year ended 30 September 2021. A final dividend in respect of the year ended 30 September 2021 of 0.12p (2020: £Nil) per ordinary share in the Bank amounting to £14m (2020: £Nil) is subject to the Virgin Money UK PLC shareholders approving the Virgin Money UK PLC dividend at the 2022 Annual General Meeting. These financial statements do not reflect the recommended dividend. 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 were appointed during the year:

- Clifford Abrahams (8 March 2021)
- Elena Novokreshchenova (22 March 2021)

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.

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 a section 172(1) statement, 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 the Bank engages with them.

Customers
Continuing to support customers through the COVID-19 pandemic has been a key factor in the Board's decision making throughout the last 12 months. It has recognised that some customers, both personal and business, have faced never before seen challenges during the pandemic and it has sought to take as many steps as possible to provide support through initiatives such as payment holidays and the government's COVID-19 related business loan scheme. A lack of available data and trends to draw upon in relation to customer behaviours during a pandemic of the scale of COVID-19 made Board decision making more difficult but our methods of obtaining customer feedback ensured that the Board kept focused on the key areas that matter most to our customers.

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

Customers (continued)
We obtain feedback from our customers through a variety of methods including our active customer panel (comprising 7.5k personal and business customers); our ongoing Customer Experience Success Measurement programme (where we partner with InMoment) and Brand Tracking (where we partner with Ipsos); independent market research to support new product or brand development, benchmark studies as well as customer research undertaken by our in-house Insight team. Our Customer Experience Success Measurement programme helps us continually engage, listen and take action on customer feedback. Over 120,000 customers take the time each year to provide their feedback about how they feel overall about the Bank, or following a key interaction (like opening a new account, using our digital apps, telephoning our contact centres or how we have responded to a complaint). This feedback is available in real-time to colleagues who can then take the appropriate action to improve customer experiences.

The Chairman attended a virtual customer engagement event during the year alongside a government representative. This provided an opportunity for open dialogue on the impacts of the pandemic on businesses and their plans for growth, views on government and bank support during the COVID-19 crisis and what additional support business customers want from their bank and policy makers as the economy rebuilds which was shared with the Board and taken into consideration when shaping the Bank's own plans.

Improvements to the digital offerings for our customers is a significant area of focus for the Board and during the year, it considered, and approved, a high value business case in relation to the development and delivery of enhanced customer, intermediary and colleague journeys in relation to our mortgage offerings on a single, modern digital platform under the Virgin Money brand.

The Board receives a monthly customer experience performance update highlighting what's gone well, areas of focus and customer frustrations, and improvement activities that are underway. These updates also include verbatim comments from customers so that the Board is provided with unfiltered customer sentiments that can assist Directors with their decision making.

The Board also held a round-table session in February where it approved a new customer experience dashboard to monitor progress of key customer experience performance indicators against quarterly FY21 targets and longer-term targets to FY23. Similarly, key matters and metrics in the Customer Complaints area are provided quarterly to the Board which allows the Board to oversee the number of complaints received, the main areas of customer dissatisfaction and the remedial action planned to manage these complaints.

The Board also monitors progress in respect of the Bank's rebrand programme (due to complete in FY22) which has now moved to the final phase of activity, which will see all new and existing customers managed under the Virgin Money brand. Providing brand harmonisation for our customers is an important milestone in our journey and feedback shows that the rebrand has been well received by customers.

This year also saw the Board consider, and support, proposals for changes to be made to Leadership Team roles to ensure that the Group's operating model could adapt to the changing external landscape and focus on providing the products and propositions that are important to our customers. One of these changes was the introduction of a new Chief Customer Experience Officer role responsible for our key customer touchpoints across our store network and operations and the critical work to digitise and improve our customer journeys. The Board supported the intention to simplify and digitise our customer journeys as well as creating ways of working that deliver digital products and propositions in a more agile, innovative and co-ordinated way across all our distribution channels. To support this our executive management governance model has been strengthened with the formation of a new Customer Experience Committee and Enterprise Conduct Committee.

Board decision spotlight – 'Digital wallet proposition'
Enhancing our digital offerings to our customers is a key area of priority for the Board. During the year, as part of the development of our Digital First strategy, the Board considered and approved a proposal for the Bank to launch a digital wallet with its strategic partner Global Payments. The digital wallet will sit at the heart of the Bank's payments, loyalty and unsecured credit offering to customers. In considering the proposal the Board had regard to the needs of, and benefits for, a range of the Bank's stakeholders including the compelling customer proposition which will see customers gain access to a seamless and secure payment mechanism integrated with our suite of customer products and services. The Board heard how the Bank will collaborate with Global Payments to develop the digital wallet and with Virgin Red – the Virgin Group's rewards club – to allow customers the opportunity to earn and utilise Virgin Red's points. The Board discussed the proposal at meetings and strategy sessions during the year, providing challenge and insight on aspects of the proposition, including the timings for key elements to be completed, costs to achieve completion, management of the strategic partner alliance, and the communication of the digital wallet to both our customers and investors. These discussions culminated with the Board approving the development of the digital wallet as part of the Strategic and Financial Plan for FY22-FY24.

Colleagues

Engagement with colleagues is regarded by the Board as key to the Bank delivering on its strategy and ambitions and in ensuring that the Bank's Purpose is embedded through the organisation. The Governance and Nomination Committee, together with the Board, reviewed the effectiveness of the approach to workforce engagement introduced in FY20 as the variety and breadth of the Board's engagement with the workforce provides a rich source of insight into colleague sentiment and informs Board decision making. It concluded that leveraging existing channels of colleague engagement had been an effective mechanism for workforce engagement providing a rich and varied insight into the views and experiences of colleagues across the workforce.

During the year, consideration was given as to how to keep colleagues connected and engaged as many were required to adopt a remote working model as a result of COVID-19. We used the colleague intranet site, VMx, to introduce new 'Hubs' where up-to-date information and guidance in relation to the impacts on working arrangements due to COVID-19 could be easily found. Our 'Purpose' Hub also allows colleagues quick access to information, such as stories from colleagues from different departments across the Bank, to support them in living the Bank's Purpose as they carry out their role. Colleagues are also communicated with directly through a weekly update from the CEO and members of the Leadership Team with spotlights around the Group's full year and half year results announcements.

Executive Directors and members of the Executive Leadership Team host interactive 'Let's Talk and Type' sessions (which Non-Executive Directors are also invited to attend) where colleagues get the opportunity to participate in a virtual, informal session where they can ask questions and provide views to management on topics that are important to them.

As a result of the ongoing restrictions on physical gatherings, the Board considered how it could leverage digital ways of communication to enhance connectivity with colleagues as part of its Workforce Engagement Programme during FY21. In December an inaugural Board 'Jam' was held. This is a live and interactive virtual session where colleagues were able to respond via a chat channel to questions posed by members of the Board. During the year, the Board held three further Board Jams with colleagues participating from a broad cross-section of our workforce including contractors and representatives from each of our inclusion networks. The Jams have covered subjects that are particularly relevant to colleagues, including well-being and diversity and inclusion and we have used the insight we gained from these sessions to help design our 'A Life More Virgin' working model. Board Jams have become a fundamental aspect of Board and workforce interaction, and we continually look to enhance them, for example, by finding ways to ensure the format is as inclusive as possible including for colleagues who have various accessibility needs.

Directors also take part in colleague events with a more specialist focus. For example, Non-Executive Directors Geeta Gopalan and David Bennett participated in a Race at Work Charter Panel session in July and the Remuneration Committee Chair, Darren Pope, held small focus groups with colleagues from a broad cross-section of the workforce including a dedicated session with Unite to discuss pay and benefit issues including an overview of the Bank's remuneration framework and how its application aligns for Executive Directors and all other colleagues. The feedback from these sessions has informed the Remuneration Committee's decision making on aspects of year end and future remuneration.

The Board gained further understanding of the views of colleagues through surveys which colleagues across the Bank were asked to complete. This included the annual 'My Voice' survey and ad hoc 'Pulse' surveys, with a summary of the results and main survey themes presented to the Board for its consideration.

A summary of Board engagement events is presented at each Board meeting, with participating Non-executive Directors providing an update to their Board colleagues on what they heard.

Twice a year the Board receives an update on our culture. The culture dashboard contains percentage scores taken from our Colleague Pulse and Engagement surveys and enables the Board to review trends to help understand areas where additional focus may be needed and also, where available, how the Group is performing compared to external benchmarks.

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

Colleagues (continued)

Board decision spotlight – 'A Life More Virgin'

Throughout the year, the Board engaged with management on the development of our A Life More Virgin colleague proposition, the Bank's response to the future world of work. At both meetings and round-table sessions the Board heard about and provided feedback on the Bank's proposed colleague proposition. The proposition seeks to provide colleagues with more flexibility, including the introduction of five dedicated well-being days each year, which allow them to balance work with their well-being, family and local community commitments. In addition, adopting a location-agonistic approach to career progression enabled by enhanced remote working, supports retention of talent, the recruitment of a diverse resource pool, and will continue to inspire colleagues to deliver on our Purpose. At the same time, the proposition harmonises a number of terms and conditions between heritage organisations – including the introduction of equal, flexible family leave for all colleagues. The Board also reviewed and provided feedback on the approach and results of the 'test and learn' experiments conducted, where - recognising every colleague need is different - colleagues were engaged with to ensure the proposed improvements to flexibility reflected their diverse needs. The Board also provided feedback on the evolution of the Bank's property and store footprint to support colleagues and customers in a changing environment, as well as the investment in our digital-first A Life More Virgin operating model, including the introduction of 4,000 new laptops and upgrade of our operating systems to improve efficiency and ways of working. As part of the proposals, the Board supported the delivery of a new colleague Code of Conduct, designed to empower colleagues to perform effectively under the Bank's Purpose. The continued focus on diversity and inclusion was welcomed, while supporting colleagues to give back to the communities they live in and serve.

Investors

The Bank is a wholly owned subsidiary of Virgin Money UK PLC. The Directors, who are the same for both the Bank and Virgin Money UK PLC, ensure that the strategy, priorities, processes and practices of the Bank are fully aligned where required to those of the Virgin Money UK Group, ensuring that the interests of Virgin Money UK as the Bank's sole shareholder are duly acknowledged. Further information in respect of the relationship of Virgin Money UK with its shareholders is included within the Strategic Report within the Virgin Money UK Annual Report and Accounts for 2021.

Society

Our ambition at the Bank is to drive positive environmental impact through everything we do. We formed our ESG strategy following a review of customer insight research and engagement with various stakeholders including colleagues and suppliers and our ESG goals and aspirations were developed, and approved by the Board, in line with our strategic objectives. Alignment of the ESG strategy to the overall Group strategy, as well as setting clear accountabilities for ESG, linked to reward, provides the foundation to firmly and deeply embed ESG in everything we do. Through the COVID-19 crisis, the Board has focused on the need for the Bank to operate responsibly in supporting customers, and the wider economy, to deal with the unexpected and unprecedented health and financial issues that have arisen as a result of the pandemic. Our commitment to the environment has also seen during 2021 the launch of our greener mortgages product, designed to reward customers who buy greener, new-build homes with lower rates of interest and we are the first bank in Europe to offer sustainability-linked loans in commercial banking for all UK companies. These loans reduce the cost of finance for those businesses whose core activities proactively help the economy transition to a more sustainable model.

The Board is responsible for approving and overseeing our ESG strategy. Quarterly ESG Board deep dive sessions were held during the year to consider progress made against our four ESG goals (more details of which can be found on pages 22 to 33 of the Virgin Money UK PLC Annual Report and Accounts) and greater focus has been given to our 'Build a brighter future' goal this year given the increased focus generally on climate change. Each of our four ESG goals is sponsored by a Leadership Team member who acts as a 'Champion' and is accountable for the delivery of agreed targets and associated initiatives within the goal.

A new Environment Committee, a sub-committee of the Executive Leadership Team, was formed in 2021 to ensure that key environmental matters can be considered and approved, supported by focused reporting and discussions.

Our more detailed engagement to understand the opportunities and differences that the Bank can make in wider society comes in various forms. We engage our colleagues in the Bank's role in our society through various initiatives such as quarterly pulse surveys which contain ESG-focused questions, virtual Board 'Jam' sessions, focused sessions on sustainability, initiatives to support our Charity of the Year, Macmillan Cancer Support, and education on financial inclusion. The Bank also hosts an annual financial inclusion event for its colleagues called 'FinInc' and 400 colleagues engaged with 24 speakers across 5 sessions as part of our evolution to making Virgin Money a more inclusive bank.

Report of the Directors (continued)

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

Society (continued)

Externally, we engage with rating agencies who track the progress we are making in respect of ESG disclosures and score us based on information that is available in the public domain and with various industry bodies to assist us in assessing and disclosing the greenhouse gas emissions linked to our financing.

We recognise the importance of contributing to our communities through volunteering and our Community Team is active in engaging colleagues in promoting opportunities through which they can utilise the two days a year we give them to volunteer to the causes they care about. During the year, we also launched a new support service pilot in partnership with Macmillan Cancer Support called Virgin Money Macmillan Guides where around 50 colleagues were given the opportunity to be trained by Macmillan to help provide the best possible support to people affected by cancer.

Significant time is spent engaging with our communities through the grassroots work carried out by the Virgin Money Foundation including assisting community groups with grant applications, providing free training and masterclasses on finance, HR and marketing matters and offering bespoke skilled volunteering provided by Bank colleagues.

Board decision spotlight – 'Closure of Virgin Money Giving (VMG)'

Following the support of over 20,000 charities and £900m of online funds raised through 1m fundraisers, the Virgin Money UK Group made the difficult decision to unwind its not-for-profit charity fundraising website, VMG, during this year. The Board considered the proud history of supporting the sponsorship of the London Marathon since 2009, at a time when the online fundraising market was dominated by a very small number of providers, with high costs for charities and donors. Through a strategic review, the Board considered the wide variety and choice of online giving platforms now available to fundraisers at a much lower fee, and the commercial difficulties of operating the entity at a loss. The Board concluded it was in Virgin Money's best interests to wind down the platform given the significant investment required for the service to remain competitive and the end of the Virgin Money UK Group's sponsorship of the London Marathon. The Bank will support charities to find alternative platforms where needed.

Government and regulators

The Board and Leadership Team maintain strong, open and transparent relationships with our regulators. Liaison with our regulators and government authorities is an ongoing priority at all levels of the organisation, allowing the Board to ensure the Bank's strategic aims align with the requirements of these important stakeholders and our customers.

The Board, Leadership Team and senior management have a programme of regular meetings with the PRA and FCA as part of their Continuous Assessment and Proactive Engagement Meetings to discuss the regulatory agenda and the Bank's response to key regulatory priorities. The key messages and areas of focus following these meetings is shared with all Directors to ensure they are fully aware and informed of regulatory standpoints.

Extensive and ongoing engagement continued throughout the year with the government and regulators in response to the COVID-19 crisis. This has ensured that our response could best support our customers at the same time as aligning with government priorities for supporting the stability of the wider economy. Examples of this are the provision of support to our customers under the government backed loan schemes and a new range of 95% LTV mortgages offered via the government's Mortgage Guarantee Scheme, which the Board continued to review. Other key regulatory areas of interest have included ensuring robust prudential standards, fair treatment of customers, the UK's exit from the EU, in addition to climate change and the Banks' ongoing financial and operational resilience. The FCA also published guidance on its expectations of firms on the fair treatment of vulnerable customers and this has led to increased efforts to identify and understand vulnerability within our customer base and embed inclusive design within our new and existing products.

Representatives from the PRA and FCA attended Board meetings throughout the year to present the findings from key regulatory reviews and to update the Board on regulatory focus areas for the coming year. Through the Board and the Board Risk Committee, a standing programme of updates on the key regulatory areas of interest is delivered with the Board Risk Committee particularly focused on the regulatory agenda, an overview of regulatory interaction and actions arising from regulatory reviews.

The Board closely monitors the status of the Bank's regulatory relationship and proactively engages across all aspects of the regulatory agenda, also extending to attendance at regulatory round tables with the Bank's peers where key issues such as operational readiness for negative interest rates are discussed. This assists the Board in keeping abreast of forthcoming, and potential areas of regulatory change which is important given the increased level of new regulation.

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

Government and regulators (continued)

In October 2020, the PRA and FCA issued a joint letter relating to firms preparedness for the UK's exit from the European Union ('Brexit') stressing the importance that firms were ready for a range of scenarios at the end of the Brexit transition period on 31 December 2020 to minimise any possible disruption to customers. The Board heard of the Bank's operational readiness to address several issues highlighted by the PRA and FCA's letter including consideration of how continuity of service would be addressed for the Bank's EU-based retail banking customers following the end of the Brexit transition period.

The Bank is an active member of UK Finance Tax Committee, which engages in a range of meetings with Her Majesty's Treasury and HMRC officials, most recently on a discussion regarding the Banking Surcharge as it impacts Challenger Banks. The Bank also contributes to UK Finance's annual Total Tax Contribution survey which is used as the basis for Policy discussions with relevant officials on the structure of Banking Taxation in the UK.

Board decision spotlight – 'Implementing negative interest rates'

A key consideration for the Board during the year was the approach for implementing negative interest rates introduced as a monetary policy tool from August 2021. Earlier in 2021, the PRA asked that UK financial institutions put in place a series of tactical solutions such as workarounds on core systems and customer communications should a negative base interest rate be announced. The Board noted the importance of ensuring that the Bank could manage the implementation of the relevant solutions and that the Bank was required to attest to the PRA by the end of July 2021 that systems and processes could cope if the Monetary Policy Committee made a fiscal decision to turn the base interest rate negative. At its meeting in July, the Board considered the level of impacted lending exposures within the Bank that would be impacted day 1 of such a change, such as base rate tracker mortgages, the underlying systems on which these products sit and the downstream processes that would be impacted. Examples of which are customer communications, the project management resource being deployed to deliver the required work to consider the end-to-end approach across all products, the tactical enhancements to manual and systems processes required to deliver the change and controls to support those enhancements, and the risks, gaps and testing associated in being able to deliver the required approach. The outcome of the discussion was that the Board received assurances that the Bank is able to support negative interest rates across all products and that it could support the required attestation sought by the PRA.

Partners and suppliers

The Bank's partners and suppliers are vital for us in delivering on our promises and meeting the expectations of our customers. Our partners are those who we join forces with to deliver on our ambitions, such as abrdn who we have partnered with to provide asset management services through UTM. We have also partnered with third-party Fintech companies such as 9Spokes who helped develop our Business banking proposition by enhancing technology to provide business customers with a comprehensive view of their business via a bespoke and customisable online dashboard, and Trade Ledger, a global technology provider, to deliver a quicker, and more user-friendly experience for business customers applying for lending. We also partnered with Virgin Experience Days Limited for a further 'Brighter Money Bundle' offer offeringboth new and existing personal current account customers a gift card or discount for Virgin Experience Days. The Board was consulted on various supplier and partner proposals during the year. One of these was the expansion of the Bank's partnership with Global Payments Inc, a leading provider of payment technology and software solutions. The Board considered the proposal to launch a new connected payment offering which would bring all Virgin Money Group's credit and debit cards onto a single platform and to achieve an early exit from the existing merchant services contract. The new connected payment offering developed by the partnership with Global Payments Inc allows Virgin Money to access end-to-end life cycle data and glean better insights about buying patterns and trends which will allow it to launch new products and services that meet the needs of its customers. Recognising that our suppliers have an important role to play in the delivery of the Bank's operations our relationship managers across the business have continued to engage with our suppliers on service, innovation, compliance and growth. Following on from the launch of the 'Voice of the Supplier', which is now part of our supplier framework, we have used this as a formal opportunity for suppliers to provide feedback on several dimensions about their relationship with the Bank outside of the informal day-today conversations that take place. Our supplier relationship management tool also allows more granular level detail to be known and understood on our key suppliers including their resilience position, which has been particularly important given the impacts of the COVID-19 pandemic on some businesses. The Board has a zero tolerance attitude with respect to modern slavery in the Bank's supply chain and during the year it approved the revised Corporate Statement on Modern Slavery hearing also of the steps the Bank is taking to educate colleagues and raise awareness of modern slavery related offences. The topic is now included in an allcolleague compliance learning module. In line with the Bank's Delegated Authorities Framework, the Board is responsible for approving the most significant supplier contracts and there were various significant contracts that required Board consideration during the year, an example of which is above.

Board decision spotlight – 'Significant contract approval'

The Board is regularly asked to consider and approve investment that enables the delivery of capabilities through our key partners and suppliers. An example of this during FY21 was the request for a significant investment to deliver enhanced customer, intermediary and colleague mortgage journeys on a single modern digital platform. The Board heard how a single preferred supplier had been selected after an extensive selection process and considered the delivery plan risks and milestones, ultimately approving the investment. This supplier relationship has already seen the successful launch of the Bank's Home Buying Coach app which supports first time buyers through the journey of buying their first home and work has commenced to deliver the new digital mortgage platform.

Report of the Directors (continued)

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

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 (2020: £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.

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.

Report of the Directors (continued)

Events after the balance sheet date
There have been no significant events between 30 September 2021 and the date of approval of the annual report and consolidated financial statements which would require a change to or additional disclosure in the financial statements.

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

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

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

By order of the Board

Lorna McMillan
Group Company Secretary
23 November 2021

Statement of Directors' responsibilities

The Directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable UK 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 Group and Bank financial statements in accordance with IAS in conformity with the requirements of the Companies Act 2006. 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 the Bank and of the profit or loss of the Group and the Bank for that period.

Under the FCA's Disclosure Guidance and Transparency Rules, group financial statements are required to be prepared in accordance with IFRSs adopted pursuant to Regulation (EC) No 1606/2002 as it applies in the European Union.

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;
- make judgements and accounting estimates that are reasonable and prudent;
- 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 Group and Company financial position and financial performance;
- in respect of the Group financial statements, state whether IASs in conformity with the requirements of the Companies Act 2006 and IFRSs adopted pursuant to Regulation (EC) No 1606/2002 as it applies in the European Union have been followed, subject to any material departures disclosed and explained in the financial statements;
- in respect of the Company financial statements, state whether IASs in conformity with the requirements of the Companies Act 2006, have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is appropriate to presume that the Company and/or the Group will not continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Group's 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 Group and Bank 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.

Statement of Directors' responsibilities (continued)

Directors' responsibility statement (DTR 4.1)

The directors confirm, to the best of their knowledge:

- that the consolidated financial statements, prepared in accordance with IASs in conformity with the requirements of the Companies Act 2006 and IFRSs adopted pursuant to Regulation (EC) No 1606/2002 as it applies in the European Union, give a true and fair view of the assets, liabilities, financial position and profit of the Bank and undertakings included in the consolidation taken as a whole;
- that the Annual Report and Accounts, including the strategic report, includes a fair review of the development and performance of the business and the position of the Bank and undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face; and
- that they 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 Bank's position, performance, business model and strategy.

Lorna McMillan
Group Company Secretary
23 November 2021

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 2021 and of the Group’s profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with International Accounting Standards in conformity with the requirements of the Companies Act 2006 and International Financial Reporting Standards adopted pursuant to Regulation (EC) No.1606/2002 as it applies in the European Union;
- the parent company financial statements have been properly prepared in accordance with International Accounting Standards in conformity with the requirements of the Companies Act 2006 as applied in accordance with section 408 of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

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

Group	Parent company
Consolidated income statement for the year then ended	
Consolidated statement of comprehensive income for the year then ended	
Consolidated balance sheet as at 30 September 2021	Company balance sheet as at 30 September 2021
Consolidated statement of changes in equity for the year then ended	Company statement of changes in equity for the year then ended
Consolidated statement of cash flows for the year then ended	Company statement of cash flow for the year then ended
Related notes 1 to 5.6 to the financial statements, including a summary of significant accounting policies	Related notes 6.1 to 6.3 to the financial statement including a summary of significant accounting policies
Information identified as “audited” within the Directors’ remuneration report	
Information identified as “audited” within the risk report	

The financial reporting framework that has been applied in their preparation is applicable law and International Accounting Standards in conformity with the requirements of the Companies Act 2006 and, as regards to the Group financial statements, International Financial Reporting Standards adopted pursuant to Regulation (EC) No. 1606/2002 as it applies in the European Union and as regards the parent company financial statements, as applied in accordance with section 408 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. We are independent of the Group 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.

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

Conclusions relating to going concern

In auditing the financial statements, we have concluded that the directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate. Our evaluation of the directors' assessment of the Group and parent company's ability to continue to adopt the going concern basis of accounting included:

- We obtained management's going concern assessment for the Group, including forecasts for the going concern period covering 12 months from the date of signing this audit opinion.
- We evaluated the Group's forecasts, and challenged the trading volume and yield assumptions, as well as considerations regarding how management initiatives and investments could reduce the Bank's cost base.
- We used economics specialists in assessing the macroeconomic assumptions in the forecast through benchmarking to institutional, HM Treasury, and BoE consensuses.
- Management has modelled adverse scenarios in order to incorporate unexpected changes to forecasted liquidity and capital positions of the Group. We reviewed these scenarios, including a consideration of the Group's operational resilience, to identify whether they indicated significant issues that might impact the Group's ability to continue as a going concern or impact its viability in the window of assessment.
- We evaluated the results of management's stress testing, including reverse stress testing, to assess the economic assumptions in light of the impact of the COVID-19 pandemic, and their impact on the Group's solvency and liquidity. We also considered the impact of COVID-19 in regard to operational resilience, third-party and other non-financial risks.
- We compared previous periods' budgeted financial information with historical actual results, in order to form a view on the reliability of management's forecasting process.
- We considered whether there were other events subsequent to the balance sheet date which could have a bearing on the going concern conclusion.
- We reviewed regulatory correspondence and committee and board meeting minutes to identify events or conditions that may impact the Group's ability to continue as a going concern.
- We reviewed the Group's going concern disclosures included in the Annual Report in order to assess whether the disclosures were appropriate and in conformity with the reporting standards.

Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the Group and parent company's ability to continue as a going concern for a period of 12 months from when the financial statements are authorised for issue, through to 23 November 2022.

In relation to the Group and parent company's reporting on how they have applied the UK 2018 Corporate Governance Code, we have nothing material to add or draw attention to in relation to the directors' statement in the financial statements about whether the directors considered it appropriate to adopt the going concern basis of accounting.

Our responsibilities and the responsibilities of the directors with respect to going concern are described in the relevant sections of this report. However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the Group's ability to continue as a going concern.

Overview of our audit approach

Audit scope	• We performed an audit of the complete financial information of the Group and parent company. • All audit work performed for the purposes of the Group audit was undertaken by the primary team.
Key audit matters	• Impairment of loans. • Revenue recognition – Effective interest rate (EIR) method accounting.
Materiality	• Overall Group materiality was £37m which represented 0.67% of equity.

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

Key audit matters

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

Risk	Our response to the risk	Key observations communicated to the Board's Audit Committee
Impairment of loans **Consolidated income statement credit - £131m (2020: £507m charge)** **Consolidated balance sheet impairment of loans - £504m (2020: £735m)** *Please refer to page 16 (Credit risk report) and pages 134 to 135 (Impairment provisions on credit exposures note).* At 30 September 2021 the Group reported total gross loans of £72,551m (30 September 2020: £72,925m) and £504m of ECLs. There is uncertainty in estimating ECLs, and management are required to make highly subjective judgements which have a material impact on the financial statements. This calculation is ordinarily complex, however in the current economic environment there is heightened uncertainty and complexity as a result of the ongoing pandemic. Key matters that could result in material misstatement 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;	We developed a detailed understanding of the Group's accounting policies to ensure they remained compliant with the requirements of IFRS 9. 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 on all portfolios that we determined to be of a higher risk. This was done by independently replicating the staging models and re-running the results in our own environment. We assessed the assumptions and performed testing over 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 a risk-based sample of portfolios. We performed testing over completeness and accuracy of data used in the ECL models and calculation by reconciling, and performing sample tests of key data fields, to source systems and contracts. 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 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 resulted in only minor differences that were considered to be immaterial in the aggregate. We also communicated that our challenge of the forecast economic inputs (such as GDP, unemployment, interest rates, HPI, CPI and average earnings) and the base, downside and upside scenarios adopted by management concluded to be reasonable, including after our independent stress testing was applied. Our testing of post-model adjustments confirmed they had been accurately recorded, and we were satisfied that their use was complete and appropriate. Our assessment of the overall provision balance through peer benchmarking and analysis of key indicators, such as the ratio of provisions to loan balances, indicated the provisions recorded as at year end were cautious but reasonable given the continued uncertainty in the overall economic environment. We communicated that we are satisfied with the accuracy and adequacy of the disclosures made.

Risk	Our response to the risk	Key observations communicated to the Board's Audit Committee
– 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.	We assessed the economic scenario base case and alternative economic scenarios adopted by management utilising economics specialists. We challenged the probability weightings ascribed to the scenarios and compared them to other scenarios from a variety of external sources. With the assistance of economics specialists, we assessed whether forecast macroeconomic variables, such as GDP, unemployment, interest rates, HPI, CPI and average earnings were appropriate loan loss provision drivers, and that the forecast variables were reasonable. We performed testing over material PMAs including those which were applied as a result of impact of the ongoing pandemic. With our credit modelling specialists, we assessed the completeness of these adjustments and their appropriateness by considering the data, judgments and methodology for these adjustments. With the support of our 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 hotels, commercial real estate and manufacturing where no specific provision was held to determine whether their stage classification was correct. Our procedures included a series of "stand-back" analyses, including industry benchmarking, internal consistency checks and analytical review. We assessed the adequacy and appropriateness of disclosures made within the financial statements, including those in respect of impact of COVID-19.	

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

Risk	Our response to the risk	Key observations communicated to the Board’s Audit Committee
Revenue recognition – EIR method The Group records income on financial instruments under the EIR method. Please refer to in note 2.2 on pages 127 and 128. As set out on page 127, 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 behavioral lives of the financial instruments. As a result, the unwinding of the fair value adjustment recorded on acquisition is connected to the EIR calculation and its key assumptions. This adds additional complexity to the calculation of amounts recognized 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 calculate EIR adjustments based on forecast future cash flows. EIR adjustments are sensitive to judgements about the expected behavioral lives and future yields of the product portfolios to which they relate. The complexity of calculations, the degree of management judgement in respect of forecast future cash flows (particularly in the context of uncertain future economic and customer impact of on- going COVID-19 pandemic) and the sensitivity of the amounts recognised in the financial statements to key assumptions are material to the financial statements.	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 behaviors 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 management for consistency and appropriateness against the assumptions used in the Group’s EIR models. We performed an independent assessment by developing a reasonable range of forecast future cash flows outcomes using the Group’s historical experience, our understanding of the industry, and our professional judgement. We assessed management’s modelled EIR outcomes against this range. We performed data integrity testing on the key sources of information used within the EIR calculations. We engaged modelling specialists to review management’s means of data extraction, and also to assist with reperformance of model calculations where required. 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 in the aggregate 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 2021 were reasonable in the aggregate. We communicated our observations on management’s key assumptions. We noted the potential downside risk present in EIR adjustments owing to possibilities in changes future customer behaviour. We considered the modelling adjustments recorded by management 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 management 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)

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 the Parent company to be £37m (2020: £26m), which was 0.67% (2020: 0.50%) of the total equity. We believe that equity provides us with an appropriate measure given the short-term income volatility expected and the unusual circumstances in respect of the on-going COVID-19 pandemic.

We have increased the proportion of total equity used as the basis to determine our materiality, and consequently the materiality used, compared to the prior year given there was greater uncertainty over macro-economic factors such as Brexit and the COVID-19 pandemic during the prior period.

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% (2020: 75%) of our planning materiality, namely £27.5m (2020: £19.5m). 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 £1.8m (2020: £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.

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 93, and Additional information set out on pages 187 to 195. The directors are responsible for the other information contained within the annual report.

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.

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 course of 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 themselves. 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, the part of the directors' remuneration report to be audited has been properly prepared in accordance with the Companies Act 2006.

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

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

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

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 and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Responsibilities of directors
As explained more fully in the directors' responsibilities statement set out on page 104, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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

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

Explanation as to what extent the audit was considered capable of detecting irregularities, including fraud
Irregularities, including fraud, are instances of non-compliance with laws and regulations. We design procedures in line with our responsibilities, outlined above, to detect irregularities, including fraud. The risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion. The extent to which our procedures are capable of detecting irregularities, including fraud is detailed below.
However, the primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the company and management.

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

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

- 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 is complying with these 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.
- 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. We utilised forensic accounting specialists in the design of certain key procedures.
- 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.
- 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 FRCs 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 Group Audit Committee, we were appointed as external auditor at the AGM on 31 January 2005 to audit the financial statements for the year ending 30 September 2005 of the National Australia Bank Group of companies, which at the time included Clydesdale Bank PLC. The period of total uninterrupted engagement as auditors of Clydesdale Bank PLC including previous renewals and reappointments, is 17 years, covering the years ending 30 September 2005 to 30 September 2021.
- The non-audit services prohibited by the FRC's Ethical Standard were not provided to the Group or the parent company, and we remain independent of the Group and the parent company in conducting the audit.
- The audit opinion is consistent with the additional report to the Audit Committee.

Use of our report

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

Ernst & Young LLP

Andrew Bates
for and on behalf of Ernst & Young LLP,
Statutory Auditor
London

23 November 2021

Financial Statements
Consolidated income statement

For the year ended 30 September	Note	**2021 £m**	2020 £m
Interest income		**1,906**	2,129
Other similar interest		**4**	8
Interest expense and similar charges		**(550)**	(853)
Net interest income	2.2	**1,360**	1,284
Gains less losses on financial instruments at fair value		**(9)**	(20)
Other operating income		**136**	171
Non-interest income	2.3	**127**	151
Total operating income		**1,487**	1,435
Operating and administrative expenses before impairment losses	2.4	**(1,202)**	(1,101)
Operating profit before impairment losses		**285**	334
Impairment credit/(losses) on credit exposures	3.2	**131**	(507)
Profit/(loss) on ordinary activities before tax		**416**	(173)
Tax credit/(expense)	2.5	**116**	(18)
Profit/(loss) for the year		**532**	(191)
Attributable to:			
Ordinary shareholders		**473**	(250)
Other equity holders		**59**	59
Profit/(loss) for the year		**532**	(191)

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

The notes on pages 122 to 185 form an integral part of these financial statements.

Financial Statements
Consolidated statement of comprehensive income

For the year ended 30 September	Notes	**2021**	2020
		£m	£m
Profit/(loss) for the year		**532**	(191)
Items that may be reclassified to the income statement			
Change in cash flow hedge reserve			
Gains/(losses) during the year		**99**	(133)
Transfers to the income statement		**24**	59
Taxation thereon - deferred tax (charge)/credit		**(33)**	20
Taxation thereon - current tax charge		**-**	(1)
	4.1.3	**90**	(55)
Change in FVOCI reserve			
Gains during the year		**34**	15
Transfers to the income statement		**-**	(16)
Taxation thereon - deferred tax (charge)/credit		**(11)**	1
		23	-
Total items that may be reclassified to the income statement		**113**	(55)
Items that will not be reclassified to the income statement			
Change in defined benefit pension plan	3.10	**54**	292
Taxation thereon - deferred tax charge		**(46)**	(117)
Taxation thereon - current tax credit		**21**	9
Total items that will not be reclassified to the income statement		**29**	184
Other comprehensive income, net of tax		**142**	129
Total comprehensive income/(losses) for the year, net of tax		**674**	(62)
Attributable to:			
Ordinary shareholders		**615**	(121)
Other equity holders		**59**	59
Total comprehensive income/(losses) for the year, net of tax		**674**	(62)

The notes on pages 122 to 185 form an integral part of these financial statements.

Financial Statements
Balance sheets

As at 30 September	Note	Group 2021 £m	Group 2020 £m	Bank 2021 £m	Bank 2020 £m
Assets					
Financial assets at amortised cost					
Loans and advances to customers	3.1	**71,874**	72,428	**70,922**	71,436
Cash and balances with central banks	3.4	**9,711**	9,107	**9,711**	9,107
Due from other banks		**800**	927	**146**	174
Financial assets at FVTPL					
Loans and advances to customers	3.5	**133**	190	**133**	190
Derivative financial instruments	3.6	**140**	318	**87**	134
Other financial assets	3.5	**16**	1	**1**	1
Due from related entities	5.3	**4**	11	**1,099**	1,163
Financial assets at FVOCI	3.7	**4,352**	5,080	**4,352**	5,080
Property, plant and equipment		**250**	288	**250**	288
Intangible assets and goodwill	3.8	**373**	491	**373**	491
Investments in controlled entities and associates	6.2	**-**	-	**50**	73
Current tax assets		**10**	22	**15**	26
Deferred tax assets	3.9	**497**	382	**493**	375
Defined benefit pension assets	3.10	**847**	723	**847**	723
Other assets		**209**	339	**200**	338
Total assets		**89,216**	90,307	**88,679**	89,599
Liabilities					
Financial liabilities at amortised cost					
Customer deposits	3.11	**66,971**	67,710	**66,971**	67,710
Debt securities in issue	3.12	**4,241**	5,933	**1,822**	1,852
Due to other banks	3.13	**5,918**	5,469	**5,918**	5,469
Financial liabilities at FVTPL					
Derivative financial instruments	3.6	**209**	250	**160**	250
Due to related entities	5.3	**3,450**	2,822	**5,485**	6,255
Deferred tax liabilities	3.9	**296**	271	**296**	270
Provisions for liabilities and charges	3.14	**104**	172	**104**	172
Other liabilities	3.15	**2,445**	2,690	**2,445**	2,690
Total liabilities		**83,634**	85,317	**83,201**	84,668
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	**44**	(69)	**53**	(52)
Retained earnings		**2,074**	1,595	**1,961**	1,519
Total equity		**5,582**	4,990	**5,478**	4,931
Total liabilities and equity		**89,216**	90,307	**88,679**	89,599

The Bank made a profit of £491m (2020: loss of £230m) during the year.

The notes on pages 122 to 185 form an integral part of these financial statements.
These financial statements were approved by the Board of Directors on 23 November 2021 and were signed on its behalf by:

David Duffy
Chief Executive Officer

Clifford Abrahams
Chief Financial Officer

Company name: Clydesdale Bank PLC
Company number: SC001111

Financial Statements
Statements of changes in equity

Group			Other reserves				
	Share capital and share premium	Other equity instruments	Asset reval' reserve	FVOCI reserve	Cash flow hedge reserve	Retained earnings	Total equity
Note	4.1.1	4.1.2		4.1.3	4.1.3		
	£m	£m	£m	£m	£m	£m	£m
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 for the year	-	-	-	-	(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)
As at 30 September 2020	2,792	672	-	11	(80)	1,595	4,990
Profit for the year	-	-	-	-	-	532	532
Other comprehensive income, net of tax	-	-	-	23	90	29	142
Total comprehensive income	-	-	-	23	90	561	674
AT1 distribution paid	-	-	-	-	-	(59)	(59)
Dividends paid to ordinary shareholders	-	-	-	-	-	(20)	(20)
Settlement of Virgin Money Holdings (UK) PLC share awards	-	-	-	-	-	(3)	(3)
At 30 September 2021	**2,792**	**672**	**-**	**34**	**10**	**2,074**	**5,582**

The notes on pages 122 to 185 form an integral part of these financial statements.

Financial Statements
Statements of changes in equity

Bank

			Other reserves				
	Share capital and share premium	**Other equity instruments**	**Asset reval' reserve**	**FVOCI reserve**	**Cash flow hedge reserve**	**Retained earnings**	**Total equity**
Note	4.1.1	4.1.2		4.1.3	4.1.3		
	£m	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
As at 1 October 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 for the year	-	-	-	(2)	(73)	(47)	(122)
AT1 distribution paid	-	-	-	-	-	(59)	(59)
Dividends paid to ordinary shareholders	-	-	-	-	-	(20)	(20)
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
Profit for the year	-	-	-	-	-	491	491
Other comprehensive income, net of tax	-	-	-	23	82	30	135
Total comprehensive income	-	-	-	23	82	521	626
Dividends paid to ordinary shareholders	-	-	-	-	-	(20)	(20)
AT1 distribution paid	-	-	-	-	-	(59)	(59)
At 30 September 2021	**2,792**	**672**	**-**	**34**	**19**	**1,961**	**5,478**

The notes on pages 122 to 185 form an integral part of these financial statements.

Financial statements
Statement of cash flows

For the year ended 30 September		Group		Bank	
		2021	2020	**2021**	2020
	Notes	**£m**	£m	**£m**	£m
Operating activities					
Profit/(loss) on ordinary activities before tax		**416**	(173)	**370**	(215)
Adjustments for:					
Non-cash or non-operating items included in profit/(loss) before tax	5.2	**(1,221)**	(544)	**(1,231)**	(808)
Changes in operating assets	5.2	**819**	(102)	**710**	34
Changes in operating liabilities	5.2	**(1,026)**	1,878	**(1,076)**	1,497
Payments for short-term and low value leases		**(1)**	(2)	**(2)**	(1)
Interest received		**2,088**	2,151	**2,097**	2,071
Interest paid		**(461)**	(790)	**(415)**	(848)
Tax paid including group relief		**(32)**	(15)	**(24)**	(11)
Net cash provided by operating activities		**582**	2,403	**429**	1,719
Cash flows from investing activities					
Interest received		**19**	35	**19**	35
Cash transfer on FSMA Part VII, net of consideration proceeds		-	-	**-**	4,141
Proceeds from maturity of financial instruments at FVOCI		**1,079**	1,568	**1,079**	1,568
Proceeds from sale of financial assets at FVOCI		**-**	587	**-**	566
Purchase of financial assets at FVOCI		**(521)**	(2,838)	**(521)**	(2,838)
Purchase of shares in UTM previously held in Virgin Money Holdings (UK) PLC		**(12)**	(2)	**(5)**	-
Proceeds from sale of property, plant and equipment		**6**	5	**6**	5
Purchase of shares issued by UTM		**-**	-	**(9)**	-
Purchase of property, plant and equipment		**(26)**	(14)	**(26)**	(14)
Purchase and development of intangible assets		**(80)**	(78)	**(80)**	(78)
Net cash provided by/(used in) investing activities		**465**	(737)	**463**	3,385
Cash flows from financing activities					
Interest paid		**(158)**	(87)	**(203)**	(19)
Repayment of principal portion of lease liabilities	3.17	**(28)**	(30)	**(28)**	(29)
Redemption and principal repayment on RMBS and covered bonds	3.12	**(1,543)**	(1,492)	**-**	-
Redemption and principal repayment on medium-term notes	3.12	**-**	(300)	**-**	(300)
Issuance of RMBS and covered bonds	3.12	**-**	491	**-**	-
Amounts drawn under the TFSME		**3,350**	1,300	**3,350**	1,300
Amounts repaid under the TFS		**(2,864)**	(3,234)	**(2,864)**	(3,234)
Net increase in amounts due from related entities		**9**	9	**64**	186
Net increase/(decrease) in amounts due to related entities		**705**	439	**(594)**	(631)
Ordinary dividends paid	4.1.1	**(20)**	(20)	**(20)**	(20)
AT1 distributions	4.1.2	**(59)**	(59)	**(59)**	(59)
Net cash used in financing activities		**(608)**	(2,983)	**(354)**	(2,806)
Net increase/(decrease) in cash and cash equivalents		**439**	(1,317)	**538**	2,298
Cash and cash equivalents at the beginning of the year		**9,814**	11,131	**9,061**	6,763
Cash and cash equivalents at the end of the year	5.2	**10,253**	9,814	**9,599**	9,061

Financial statements
Statement of cash flows (continued)

Movements in liabilities arising from financing activities

Group	Term funding schemes(1)	Debt securities in issue	Intercompany loans	Lease liabilities	Total
	£m	£m	£m	£m	£m
At 1 October 2019	7,308	7,267	2,315	205	17,095
Cash flows:					
Issuances	-	491	448	-	939
Drawdowns	1,300	-	-	-	1,300
Redemptions	-	(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 foreign exchange movements	-	(27)	6	-	(21)
Unamortised costs	-	(4)	(5)	-	(9)
Other movements	-	-	65	-	65
At 1 October 2020	5,397	5,933	2,822	175	14,327
Cash flows:					
Issuances	-	-	732	-	732
Drawdowns	3,350	-	19	-	3,369
Redemptions	-	(1,543)	(30)	-	(1,573)
Repayment	(2,864)	-	(16)	(28)	(2,908)
Non-cash flows:					
Fair value adjustments and associated unwind on acquired TFS and debt securities in issue	12	(49)	-	-	(37)
Additions to right-of-use asset in exchange for increased lease liabilities	-	-	-	4	4
Remeasurement/disposal	-	-	-	1	1
Movement in accrued interest	1	-	7	2	10
Unrealised foreign exchange movements	-	(104)	(28)	-	(132)
Unamortised costs	-	4	-	-	4
Other movements	-	-	(56)	-	(56)
At 30 September 2021	**5,896**	**4,241**	**3,450**	**154**	**13,741**

(1) This includes amounts drawn under the TFS and TFSME.

The notes on pages 122 to 185 form an integral part of these financial statements.

Financial statements
Statement of cash flows (continued)

Movements in liabilities arising from financing activities

Bank	Term funding schemes[1]	Debt securities in issue	Intercompany loans	Lease liabilities	Total
	£m	£m	£m		£m
At 1 October 2019	2,254	709	5,336	176	8,475
Cash flows:					
Issuances	-	-	478	-	478
Drawdowns	1,300	-	-	-	1,300
Repayments	(3,234)	-	(1,108)	(30)	(4,372)
Redemptions	-	(300)	-	-	(300)
Non-cash flows					
FSMA Part VII banking business transfer from Virgin Money PLC	5,092	1,424	1,801	28	8,345
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)
1 October 2020	5,409	1,852	6,255	175	13,691
Cash flows:					
Issuances	-	-	(1,143)	-	(1,143)
Drawdowns	3,350	-	(10)	-	3,340
Repayments	(2,864)	-	559	(28)	(2,333)
Non-cash flows					
Additions to right-of-use asset in exchange for increased lease liabilities	-	-	-	4	4
Remeasurement/disposal	-	-	-	1	1
Movement in accrued interest	1	-	-	2	3
Unrealised foreign exchange movements		(30)	-	-	(30)
Other movements	-	-	(176)	-	(176)
At 30 September 2021	**5,896**	**1,822**	**5,485**	**154**	**13,357**

(1) This includes amounts drawn under the TFS and TFSME.

The notes on pages 122 to 185 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 highlights newly adopted accounting standards, amendments and interpretations which are relevant to the Group. Where relevant, we explain how these changes are expected to impact the financial position and performance of the Group.

The Group has adopted the UK Finance Code for Financial Reporting Disclosure and has prepared the 2021 Annual Report and Accounts in compliance with the Code.

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, which should be read in conjunction with the Strategic report and the Directors' report, have been prepared in accordance with IASs in conformity with the requirements of the Companies Act 2006 and in accordance with IFRSs adopted pursuant to regulation (EC) No 1606/2002 as it applies in the European Union(1). No individual income statement is presented for the Bank, as permitted by Section 408 of the Companies Act 2006.

As the Group has early adopted 'Amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16 Interest Rate Benchmark Reform – Phase 2', which have been endorsed by the EU and UK in January 2021 (note 1.10), the Group has applied international accounting standards which have been adopted for use within the UK.

The financial information has been prepared under the historical cost convention, as modified by the revaluation of certain financial assets and liabilities at fair value through profit or loss 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 objectives, policies and processes for managing its capital.

In assessing the Group's going concern position as at 30 September 2021, 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 the Group has sufficient capital and liquidity for at least 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.

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 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) As the Group's accounting year straddles 31 December 2020, the date the UK ceased to be subject to EU law, 2021 published financial reports are required to follow and refer to EU adopted IASs. From 1 October 2021, the Group will follow and refer only to UK adopted IFRSs, with the UK Endorsement Board being the body responsible for providing authorisation for the use of new International Accounting Standards Board (IASB) standards, amendments or interpretations in the UK from 1 January 2021. As at 30 September 2021, there were no material endorsement disparities between the UK and EU that would impact the Group.

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 joint venture (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 FVOCI 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 derivative contracts, other than those which are financial guarantee contracts or designated and effective hedging instruments.

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.

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 ECLs, 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); and
- retirement benefit obligations (note 3.10).

The only change to the Group's critical accounting estimates and judgements compared to those stated in the Group's 2020 Annual Report and Accounts relates to PPI redress provisions. The Group has finalised all complaints received up to the time bar of August 2019 and has closed its PPI operation. Consequently, the level of management estimate and judgement required has significantly reduced to a level where this is no longer assessed as critical.

1.10 New accounting standards and interpretations

The Group has adopted a number of IASB pronouncements in the current financial year and except where otherwise stated, they did not have a material impact on the Group's consolidated financial statements:

- amendments to IFRS 3 'Business Combinations' issued October 2018 and effective for financial years beginning on or after 1 January 2020. This amendment revises the definition of a business and will assist in clarifying whether a transaction is an asset acquisition or a business combination;
- amendment to IAS 1 and IAS 8 'Definition of Material' issued in October 2018 and effective prospectively for financial years beginning on or after 1 January 2020. The amendments are intended to make the definition of material easier to understand and are not intended to alter the underlying concept of materiality in IFRS Standards. The concept of obscuring material information with immaterial information has been included as part of the new definition; and
- amendment to IFRS 16 and COVID-19 related rent concessions issued in May 2020 and effective for financial years beginning on or after 1 June 2020. The amendment provides an optional practical expedient for lessees from assessing whether a rent concession related to COVID-19 is a lease modification. The Group does not receive rent concessions.

Early adoption – 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 (adopted for use in both the UK and EU in January 2021) and effective for financial years beginning on or after 1 January 2021. The Group early adopted the amendments from 1 October 2020.

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.

There was no impact on amounts reported for prior years as a result of early adoption. Further detail is provided in note 3.6.

New accounting standards and interpretations not yet adopted
The IASB has issued a number of other minor amendments to IFRSs that are not mandatory for the current reporting year 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

Change in presentation – ECLs on off-balance sheet exposures
ECLs on off-balance sheet exposures of £8m are now presented as part of the provisions for liabilities and charges balance (note 3.14). In previous years, these had been presented as part of the impairment provision on credit exposures offset against loans and advances to customers (£7m as at 30 September 2020). The prior year comparative has not been restated for this change in presentation.

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.

In March 2021, the business announced changes in the Executive Leadership Team. The Group will continue to operate under a three segment model: Mortgages, Personal and Business, which will now be reported through the Chief Commercial Officer. At this point in time, 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.

Summary income statement

	2021	2020
	£m	£m
Net interest income	**1,360**	1,284
Non-interest income	**127**	151
Total operating income	**1,487**	1,435
Operating and administrative expenses	**(1,202)**	(1,101)
Impairment credit/(losses) on credit exposures	**131**	(507)
Segment profit/(loss) before tax	**416**	(173)
Average interest earning assets	**86,947**	86,826

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 EIR. 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 period) and the early repayment charge income receivable. If customer repayments, redemptions or product transfers were to take place one month earlier, the loans and advances to customers balance would reduce by £11m 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, transaction and repayment activity and the retention of the customer balance after the end of a promotional period.

The Group continues to monitor the impact of COVID-19 on actual and expected cash flows. Following the easing of restrictions in the summer, retail spend has improved and the previously observed elevated levels of customer repayments have reduced. The Group therefore expects balance attrition in the post-promotional period to normalise at 1.5% per month. If, however, the actual level of customer balance attrition was to increase by 0.5% per month, the Group estimates it would result in a negative present value adjustment of approximately £14m, which would be recognised in the income statement.

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

2.2 Net interest income (continued)

	2021 £m	2020 £m
Interest income		
Loans and advances to customers	**1,880**	2,062
Loans and advances to other banks	**8**	35
Financial assets at FVOCI	**18**	32
Total interest income	**1,906**	2,129
Other similar interest		
Financial assets at FVTPL	**9**	15
Derivatives economically hedging interest bearing assets	**(5)**	(7)
Total other similar interest	**4**	8
Less: interest expense and similar charges		
Customer deposits	**(361)**	(588)
Debt securities in issue	**(44)**	(86)
Due to other banks	**(20)**	(68)
Due to related entities	**(122)**	(106)
Other interest expense	**(3)**	(5)
Total interest expense and similar charges	**(550)**	(853)
Net interest income	**1,360**	1,284

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 designated at FVTPL - these relate to the Group's fixed interest rate loan portfolio (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 monthly; the fees are recognised in income on this basis. Costs incurred to generate fee and commission income are charged to fees and commissions expense as they are incurred.

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

2.3 Non-interest income (continued)

	2021 £m	2020 £m
Gains less losses on financial instruments at fair value		
Held for trading derivatives	**6**	16
Financial assets at fair value(1)	**3**	(4)
Ineffectiveness arising from fair value hedges (note 3.6)	**(13)**	(21)
Amounts recycled to profit and loss from cash flow hedges(2) (note 3.6)	**(5)**	(5)
Ineffectiveness arising from cash flow hedges (note 3.6)	**-**	(6)
	(9)	(20)
Other operating income		
Net fee and commission income	**124**	142
Margin on foreign exchange derivative brokerage	**16**	17
Gain on sale of financial assets at FVOCI	**-**	16
Share of JV loss after tax	**(5)**	(7)
Other income	**1**	3
	136	171
Total non-interest income	**127**	151

(1) Included within financial assets at fair value is a credit risk gain on loans and advances at fair value of £1m (2020: £1m gain), and a fair value gain on equity investments of £15m (2020: £Nil).

(2) In respect of terminated hedges

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

- Current account and debit card fees	**90**	94
- Credit cards	**38**	41
- Insurance, protection and investments	**10**	16
- Other fees(1)	**29**	31
Total fee and commission income	**167**	182
Total fee and commission expense	**(43)**	(40)
Net fee and commission income	**124**	142

(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

Staff costs 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.

	2021	2020
	£m	£m
Staff costs	**426**	436
Property and infrastructure	**89**	72
Technology and communications	**121**	117
Corporate and professional services	**159**	133
Depreciation, amortisation and impairment	**191**	159
Other expenses	**216**	184
Total operating and administrative expenses	**1,202**	1,101

During the year, the Group identified indicators of impairment for a freehold office property asset. This was as a consequence of a review of the office footprint required as the Group realises its vision for A Life More Virgin as well as indicators of a reduction in market value. An impairment review was carried out which resulted in the carrying value being impaired to the recoverable amount of the asset (£20m) with a resulting impairment charge of £7m recognised in the category depreciation, amortisation and impairment above. The impairment was calculated based on fair value less cost of disposal using a market value approach, taking account of advice received from independent valuers and including adjustments to observable market inputs reflecting any specific characteristics of the land and buildings. The valuation is classified in Level 3 of the fair value hierarchy.

During the year, the Group has refined the methodology for categorising operating and administrative expenses before impairment losses to provide a more accurate reflection of what these costs represent. There has been no change to the total operating and administrative expenses in the prior year and comparatives have been amended to conform with the current year's presentation.

The change took the original other expenses figure of £556m and analysed this further with new line items created to better reflect the nature of the expenditure. The revised prior year other expenses is now £184m, with the £372m reallocated to i) £349m re-classified into three new line items of property and infrastructure (£72m), technology and communications (£117m), and corporate and professional services (£160m), which has been further adjusted to £133m due to the capitalisation of project costs (£27m) which have been reclassified from staff costs and now more appropriately classified as corporate and professional services; ii) £10m of impairments to right-of-use assets re-classified to the depreciation, amortisation and impairment line item (previously £149m); and iii) £13m primarily related to redundancy costs that are now reclassified to staff costs.

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2.4 Operating and administrative expenses before impairment losses (continued)

Staff costs comprise the following items:

	2021	2020
	£m	£m
Salaries and wages	**248**	251
Social security costs	**30**	33
Defined contribution pension expense	**49**	49
Defined benefit pension credit	**(8)**	-
Compensation costs	**319**	333
Equity based compensation[1]	**8**	10
Bonus awards	**22**	6
Performance costs	**30**	16
Redundancy and restructuring	**29**	15
Temporary staff costs	**13**	38
Other	**35**	34
Other staff costs	**77**	87
Total staff costs	**426**	436

(1) Includes National Insurance on equity based compensation.

The analysis of staff costs has therefore also been impacted by this change, with the prior year salaries, wages and non-cash benefits and social security costs of £252m increasing by £32m to £284m and now split between salaries and wages (£251m) and social security costs (£33m). Redundancy costs in the prior year of £15m is also now separately disclosed. In addition, other personnel costs in the prior year of £85m have also been further analysed to provide greater detail on the nature of the costs. These are now disclosed as £34m, with the difference of £51m primarily the result of the introduction of the new temporary staff costs line item of £38m.

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

	2021	2020
	Number	Number
Managers[1]	**2,691**	2,911
Clerical staff	**4,724**	5,345
	7,415	8,256

(1) Includes a combination of managers with and without staff responsibilities.

The average monthly number of employees was 8,613 (2020: 9,275). All staff are contracted employees of the Group and its subsidiary undertakings. The average figures above do not include contractors.

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

	2021	2020
	£'000	£'000
Fees payable to the Bank's auditor for the audit of the Bank's financial statements	**4,075**	2,998
Fees payable to the Bank's auditor for the audit of the Bank's subsidiaries[1]	**197**	220
Total audit fees	**4,272**	3,218
Audit related assurance services	**30**	38
Other assurance services	**330**	329
Fees payable to the Bank's auditor in respect of associated pension schemes	**79**	91
Total fees payable to the Bank's auditor	**4,711**	3,676

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

Non-audit services of £0.4m (2020: £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.

No out of pocket expenses (2020: £0.1m) were borne by the Group during the year.

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

2.5 Taxation

Accounting policy

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

	2021 £m	2020 £m
Current tax		
Current year	**65**	15
Adjustment in respect of prior years	**-**	(5)
	65	10
Deferred tax (note 3.9)		
Current year	**(180)**	1
Adjustment in respect of prior years	**(1)**	7
	(181)	8
Tax (credit)/expense for the year	**(116)**	18

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 charge/(credit) implied by the standard rate to the actual tax (credit)/expense is as follows:

	2021 £m	2020 £m
Profit/(loss) on ordinary activities before tax	**416**	(173)
Tax expense/(credit) based on the standard rate of corporation tax in the UK of 19% (2020: 19%)	**79**	(33)
Effects of:		
Disallowable expenses	**12**	5
Bank levy	**1**	90
Deferred tax assets (recognised)/derecognised	**(126)**	90
Banking surcharge	**20**	-
Impact of rate changes	**(90)**	(35)
AT1 distribution	**(11)**	(11)
Adjustments in respect of prior years	**(1)**	2
Tax (credit)/expense for the year	**(116)**	18

Deferred tax assets recognised represent historic losses, previously derecognised, that are now brought onto the balance sheet in accordance with the Group's established methodology, reflecting their expected utilisation against future taxable profits. Further detail on deferred tax is provided in note 3.9.

It was announced in the March 2021 Budget that the UK main rate of corporation will increase from 19% to 25% with effect from 1 April 2023. This legislative change has been enacted, resulting in the Group's UK deferred tax assets increasing by £57m with a tax credit in the income statement of £90m. For details of the impact of the announced, but not yet enacted, changes to the banking surcharge, refer to note 3.9.

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	
	2021	2020	**2021**	2020
	£m	£m	**£m**	£m
Gross loans and advances to customers	**72,549**	72,923	**71,594**	71,925
Impairment provisions on credit exposures[1] (note 3.2)	**(496)**	(735)	**(493)**	(729)
Fair value hedge adjustment	**(179)**	240	**(179)**	240
	71,874	72,428	**70,922**	71,436

(1) ECLs on off-balance sheet exposures are now presented as part of the provisions for liabilities and charges balance (note 3.14). In previous years, these had been presented as part of the overall ECL allowance (2020: £7m). Prior years have not been restated for this change in presentation.

The Group and Bank have a portfolio of fair valued business loans of £133m (2020: £190m) 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 £72,007m (2020: £72,618m) in respect of Group and £71,055m (2020: £71,626m) in respect of Bank.

The fair value hedge adjustment represents an offset to the fair value movement on hedging derivatives transacted 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 £9m (2020: £61m) and £301m (2020: £346m) 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	**2021**	2020
	£m	£m
Less than 1 year	**257**	265
1-2 years	**156**	186
2-3 years	**99**	125
3-4 years	**50**	65
4-5 years	**26**	32
More than 5 years	**26**	33
	614	706
Unearned finance income	**(30)**	(36)
Net investment in finance lease and hire purchase receivables	**584**	670

Finance income recognised on the net investment in the lease was £19m (2020: £22m) and is included in interest income in the income statement (note 2.2).

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:

Collective: 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 and can be allocated to Stages 1, 2 or 3.

Individual: 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. These will all be allocated to Stage 3.

Regardless of the calculation basis, the Group generates an allowance at the individual financial instrument level. Management judgements in the form of PMAs are added to these where appropriate.

SICR 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 subject to certain restrictions for forborne assets. 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. The ECLs relating to loan commitments and financial guarantees can be found in note 3.14.

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, the weightings used in the ECL calculation, and management's use of PMAs together with sensitivity analysis is detailed in the credit risk section of the Risk report on pages 41 – 48.

3.2 Impairment provisions on credit exposures (continued)

Movement in impairment provision on credit exposures

	Group		Bank	
	2021	2020	**2021**	2020
	£m	£m	**£m**	£m
Opening balance	**735**	362	**729**	224
FSMA Part VII transfer from Virgin Money PLC	**-**	-	**-**	138
(Credit)/charge for the year[1]	**(132)**	507	**(130)**	499
Amounts written off	**(126)**	(159)	**(125)**	(157)
Recoveries of amounts written off in previous years	**26**	25	**26**	25
Transfer of off-balance sheet ECLs to provisions (note 3.14)	**(7)**	-	**(7)**	-
Closing balance	**496**	735	**493**	729

(1) The £131m credit for impairment losses on credit exposures for the current year shown in the income statement for Group and Bank also includes a £1m charge in respect of off-balance sheet ECLs which are now disclosed within provisions (note 3.14).

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

	Group		Bank	
	2021	2020[2]	**2021**	2020[2]
	£m	£m	**£m**	£m
Stage 1	**109**	136	**109**	135
Stage 2	**297**	465	**296**	462
Stage 3[1]	**90**	134	**88**	132
	496	735	**493**	729

(1) Stage 3 includes £2m (2020: £2m) of POCI gross loans and advances for Group and £2m (2020: £2m) for Bank.
(2) Includes £7m of off-balance sheet ECLs which are now presented within provisions for liabilities and charges (refer to note 3.14), of which £1m were held under Stage 1 and £6m under Stage 2.

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 Bonds No.2 LLP and Eagle Place Covered Bonds 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	2021		2020	
	Loans and advances securitised	**Notes in issue**	Loans and advances securitised	Notes in issue
	£m	**£m**	£m	£m
Securitisation Programmes				
Lanark	**4,383**	**3,396**	5,686	4,757
Lannraig	**921**	**693**	860	765
Gosforth 2016-1	**-**	**-**	1,141	947
Gosforth 2017-1	**712**	**591**	910	709
Gosforth 2018-1	**1,107**	**887**	1,227	1,060
	7,123	**5,567**	9,824	8,238
Less held by the Group		**(3,181)**		(4,236)
		2,386		4,002
Covered Bond Programmes				
Clydesdale Bank PLC	**999**	**742**	905	781
Clydesdale Bank PLC (formerly Virgin Money PLC)	**3,960**	**1,100**	3,446	1,137
	4,959	**1,842**	4,351	1,918

Bank	2021		2020	
	Loans and advances securitised	**Notes in issue**	Loans and advances securitised	Notes in issue
	£m	**£m**	£m	£m
Covered Bond Programmes				
Clydesdale Bank PLC	**999**	**699**	905	699
Clydesdale Bank PLC (formerly Virgin Money PLC)	**3,960**	**1,113**	3,446	1,143
	4,959	**1,812**	4,351	1,842

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 £7,171m and £2,406m respectively (2020: £9,807m and £3,988m).

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 and Bank	
	2021	2020
	£m	£m
Beneficial interest held	**1,521**	1,795
Subordinated loans	**1**	46
Junior notes held	**1,206**	1,299
	2,728	3,140

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 £541m (2020: £520m) in the Clydesdale Bank PLC programme and £2,827m (2020: £2,314m) 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.

On 22 October 2021, following a successful consent solicitation proces, the Series 2012-2 Covered Bonds transfered from the Clydesdale Bank PLC Global Covered Bond Programme to the Clydesdale Bank PLC (formerly Virgin Money PLC) Global Covered Bond Programme. There was no financial impact to the group or bank in relation to this transfer.

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 and Bank	
	2021	2020
	£m	£m
Cash assets	**1,374**	1,560
Balances with central banks (including EU payment systems)	**8,337**	7,547
	9,711	9,107
Less mandatory deposits with central banks[1]	**(258)**	(220)
Included in cash and cash equivalents (note 5.2)	**9,453**	8,887

(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 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.

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).

Loans and advances

Included in financial assets at FVTPL is a historical portfolio of loans. 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 £133m (2020: £190m) including accrued interest receivable of £Nil (2020: £1m). The cumulative loss in the fair value of the loans attributable to changes in credit risk amounts to £2m (2020: £3m); the change for the current year is a decrease of £1m (2020: decrease of £1m).

Other financial assets

Other financial assets of £16m (2020: £1m) consists entirely of unlisted securities.

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.

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 primarily due to the mismatch, or duration, between repricing dates of interest-bearing assets and liabilities, or basis risk from assets and liabilities repricing to different reference rates. 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 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).

<u>Interest Rate Benchmark Reform – Phase 1</u>

The Group early adopted the Amendments to IAS and IFRS 7 on Interest Rate Benchmark Reform (the Phase 1 amendments) from 1 October 2019.

The Phase 1 amendments provide temporary relief from applying specific hedge accounting requirements to hedging relationships directly affected by IBOR 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 Phase 1 amendments that have applied by the Group the current and prior year 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 during the period of IBOR uncertainty solely because the retrospective assessment of hedge effectiveness falls outside the 80-125% 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)

Interest Rate Benchmark Reform – Phase 2

As highlighted in note 1.10, the Group has early adopted the Interest Rate Benchmark Reform – Phase 2 (Amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16) from 1 October 2020.

The Phase 2 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.

In summary, the reliefs provided by the Phase 2 amendments that have been applied by the Group in the current year are:

• under a temporary exception, the Group has considered that changes to the hedge designation and hedge documentation due to the interest rate benchmark reform would not constitute the discontinuation of the hedge relationship nor the designation of a new hedging relationship;

• in respect of the retrospective hedge effectiveness assessment, the Group may elect, on a hedge-by-hedge basis, to reset the cumulative fair value changes to zero when the exception to the retrospective assessment ends (Phase 1 relief). Any hedge ineffectiveness will continue to be measured and recognised in full in profit or loss;

• the Group has deemed the amounts accumulated in the cash flow hedge reserve to be based on the alternative benchmark rate (on which the hedge future cash flows are determined) when there is a change in basis for determining the contractual cash flows;

• for hedges of groups of items (such as those forming part of a macro cash flow hedging strategy), the amendments provide relief for items within a designated group of items that are amended for changes directly required by the reform; and

• in respect of whether a risk component of a hedged item is separately identifiable, the amendments provide temporary relief to entities to meet this requirement when an alternative risk free rate (RFR) financial instrument is designated as a risk component. These amendments allow the Group upon designation of the hedge to assume that the separately identifiable requirement is met if the Group reasonably expects the RFR risk will become separately identifiable within the next 24 months. The Group applies this relief to each RFR on a rate-by-rate basis and starts when the Group first designates the RFR as a non-contractually specified risk component.

The amendments to IFRS 7 require certain disclosures to be made to enable users of financial statements to understand the effect of interest rate benchmark reform on an entity's financial instruments and risk management strategy. Refer to page 78 where these disclosures have been included.

There was no impact on amounts reported for prior years as a result of early adoption of the Phase 2 amendments.

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).

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	
	2021	2020	**2021**	2020
	£m	£m	**£m**	£m
Fair value of derivative financial assets				
Designated as hedging instruments	**94**	198	**43**	66
Designated as held for trading	**46**	120	**44**	68
	140	318	**87**	134
Fair value of derivative financial liabilities				
Designated as hedging instruments	**143**	158	**97**	158
Designated as held for trading	**66**	92	**63**	92
	209	250	**160**	250

In respect of derivatives with other banks, cash collateral totalling £18m (2020: £53m) has been pledged and £76m has been received (2020: £93m). 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 £82m (2020: £202m) and is included within other assets and other liabilities.

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**	2021 Notional contract amount £m	2021 Fair value of assets £m	2021 Fair value of liabilities £m	2020 Notional contract amount £m	2020 Fair value of assets £m	2020 Fair value of liabilities £m
Derivatives designated as hedging instruments						
Cash flow hedges						
Interest rate swaps (gross)	**24,886**	**71**	**90**	29,645	74	215
Less: net settled interest rate swaps(1)	**(21,500)**	**(64)**	**(79)**	(19,187)	(13)	(171)
Interest rate swaps (net)(2)	**3,386**	**7**	**11**	10,458	61	44
Cross currency swaps(2)	**-**	**-**	**-**	420	28	-
	3,386	**7**	**11**	10,878	89	44
Fair value hedges						
Interest rate swaps (gross)	**30,707**	**295**	**447**	37,803	182	751
Less: net settled interest rate swaps (1)	**(25,260)**	**(209)**	**(390)**	(30,603)	(92)	(642)
Interest rate swaps (net)(2)	**5,447**	**86**	**57**	7,200	90	109
Cross currency swaps(2)	**1,880**	**1**	**75**	1,448	19	5
	7,327	**87**	**132**	8,648	109	114
Total derivatives designated as hedging instruments	**10,713**	**94**	**143**	19,526	198	158
Derivatives designated as held for trading						
Foreign exchange rate related contracts						
Spot and forward foreign exchange(2)	**805**	**13**	**12**	1,003	15	15
Cross currency swaps(2)	**490**	**-**	**3**	1,263	56	7
Options(2)	**1**	**-**	**-**	1	-	-
	1,296	**13**	**15**	2,267	71	22
Interest rate related contracts						
Swaps(2)	**734**	**14**	**31**	704	28	47
Swaptions(2)	**10**	**-**	**1**	10	-	2
Options(2)	**495**	**1**	**2**	426	2	3
	1,239	**15**	**34**	1,140	30	52
Commodity related contracts	**97**	**17**	**17**	131	19	18
Equity related contracts	**1**	**1**	**-**	-	-	-
Total derivatives designated as held for trading	**2,633**	**46**	**66**	3,538	120	92

(1) Presented within other assets.

(2) Presented within derivative financial instruments.

3.6 Derivative financial instruments (continued)

Bank Total derivative contracts	2021 Notional contract amount £m	2021 Fair value of assets £m	2021 Fair value of liabilities £m	2020 Notional contract amount £m	2020 Fair value of assets £m	2020 Fair value of liabilities £m
Derivatives designated as hedging instruments						
Cash flow hedges						
Interest rate swaps (gross)	**24,886**	**71**	**90**	29,645	74	215
Less: net settled interest rate swaps(1)	**(21,500)**	**(64)**	**(79)**	(19,187)	(13)	(171)
Interest rate swaps (net)(2)	**3,386**	**7**	**11**	10,458	61	44
Fair value hedges						
Interest rate swaps (gross)	**30,007**	**244**	**447**	37,103	92	751
Less: net settled interest rate swaps (1)	**(25,260)**	**(209)**	**(390)**	(30,603)	(92)	(642)
Interest rate swaps (net)(2)	**4,747**	**35**	**57**	6,500	-	109
Cross currency swaps(2)	**958**	**1**	**29**	526	5	5
Total derivatives designated as hedging instruments	**9,091**	**43**	**97**	17,484	66	158
Derivatives designated as held for trading						
Foreign exchange rate related contracts						
Spot and forward foreign exchange(2)	**805**	**13**	**12**	1,003	15	15
Cross currency swaps(2)	**400**	**-**	**-**	764	4	7
Options(2)	**1**	**-**	**-**	1	-	-
	1,206	**13**	**12**	1,768	19	22
Interest rate related contracts						
Swaps(2)	**734**	**13**	**31**	704	28	47
Swaptions(2)	**10**	**-**	**1**	10	-	2
Options(2)	**495**	**1**	**2**	426	2	3
	1,239	**14**	**34**	1,140	30	52
Commodity related contracts	**97**	**17**	**17**	131	19	18
Total derivatives designated as held for trading	**2,542**	**44**	**63**	3,039	68	92

(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.

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.

3.6 Derivative financial instruments (continued)

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. There are no active micro cash flow hedges at the Group's balance sheet date.

Portfolio fair value hedges

The Group applies macro fair value hedging to its fixed rate mortgages. The Group determines hedged items by identifying portfolios of homogeneous loans or deposits based on their contractual maturity and other risk characteristics. Loans 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 are recognised on the Group's balance sheet as an asset. 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. Fair value hedging of fixed rate deposits was discontinued in prior year, and the hedge adjustment recognised on the Group's balance sheet is amortised to profit and loss over the life of the hedged item.

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 - Phase 1

The Group has a fair value hedge accounting relationship that is exposed to GBP LIBOR, which is subject to the interest rate benchmark reform.

At 30 September 2021, the notional amount of hedged item and hedging instrument to which these Phase 1 amendments apply was £700m relating to a fixed rate issuance.

At 30 September 2020, the notional amount of hedged items to which the Phase 1 amendments applied was £780m, of which £78m related to EURIBOR in fair value hedges and £611m in cash flow hedges. At 30 September 2020, the notional amount of hedging instruments to which the Phase 1 amendments applied was £778m in fair value hedges and £130m in cash flow hedges.

The Group has applied and will continue to apply the Phase 1 amendments to IAS 39 until the uncertainty arising from interest rate benchmark reform is no longer present. The Group has assumed that this uncertainty will not end until items that reference IBORs are amended to specify the alternative benchmark rate, the relevant spread adjustment and the date on which the interest rate benchmark will be replaced.

Interest Rate Benchmark Reform – Phase 2

As highlighted in note 1.4, the Group has early adopted and applied the Interest Rate Benchmark Reform – Phase 2 (Amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16) from 1 October 2020. During the year, the Group has applied the relief which permits the amount in the cash flow hedge reserve relating to a de-designated hedge to be deemed based on the alternative benchmark rate on which the future cash flows will be based. There was no impact on amounts reported for prior years as a result of early adoption of the Phase 2 amendments.

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	2021				2020			
		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)]	**24,886**	**71**	**90**	**127**	29,645	74	215	(80)
Foreign exchange risk								
Cross currency swaps	**-**	**-**	**-**	**(28)**	420	28	-	(59)
Total derivatives designated as cash flow hedges	**24,886**	**71**	**90**	**99**	30,065	102	215	(139)
FAIR VALUE HEDGES								
Interest rate risk								
Interest rate swaps[(1)]	**30,707**	**295**	**447**	**500**	37,803	182	751	(40)
Foreign exchange and interest rate risk								
Cross currency swaps	**1,880**	**1**	**75**	**(12)**	1,448	19	5	-
Total derivatives designated as fair value hedges	**32,587**	**296**	**522**	**488**	39,251	201	756	(40)

Bank	2021				2020			
		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)]	**24,886**	**71**	**90**	**127**	29,645	74	215	(94)
Total derivatives designated as cash flow hedges	**24,886**	**71**	**90**	**127**	29,645	74	215	(94)
FAIR VALUE HEDGES								
Interest rate risk								
Interest rate swaps[(1)]	**30,007**	**244**	**447**	**539**	37,103	92	751	(58)
Foreign exchange and interest rate risk								
Cross currency swaps	**958**	**1**	**29**	**1**	526	5	5	3
Total derivatives designated as fair value hedges	**30,965**	**245**	**476**	**540**	37,629	97	756	(55)

(1) As shown in the total derivatives contracts table on pages 143 - 144, 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 recognised in the income statement in non-interest income.

3.6 Derivative financial instruments (continued)

Summary of hedged items 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	2021			2020		
		Cash flow hedge reserve			Cash flow hedge reserve	
	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)	**(127)**	**2**	**13**	74	(123)	17
Foreign exchange risk						
Floating rate currency issuances(2)	**29**	**-**	**-**	59	(1)	-
Total	**(98)**	**2**	**13**	133	(124)	17

Group	2021				2020			
	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)	**24,265**	**-**	**(179)**	**(420)**	31,110	-	240	29
Fixed rate customer deposits(4)	**-**	**-**	**(5)**	**-**	-	-	(11)	1
Fixed rate FVOCI debt instruments(5)	**3,010**	**-**	**(115)**	**(197)**	3,001	-	74	16
Fixed rate issuances(2)	**-**	**(2,768)**	**28**	**104**	-	(2,565)	132	(27)
Foreign exchange and interest rate risk								
Fixed rate currency FVOCI debt instruments(5)	**78**	**-**	**-**	**(5)**	83	-	5	3
Fixed rate currency issuances(2)	**-**	**(1,730)**	**(13)**	**17**	-	(1,389)	4	(3)
Total	**27,353**	**(4,498)**	**(284)**	**(501)**	34,194	(3,954)	444	19

(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 customer deposits.

(5) Hedged item is recorded in financial assets at FVOCI.

3.6 Derivative financial instruments (continued)

Summary of hedged items in designated hedge relationships (continued)

Bank	2021			2020		
		Cash flow hedge reserve			Cash flow hedge reserve	
	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)	**(127)**	**3**	**25**	90	(123)	37
Total	**(127)**	**3**	**25**	90	(123)	37

Bank	2021				2020			
	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)	**24,265**	**-**	**(179)**	**(420)**	31,110	-	240	29
Fixed rate customer deposits(4)	**-**	**-**	**(5)**	**-**	-	-	(11)	1
Fixed rate FVOCI debt instruments(5)	**3,010**	**-**	**(115)**	**(197)**	3,001	-	74	30
Fixed rate issuances(2)	**-**	**(2,015)**	**(15)**	**64**	-	(1,769)	50	(21)
Foreign exchange and interest rate risk								
Fixed rate currency FVOCI debt instruments(5)	**78**	**-**	**-**	**(5)**	83	-	5	3
Fixed rate currency issuances(2)	**-**	**(856)**	**(3)**	**4**	-	(455)	(1)	(6)
Total	**27,353**	**(2,871)**	**(317)**	**(554)**	34,194	(2,224)	357	36

(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 in the prior year. The fair value adjustment taken will be amortised over the remaining life of the hedged items, and is recorded in customer deposits.

(5) Hedged item is recorded in financial assets at FVOCI.

3.6 Derivative financial instruments (continued)

Group	2021				2020			
			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	**-**	**127**	**10**	**(5)**	(6)	(74)	5	(5)
Foreign exchange risk								
Floating rate currency issuances	**-**	**(28)**	**-**	**-**	-	(59)	-	(59)
Total gains/(losses) on cash flow hedges	**-**	**99**	**10**	**(5)**	(6)	(133)	5	(64)

Group	Hedge ineffectiveness recognised in income	
	2021 £m	2020 £m
FAIR VALUE HEDGES		
Interest rate risk		
Fixed rate mortgages	**(10)**	(22)
Fixed rate customer deposits	**-**	3
Fixed rate FVOCI debt instruments	**1**	-
Fixed rate issuances	**(4)**	(2)
Total losses on fair value hedges[1]	**(13)**	(21)

(1) Recognised in gains less losses on financial assets at fair value.

Bank	2021				2020			
			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	**-**	**127**	**14**	**-**	(4)	(90)	8	-
Total gains/((losses) on cash flow hedges	**-**	**127**	**14**	**-**	(4)	(90)	8	-

Bank	Hedge ineffectiveness recognised in income	
	2021 £m	2020 £m
FAIR VALUE HEDGES		
Interest rate risk		
Fixed rate mortgages	**(10)**	(15)
Fixed rate customer deposits	**-**	(1)
Fixed rate FVOCI debt instruments	**1**	-
Fixed rate issuances	**(5)**	(3)
Total losses on fair value hedges[1]	**(14)**	(19)

(1) Recognised in gains less losses on financial assets at fair value.

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

3.6 Derivative financial instruments (continued)

The table below discloses the impact derivatives held in micro cash flow hedges 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.

2021 - 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)	**-**	**-**	**-**	**-**
Average GBP/EUR rate	**-**	**-**	**-**	**n/a**
Average GBP/USD rate	**-**	**-**	**-**	**n/a**

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

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 FVOCI, 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.

Financial assets at FVOCI consists of £4,352m of listed securities (2020: £5,080m).

Refer to note 3.16 for further information on the valuation methodology applied to financial instruments at FVOCI at 30 September 2021 and their classification within the fair value hierarchy.

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.

Group	Capitalised software £m	Goodwill £m	Core deposit intangible £m	Total £m
Cost				
At 1 October 2019	950	11	6	967
Additions	78	-	-	78
At 30 September 2020	1,028	11	6	1,045
Additions	80	-	-	80
Write-off	(65)	-	-	(65)
At 30 September 2021	**1,043**	**11**	**6**	**1,060**
Accumulated amortisation				
At 1 October 2019	450	-	1	451
Charge for the year	102	-	1	103
At 30 September 2020	552	-	2	554
Charge for the year	123	-	1	124
Impairment	9	-	-	9
At 30 September 2021	**684**	**-**	**3**	**687**
Net book value				
At 30 September 2021	**359**	**11**	**3**	**373**
At 30 September 2020	476	11	4	491

3.8 Intangible assets and goodwill (continued)

Bank	Capitalised software	Goodwill	Core deposit intangible	Total
	£m	£m	£m	£m
Cost				
At 1 October 2019	752	-	-	752
Additions	78	-	-	78
FSMA Part VII transfer from Virgin Money PLC	269	11	6	286
At 30 September 2020	1,099	11	6	1,116
Additions	80	-	-	80
Write-off	(65)	-	-	(65)
At 30 September 2021	**1,114**	**11**	**6**	**1,131**
Accumulated amortisation				
At 1 October 2019	354	-	-	354
Charge for the year	102	-	1	103
FSMA Part VII transfer from Virgin Money PLC	167	-	1	168
At 30 September 2020	623	-	2	625
Charge for the year	123	-	1	124
Impairment	9	-	-	9
At 30 September 2021	**755**	**-**	**3**	**758**
Net book value				
At 30 September 2021	**359**	**11**	**3**	**373**
At 30 September 2020	476	11	4	491

£Nil (2020: £4m) of the £80m (2020: £78m) software additions in both Group and Bank do not form part of internally generated software projects.

A £68m charge (comprising write-offs of £65m and impairments of £3m) was recognised in the year following a reassessment of the Group's practices on the capitalisation of work-in-progress (WIP) balances against the backdrop of the new digital first strategy and the move to an agile project delivery.

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 £497m (2020: £382m), 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 2021 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. 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 £441m or £546m respectively. All tax assets arising will be used within the UK.

3.9 Deferred tax (continued)

Movement in net deferred tax asset

	Group		Bank	
	2021	2020	**2021**	2020
	£m	£m	**£m**	£m
At 1 October	**111**	219	**105**	205
Recognised in the income statement (note 2.5)	**180**	(8)	**179**	(13)
Recognised directly in equity	**(90)**	(100)	**(87)**	(90)
Transfers from other group entities	**-**	-	**-**	3
At 30 September	**201**	111	**197**	105

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

	Group		Bank	
	2021	2020	**2021**	2020
Deferred tax assets	**£m**	£m	**£m**	£m
Tax losses carried forward	**385**	215	**382**	213
Capital allowances	**124**	113	**120**	110
Cash flow hedge reserve	**(9)**	23	**(9)**	23
Acquisition accounting adjustments(1)	**(10)**	1	**(10)**	-
Transitional adjustment - IFRS 9	**15**	15	**15**	15
Employee equity based compensation	**8**	5	**8**	5
Pension spreading	**5**	9	**5**	9
Intangible assets	**(3)**	-	**(3)**	-
Gains on financial instruments at FVOCI	**(15)**	-	**(15)**	-
Other	**(3)**	1	**-**	-
	497	382	**493**	375
Deferred tax liabilities				
Defined benefit pension scheme surplus	**(296)**	(253)	**(296)**	(253)
Acquisition accounting adjustments(1)	**-**	(11)	**-**	(10)
Intangible assets	**-**	(3)	**-**	(3)
Gains on financial instruments at FVOCI	**-**	(4)	**-**	(4)
	(296)	(271)	**(296)**	(270)
Net deferred tax asset	**201**	111	**197**	105

(1) Following the execution of Financial Services and Markets Act 2000 (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 which has a right to offset current tax assets against current tax liabilities and is party to a Group Payment Arrangement for payments of tax to HMRC. Therefore, in accordance with IAS 12, deferred tax assets and deferred tax liabilities have also been offset in this period where they relate to payments of income tax to this Tax Authority. This is a presentational change only; the prior period column has not been restated. The deferred tax liability arising in relation to the defined benefit pension scheme surplus does not meet the accounting standard’s criteria for offset, and so continues to be presented separately both on the face of the balance sheet and detailed in this note.

The value of tax losses carried forward of £385m (2020: £215m) has increased due to the additional recognition in the current period of historic losses, previously derecognised, that are now brought onto the balance sheet in accordance with the Group’s established methodology, reflecting their expected utilisation against future taxable profits and an increase in the rate at which deferred tax is recognised (see below). In addition, the Group has an unrecognised deferred tax asset of £112m (2020: £217m) representing trading losses with a gross value of £449m valued at 25% (2020: £1,142m valued at 19%).

It was announced in the March 2021 Budget that the UK main rate of corporation tax will increase from 19% to 25% with effect from 1 April 2023. This legislative change has been enacted, resulting in the Group’s UK deferred tax assets increasing by £57m with a tax credit in the income statement of £90m and a tax charge within equity of £33m.

On 27 October 2021 the Government also announced that the banking surcharge will be reduced from a rate of 8% to 3%, and that it will be chargeable on banking profits above £100m (previously £25m). The changes will be effective 1 April 2023 for current tax, aligning with the already enacted rise in the main rate of corporation tax, so that the combined rate of tax on banking profits in excess of £100m will be 28%. Once enacted, this reduction in the surcharge rate will drive a significant rate change charge and reduce the value of the balance sheet deferred tax asset. This is because relevant surcharge-saving losses will be valued only at a lower, tax rate. The quantum of the rate change will depend upon the Group’s tax loss position at the effective date, but if the new rate were to be enacted by 30 September 2022, the impact on the Group’s existing net deferred tax asset is estimated to be a reduction of circa £29m.

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 Group's principal trading subsidiary, Clydesdale Bank PLC, is the sponsoring employer of the defined benefit pension scheme, the Yorkshire and Clydesdale Bank Pension Scheme ('the Scheme'). 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	**2021** **£m**	2020 £m
Active members' defined benefit obligation	**(16)**	(23)
Deferred members' defined benefit obligation	**(1,973)**	(2,064)
Pensioner and dependant members' defined benefit obligations	**(1,800)**	(1,871)
Total defined benefit obligation	**(3,789)**	(3,958)
Fair value of Scheme assets	**4,636**	4,681
Net defined benefit pension asset	**847**	723

The Group's pension arrangements

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 several reforms to the Scheme to manage the obligation. It closed the Scheme to new members in 2004 and since April 2006 has provided 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 both affected and new employees' future pension benefits being provided through the Group's existing defined contribution scheme, 'My Retirement'. 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 some 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 2021 (2020: £2m) 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, considering 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.

The latest triennial valuation for the Scheme 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, the future payments to the Scheme were 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 totalled £52m and were paid in full by the end of September 2021.

Scheme assets are not subject to the same valuation differences as Scheme obligations and are consistently valued at current market value.

3.10 Retirement benefit obligations (continued)

IAS 19 position

The Scheme movements in the year are as follows:

Group and Bank

	2021				2020			
	Present value of obligation	**Fair value of plan assets**	**Total**	**Cumulative impact in other comprehensive income**	Present value of obligation	Fair value of plan assets	Total	Cumulative impact in other comprehensive income
	£m	**£m**	**£m**	**£m**	£m	£m	£m	£m
Balance sheet surplus at 1 October	**(3,958)**	**4,681**	**723**	**(302)**	(4,311)	4,707	396	(594)
Total expense								
Past service credit/(cost)	**3**	**-**	**3**		(1)	-	(1)	
Interest (expense)/income	**(61)**	**73**	**12**		(75)	82	7	
Administrative costs	**-**	**(6)**	**(6)**		-	(6)	(6)	
Total (expense)/income recognised in the consolidated income statement	**(58)**	**67**	**9**		(76)	76	-	
Remeasurements								
Return on Scheme assets greater than discount rate	**-**	**(19)**	**(19)**	**(19)**	-	61	61	61
Actuarial:								
(Loss)/gain - experience adjustments	**(15)**	**-**	**(15)**	**(15)**	140	-	140	140
Gain - demographic assumptions	**2**	**-**	**2**	**2**	116	-	116	116
Gain/(loss) - financial assumptions	**86**	**-**	**86**	**86**	(25)	-	(25)	(25)
Remeasurement gains/(losses) recognised in other comprehensive income	**73**	**(19)**	**54**	**54**	231	61	292	292
Contributions and payments								
Employer contributions	**-**	**61**	**61**		-	35	35	
Benefit payments	**99**	**(99)**	**-**		105	(105)	-	
Transfer payments	**55**	**(55)**	**-**		93	(93)	-	
	154	**(93)**	**61**		198	(163)	35	
Balance sheet surplus at 30 September	**(3,789)**	**4,636**	**847**	**(248)**	(3,958)	4,681	723	(302)

On 20 November 2020, a judgement was announced following on from an earlier judgement requiring schemes to equalise pension benefits for men and women. This new judgement 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, and gave rise to a past service cost of £1.7m recognised this year.

In July 2021, the Trustee communicated a Pension Increase Exchange (PIE) exercise to members. A PIE gives members the option to exchange future increases on their pensions for a one-off uplift to their current pension. The exercise is being undertaken in two phases and is due to complete in calendar year 2022. A past service credit of £5m has been recognised in the year to 30 September 2021 in line with member acceptance of the PIE offer by the balance sheet date; the balance of the credit will be recognised next year as the exercise concludes.

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

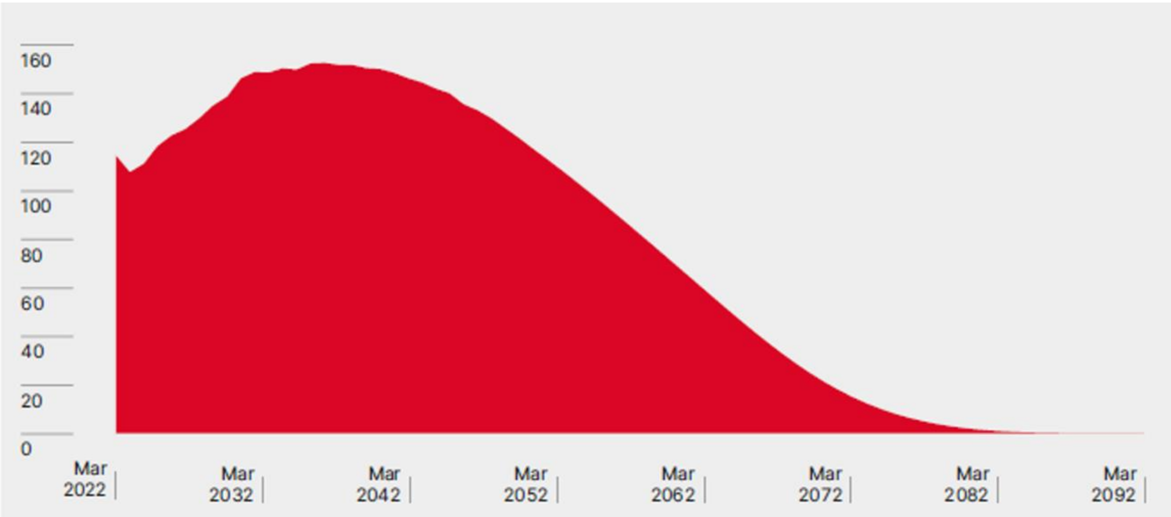
3.10 Retirement benefit obligations (continued)

The expected contributions and benefit payments for the year ending 30 September 2022 are £7m (2021: £39m) and £115m (2021: £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:

Annual Pension Scheme liability cash flows - £m



The discounted mean term of the defined benefit obligation at 30 September 2021 is 18.5 years (2020: 19 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 2021, the interest rate and inflation rate hedge ratios were both around 95% (2020: 97% and 84%) 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:

	2021				2020			
	Quoted £m	**Unquoted £m**	**Total £m**	**%**	Quoted £m	Unquoted £m	Total £m	%
Bonds								
Fixed government	**894**	**-**	**894**		930	-	930	
Index-linked government	**1,815**	**-**	**1,815**		2,001	-	2,001	
Global sovereign	**117**	**4**	**121**		115	1	116	
Corporate and other	**1,011**	**47**	**1,058**		879	48	927	
	3,837	**51**	**3,888**	**84%**	3,925	49	3,974	85%
Equities(1)								
Global equities	**-**	**150**	**150**		-	368	368	
Emerging market equities	**-**	**16**	**16**		-	43	43	
UK equities	**-**	**8**	**8**		-	114	114	
	-	**174**	**174**	**4%**	-	525	525	11%
Other								
Secured income alternatives	**-**	**197**	**197**		-	165	165	
Derivatives(2)	**-**	**6**	**6**		-	78	78	
Repurchase agreements	**-**	**(719)**	**(719)**		-	(1,025)	(1,025)	
Property	**-**	**122**	**122**		-	122	122	
Alternative credit	**-**	**597**	**597**		-	563	563	
Infrastructure	**-**	**161**	**161**		-	127	127	
Cash	**-**	**209**	**209**		-	146	146	
Equity options	**1**	**-**	**1**		6	-	6	
	1	**573**	**574**	**12%**	6	176	182	4%
Total Scheme assets	**3,838**	**798**	**4,636**	**100%**	3,931	750	4,681	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 2021, the Scheme had employer-related investments within the meaning of Section 40 (2) of the Pensions Act 1995 totalling £2m (2020: £2m)

3.10 Retirement benefit obligations (continued)

Actuarial assumptions

The following assumptions were used in arriving at the IAS 19 defined benefit obligation:

	2021	2020
	% p.a.	% p.a.
Financial assumptions		
Discount rate	**2.08**	1.58
Inflation (RPI)	**3.40**	2.93
Inflation (CPI)	**2.77**	2.03
Career average revalued earnings revaluations:		
Pre-31 March 2012 benefits (RPI)	**3.40**	2.93
Post-31 March 2012 benefits (CPI capped at 5% per annum)	**2.73**	2.03
Pension increases (capped at 2.5% per annum)	**2.16**	2.01
Pension increases (capped at 5% per annum)	**3.23**	2.85
Rate of increase for pensions in deferment	**2.73**	2.03

	2021	2020
	Years	Years
Demographic assumptions		
Post retirement mortality:		
Current pensioners at 60 - male	**27.2**	27.2
Current pensioners at 60 - female	**29.4**	29.3
Future pensioners at 60 - male	**28.3**	28.2
Future pensioners at 60 - female	**30.5**	30.4

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%	(61)	(166)	(6)
	- 0.25%	62	178	5
Inflation	+ 0.25%	34	104	2
	- 0.25%	(31)	(104)	(2)
Life expectancy	+1 year	(150)	150	3
	-1 year	147	(147)	(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 and Bank	
	2021	2020
	£m	£m
Interest bearing demand deposits	**46,839**	41,866
Term deposits	**15,097**	21,107
Non-interest bearing demand deposits	**4,936**	4,549
	66,872	67,522
Accrued interest payable	**99**	188
	66,971	67,710

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 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:

2021

Group	**Securitisation £m**	**Covered bonds £m**	**Total £m**
Amortised cost	**2,382**	**1,812**	**4,194**
Fair value hedge adjustments	**4**	**30**	**34**
Total debt securities	**2,386**	**1,842**	**4,228**
Accrued interest payable	**3**	**10**	**13**
	2,389	**1,852**	**4,241**

2020

Group	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

2021

Bank	**Covered bonds £m**	**Total £m**
Amortised cost	**1,812**	**1,812**
Fair value hedge adjustments	**-**	**-**
Total debt securities	**1,812**	**1,812**
Accrued interest payable	**10**	**10**
	1,822	**1,822**

2020

Bank	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

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**
Securitisation	USD, GBP	-	USD, EUR, GBP	1,543

(1) Other movements relate to foreign exchange, amortisation of issuance costs and the unwinding of acquisition accounting adjustments.

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. No transactions have been recorded in respect of repos in the current or prior year, however this is activity that the Group does undertake as and when required.

	Group and Bank	
	2021	2020
	£m	£m
Secured loans	**5,896**	5,397
Transaction balances with other banks	**-**	15
Deposits from other banks	**22**	57
	5,918	5,469

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.

	Group		Bank	
	2021	2020	**2021**	2020
	£m	£m	**£m**	£m
PPI redress provisions				
Opening balance	**107**	379	**107**	379
Charge to the income statement	**59**	-	**59**	-
Utilised	**(165)**	(272)	**(165)**	(272)
Closing balance	**1**	107	**1**	107
Customer redress and other provisions				
Opening balance	**31**	33	**31**	29
Virgin Money provision on acquisition	**-**	-	**-**	3
Charge to the income statement	**21**	28	**21**	28
Utilised	**(24)**	(30)	**(24)**	(29)
Closing balance	**28**	31	**28**	31
Property closure and redundancy provision				
Opening balance	**34**	44	**34**	31
Virgin Money provision on acquisition	**-**	-	**-**	11
Charge to the income statement	**68**	19	**68**	18
Utilised	**(35)**	(29)	**(35)**	(26)
Closing balance	**67**	34	**67**	34
Off-balance sheet ECL provision(1)				
Opening balance	**-**	-	**-**	-
Transfer of ECL provision from loans and advances	**7**	-	**7**	-
Charge to the income statement	**1**	-	**1**	-
Closing balance	**8**	-	**8**	-
Total provisions for liabilities and charges	**104**	172	**104**	172

(1) During the year, the Group changed its presentation of off-balance sheet ECLs. The off-balance sheet provision, which relates to credit-related commitments, is now presented as part of the provision for liabilities and charges instead of as part of the impairment provision offset against loans and advances (note 3.2). Prior year comparatives have not been restated.

3.14 Provision for liabilities and charges (continued)

PPI redress provision

The Group has now dealt with complaints received in the period up to the time bar in August 2019, including the settlement of claims received from the Official Receiver. The total provision raised in respect of PPI is £3,114m (2020: £3,055m), with £1m of this remaining (2020: £107m).

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. A number of these matters are now reaching a conclusion and the risk that the final amount required to settle the Group's potential liabilities in these matters being materially more than the remaining provision is now considered to be low.

Property closure and redundancy position

Property closure and redundancy provision includes costs for stores and office closures and staff redundancy costs. During the year, provisions of £68m were raised with £33m related to stores and office closures and £35m related to staff redundancy costs.

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	
	2021	2020	**2021**	2020
	£m	£m	**£m**	£m
Notes in circulation	**2,104**	2,319	**2,104**	2,319
Accruals and deferred income	**72**	91	**71**	90
Deferred grant	**20**	35	**20**	35
Other	**249**	245	**250**	246
	2,445	2,690	**2,445**	2,690

During the year, the Group received £9m (2020: £35m) from the Capability and Innovation Fund (as part of the RBS alternative remedies package). This is being utilised under the terms of the grant application. As part of the grant the Group is subject to delivering a number of public commitments. These commitments can be found on BCR's (the awarding body) website. As at 30 September 2021 the Group is currently on track with the delivery of these commitments.

The movement in the deferred grant is shown below:

	Group and Bank	
	2021	2020
	£m	£m
Opening balance	**35**	-
Grants received	**9**	35
Utilised against income statement spend in the year	**(24)**	-
Closing balance	**20**	35

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 credit 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.

3.16 Fair value of financial instruments (continued)

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

The tables 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

	2021		2020	
	Carrying value	**Fair value**	Carrying value	Fair value
Financial assets	**£m**	**£m**	£m	£m
Loans and advances to customers[(1)]	**71,874**	**72,227**	72,428	71,786
Financial liabilities				
Customer deposits[(2)]	**66,971**	**67,012**	67,710	67,809
Debt securities in issue[(3)]	**4,241**	**4,346**	5,933	5,990
Due to related entities[(2)]	**3,450**	**3,783**	2,822	2,950

Bank

	2021		2020	
	Carrying value	**Fair value**	Carrying value	Fair value
Financial assets	**£m**	**£m**	£m	£m
Loans and advances to customers[(1)]	**70,922**	**71,267**	71,436	70,794
Financial liabilities				
Customer deposits[(2)]	**66,971**	**67,012**	67,710	67,809
Debt securities in issue	**1,822**	**1,940**	1,852	2,002
Due to related entities[(2)]	**5,485**	**5,819**	6,255	6,383

(1) Loans and advances to customers are categorised as Level 3 in the fair value hierarchy with the exception of £1,057m (2020: £1,060m) of overdrafts which are categorised as Level 2.
(2) Categorised as Level 2 in the fair value hierarchy.

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) *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;

(c) *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; and

(d) *Amounts due to related entities* - The fair value of subordinated debt due to related entities is derived from quoted market prices of the related debt security in issue by 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.

3.16 Fair value of financial instruments (continued)

(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 as at 2021**				Fair value measurement as at 2020			
	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 FVOCI	**4,352**	**-**	**-**	**4,352**	5,080	-	-	5,080
Loans and advances at FVTPL	**-**	**133**	**-**	**133**	-	190	-	190
Other financial assets at FVTPL	**-**	**14**	**2**	**16**	-	-	1	1
Derivative financial assets	**-**	**139**	**1**	**140**		318		318
Total financial assets at fair value	**4,352**	**286**	**3**	**4,641**	5,080	508		5,589
Financial liabilities								
Derivative financial liabilities	**-**	**209**	**-**	**209**	-	250	-	250
Total financial liabilities at fair value	**-**	**209**	**-**	**209**	-	250	-	250

Bank	**Fair value measurement as at 2021**				Fair value measurement as at 2020			
	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 FVOCI	**4,352**	**-**	**-**	**4,352**	5,080	-	-	5,080
Loans and advances at FVTPL	**-**	**133**	**-**	**133**	-	190	-	190
Other financial assets at FVTPL	**-**	**-**	**1**	**1**	-	-	1	1
Derivative financial assets	**-**	**87**	**-**	**87**	-	134	-	134
Total financial assets at fair value	**4,352**	**220**	**1**	**4,573**	5,080	324	1	5,405
Financial liabilities								
Derivative financial liabilities	**-**	**160**	**-**	**160**	-	250	-	250
Total financial liabilities at fair value	**-**	**160**	**-**	**160**	-	250	-	250

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) *FVOCI* – The fair values of listed investments are based on quoted closing market prices.

(b) *Loans and advances to customers (Level 2)* – The fair value is 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.

(c) *Other financial assets FVTPL (Level 2)* – Represents £14m of an unlisted equity investment that is valued based on an offer of purchase by an independent third party. The sale is expected to conclude in Q1 FY22, subject to regulatory approval.

(c) *Other financial assets at FVTPL (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.

(d) *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:	2021		2020	
Group	Financial assets at FVTPL £m	Derivative financial assets £m	Financial assets at FVTPL £m	Derivative financial assets £m
Balance at the beginning of year	**1**	**-**	8	-
Fair value gains recognised[1]				
In profit or loss - unrealised	**1**	**1**	5	-
In profit or loss - realised	**-**	**-**	-	-
Sales	**-**	**-**	(10)	-
Settlements	**-**	**-**	(2)	-
Balance at the end of the year	**2**	**1**	1	-

Level 3 movements analysis:	2021		2020	
Bank	Financial assets at FVTPL £m	Derivative financial assets £m	Financial assets at FVTPL £m	Derivative financial assets £m
Balance at the beginning and end of the year	**1**	**-**	1	-

(1) Net gains or losses were recorded in non-interest income.

Sensitivity of Level 3 fair value measurements to reasonably possible alternative assumptions

The Group, and Bank has limited exposure to Level 3 fair value measurements. If all risks inherent in the valuations were to crystallise in their entirety, total assets would reduce by £3m and £1m respectively, which would be recognised directly in profit or loss.

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 several 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:	**Group and Bank**	
	2021	**2020**
	£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	**(28)**	(30)
Expense relating to short-term leases	**(1)**	(3)
Expense relating to leases of low-value assets that are not short-term leases	**(1)**	(2)
Total	**(32)**	(37)

The total leasing cash outflow in the year was £29m for Group and Bank (2020: £30m).

3.17 Lessee accounting (continued)

b) Amounts recognised on the balance sheet

Right-of-use assets

	2021	2020
Group	**£m**	£m
As at 1 October	**161**	194
Additions	**4**	3
Remeasurements	**1**	(6)
Disposals	**(2)**	-
Depreciation and impairment	**(29)**	(30)
As at 30 September	**135**	161

Bank	2021	2020
	£m	£m
As at 1 October	**160**	168
Additions	**4**	3
Acquisition through business combination (FSMA Part VII)	**1**	25
Remeasurements	**(2)**	(6)
Depreciation and impairment	**(29)**	(30)
As at 30 September	**134**	160

All right-of-use assets relate to leases of land and buildings and are presented within property, plant and equipment on the balance sheet.

On 30 September 2021 the Group announced plans for the closure of 30 stores leased by the Group and to relocate four stores to more prime locations within their existing towns. Following the announcement, the associated right-of-use assets were assessed for impairment. Where it is expected the Group can sub-lease the property, the recoverable amount was determined based 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. An impairment charge of £5m has been recognised within operating and administrative 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).

In the prior period the Group announced plans for the closure of 35 properties leased by the Group. The right-of-use assets were assessed following the above methodology resulting in an impairment charge of £6m.

The Group also reviewed its existing surplus estate population for impairment. It was concluded that 22 properties (2020: 27) should be impaired following this assessment resulting in an impairment charge of £1m (2020: £0.5m).

3.17 Lessee accounting (continued)

Sub-leases

Future undiscounted minimum payments receivable in respect of sub-leased assets at 30 September were as follows:

	Group and Bank	
	2021	2020
	£m	£m
Operating leases	**1**	4
Finance leases	**5**	5
	6	9

Lease liabilities

	Group and Bank	
	2021	2020
	£m	£m
Lease liabilities(1)	**154**	175

(1) Lease liabilities are presented within other liabilities on the balance sheet.

Future undiscounted minimum payments under lease liabilities at 30 September 2021 were as follows:

	Group and Bank	
	2021	2020
Amounts falling due	**£m**	£m
Within 1 year	**26**	27
Between 1 and 5 years	**73**	84
Over 5 years	**78**	88
	177	199

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:

	Group and Bank	
	2021	2020
Amounts falling due	**£m**	£m
Between 1 and 5 years	**21**	18
Over 5 years	**104**	112
	125	120

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

	2021	2020
	£m	£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	**2021 Number of shares**	2020 Number of shares	**2021 £m**	2020 £m
Ordinary shares of £0.10 each- allotted, called up and fully paid				
Opening and 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 2021 rank equally with regard to the Bank's residual assets.

Interim dividends totalling 0.16p (2020: 0.16p) per ordinary share amounting to £20m (2020: £20m) were paid by the Bank in respect of the year ended 30 September 2021. A final dividend in respect of the year ended 30 September 2021 of 0.12p (2020: £Nil) per ordinary share in the Bank amounting to £14m (2020: £Nil) is subject to the Virgin Money UK PLC shareholders approving the Virgin Money UK PLC dividend at the 2022 Annual General Meeting. These financial statements do not reflect the recommended dividend.

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.

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 (2020: £3m). AT1 distributions of £59m were paid in the year (2020: £59m paid).

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	
	2021	2020	**2021**	2020
	£m	£m	**£m**	£m
At 1 October	**(80)**	(25)	**(63)**	10
Amounts recognised in other comprehensive income:				
Cash flow hedge – interest rate risk				
Effective portion of changes in fair value of interest rate swaps	**127**	(74)	**127**	(90)
Amounts transferred to the income statement	**(5)**	-	**(14)**	(8)
Taxation	**(33)**	19	**(31)**	25
Cash flow hedge – foreign exchange risk				
Effective portion of changes in fair value of cross currency swaps	**(28)**	(59)	**-**	-
Amounts transferred to the income statement	**29**	59	**-**	-
At 30 September	**10**	(80)	**19**	(63)

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.

4.2 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 UK PLC'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 £5m (2020: £10m).

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 2020	Number awarded	Number forfeited	Number released	**Number outstanding at 30 September 2021**	**Average fair value of awards at grant pence**
DEP						
2016 Commencement	5,710	-	-	(3,090)	**2,620**	266.03
2017 Bonus	223,364	-	-	(173,455)	**49,909**	313.20
2018 Bonus	170,649	-	-	-	**170,649**	192.35
2019 Bonus	91,928	-	-	(6,384)	**85,544**	174.50
2019 Commencement	31,638	-	-	(11,795)	**19,843**	174.50
2020 Commencement	-	29,540	-	(9,970)	**19,570**	135.40
LTIP						
2017 LTIP	2,043,402	-	(1,467,372)	(195,106)	**380,924**	313.20
2018 LTIP	5,646,210	-	(890,558)	(3,916)	**4,751,736**	190.47
2019 LTIP	8,937,017	-	(1,256,381)	-	**7,680,636**	174.50
2020 LTIP	-	10,914,593	(535,074)	-	**10,379,519**	135.40
SIP						
2015 Demerger	928,029	-	-	(298,860)	**629,169**	194.67
2017 Free Share	770,037	-	-	(205,919)	**564,118**	313.20
2019 Free Share	1,980,792	-	(101,844)	(194,094)	**1,684,854**	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. Awards were granted under the LTIP and DEP on 9 December 2020, based on the middle market share price on the day immediately preceding the grant (135.4p).

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**	
	2021	2020	**2021**	2020
	£m	£m	**£m**	£m
Financial guarantees				
Guarantees and assets pledged as collateral security:				
Due in less than 3 months	**20**	18	**20**	18
Due between 3 months and 1 year	**21**	15	**21**	15
Due between 1 year and 3 years	**13**	14	**13**	14
Due between 3 years and 5 years	**2**	2	**2**	2
Due after 5 years	**45**	46	**45**	46
	101	95	**101**	95
Other credit commitments				
Undrawn formal standby facilities, credit lines and other commitments to lend at call	**17,020**	16,775	**16,960**	16,714

Capital commitments

The Group has committed to providing additional funding of up to £5.5m over an eight-month period from June 2021 to enable the JV UTM to support the business transformation and to meet its regulatory capital and liquidity requirements, of which £4m was the remaining commitment as at 30 September 2021. This will be paid by 6 January 2022. Further detail on UTM can be found in the JVs and associates section of note 5.3.

The Group had future capital expenditure which had been contracted for, but not provided for, at 30 September 2021 of £0.2m (2020: £0.4m).

Other contingent liabilities

Conduct risk related matters

Although substantially reduced with the close-down of the PPI operation, 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 a number of these matters where a provision can be reliably estimated. Until all matters are closed the final amount required to settle the Group's potential liabilities for conduct related matters remains uncertain.

The Group will continue to reassess the adequacy of provisions for these matters and the assumptions underlying the calculations at each reporting date based upon experience and other relevant factors at that time.

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	
	2021	2020	**2021**	2020
	£m	£m	**£m**	£m
Adjustments included in profit/(loss) before tax				
Interest receivable	**(1,910)**	(2,137)	**(1,897)**	(2,060)
Interest payable	**550**	853	**568**	840
Depreciation, amortisation and impairment (note 2.4)	**191**	159	**191**	152
Derivative financial instruments fair value movements	**9**	20	**21**	12
Impairment (credit)/losses on credit exposures (note 3.2)	**(131)**	507	**(129)**	499
Equity based compensation (note 4.2)	**5**	10	**-**	8
Costs recharged to parent entity	**3**	56	**(80)**	(264)
Impairment of investment in subsidiaries	**-**	-	**38**	19
Gain on disposal of FVOCI assets (note 2.3)	**-**	(16)	**-**	(16)
Other non-cash movements	**62**	4	**57**	2
	(1,221)	(544)	**(1,231)**	(808)
Changes in operating assets				
Net decrease /(increase) in:				
Balances with supervisory central banks	**(38)**	(38)	**(38)**	(48)
Derivative financial instruments	**257**	(123)	**175**	314
Financial assets at FVTPL	**29**	65	**44**	67
Loans and advances to customers	**491**	134	**450**	(116)
Defined benefit pension assets	**(61)**	(35)	**(61)**	(36)
Other assets	**141**	(105)	**140**	(147)
	819	(102)	**710**	34
Changes in operating liabilities				
Net (decrease)/increase in:				
Due to other banks	**(50)**	(1,531)	**(50)**	(1,531)
Derivative financial instruments	**(41)**	(23)	**(89)**	(45)
Financial liabilities at FVTPL	**-**	(4)	**-**	(4)
Customer deposits	**(644)**	3,728	**(644)**	3,388
Provisions for liabilities and charges	**(72)**	(294)	**(72)**	(292)
Other liabilities	**(219)**	2	**(220)**	(19)
	(1,026)	1,878	**(1,075)**	1,497

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).

Cash and balances with central banks (less mandatory deposits)	**9,453**	8,887	**9,453**	8,887
Due from other banks	**800**	927	**146**	174
	10,253	9,814	**9,599**	9,061

5.3 Related party transactions

	Group		Bank	
	2021	2020	**2021**	2020
Amounts due from related entities	**£m**	£m	**£m**	£m
Loans and advances	**-**	2	**999**	1,010
Other receivables	**4**	9	**100**	153
Total amounts due from related entities	**4**	11	**1,099**	1,163
Interest income on the above amounts was as follows:				
Interest income	**-**	-	**11**	17
Total interest income from related entities	**-**	-	**11**	17

Amounts due to related entities	Group		Bank	
	2021	2020	**2021**	2020
	£m	£m	**£m**	£m
Deposits	**19**	-	**449**	586
Other payables	**5**	8	**1,610**	2,855
Subordinated debt(1)	**1,015**	757	**1,015**	757
Medium-term notes(2)	**2,411**	2,057	**2,411**	2,057
Total amounts due to related entities	**3,450**	2,822	**5,485**	6,255
Interest expense on the above amounts was as follows (note 2.2):				
Interest expense to related entities	**122**	106	**155**	169
Total interest expense	**122**	106	**155**	169

(1) 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.

(2) 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.

5.3 Related party transactions (continued)

Other transactions with related entities	**Group**		**Bank**	
	2021	2020	**2021**	2020
	£m	£m	**£m**	£m
Other income				
Non-interest income received	**-**	-	**49**	23
Other expenses				
Other expenses	**17**	15	**17**	15
Equity				
Ordinary dividends paid	**20**	20	**20**	20
AT1 distributions	**59**	59	**59**	59
Total dividends to related entities	**79**	79	**79**	79

In addition to the above, the Group also undertakes activity with the following entities which are considered to be related party transactions:

Yorkshire and Clydesdale Bank Pension Scheme ('the Scheme')
The Group provides banking services to the Scheme, with customer deposits of £40m (2020: £17m). Pension contributions of £61m were made to the Scheme in the year (2020: £35m).

The Group and the Trustee to the Scheme (note 3.10) 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.

Joint ventures and associates
The Group holds investments in JVs of £10m (2020: £3m). The total share of loss for the year was £5m (2020: £7m). In addition, the Group had the following transactions with JV entities during the period:

- Salary Finance Loans Limited ('Salary Finance') - the Group provides Salary Finance with a revolving credit facility funding line, of which the current gross lending balance was £223m (2020: £119m) and the undrawn facility was £37m (2020: £81m). The facility is held under Stage 1 for credit risk purposes. Board approval is in place for this facility up until March 2023 with £400m being the approved limit; and
- UTM - the Group provides banking services to UTM which has resulted in amounts due of £3m (2020: £3m). Additionally, the Group received £7m of recharge income in the year (2020: £7m) from UTM in accordance with a Service Level Agreement in respect of resourcing, infrastructure and marketing.

During the year, the Group provided £12.4m of additional funding to UTM with a further commitment of £4m as at 30 September 2021; this amount will be paid in two instalments with the final payment due 6 January 2022.

Other related party transactions with Virgin Group
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. Amounts payable to VAA totalled £2m (2020: £1m) and expenses of £12m were incurred in the year (2020: £12m).

Charities
The Group provides banking services to the Virgin Money Foundation ('Foundation') which has resulted in customer deposits of £1m (2020: £Nil). The Group has made donations of £1m (2020: £1m) 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 (2020: £0.4m).

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

5.3 Related party transactions (continued)

Compensation of key management personnel (KMP)

KMP comprise Directors of the Bank and members of the Executive Leadership Team.

	2021	2020
	£m	£m
Salaries and short-term benefits	**9**	10
Termination benefits	**-**	1
Equity based compensation(1)	**3**	4
	12	15

(1) The expense recognised in the year is 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 2021 were £3m (2020: £4m).

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 or defined benefit pension schemes during 2021 (2020: none).

None of the Directors hold share options and none were exercised during the year (2020: none).

Disclosures in respect of the highest paid Director

	2021	2020
	£m	£m
Aggregate remuneration(1)	**2**	2

(1) Aggregate remuneration includes amounts paid for the 2021 year and amounts paid under the LTIPs in 2021 relating to the 2017 LTIP award released in 2021. LTIP figures in the single figure table for Executive Directors' 2021 remuneration in the Remuneration report relate to the 2018 LTIP award in respect of the 2019-2021 LTIP performance period cycle.

The highest paid Director does not hold any share options, nor were they a member of any pension plan during 2021, nor 2020.

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

	2021	2020
	£m	£m
Loans and advances	**3**	4
Deposits	**2**	2

No provisions have been recognised in respect of loans provided to KMPs (2020: £Nil). There were no debts written off or forgiven during the year to 30 September 2021 (2020: £Nil). Included in the above are six (2020: eight) loans totalling £0.3m (2020: £1m) made to Directors. In addition to the above, there are guarantees of £Nil (2020: £Nil) made to Directors and their related parties.

5.4 Pillar 3 disclosures

Basel III CRD IV

Pillar 3 disclosure requirements are set out in Part Eight of the CRR. The consolidated disclosures of Virgin Money UK PLC, for the 2021 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/.**

5.5 Post balance sheet events

There have been no significant events between 30 September 2021 and the date of approval of the annual report and consolidated financial statements which would require a change to or additional disclosure in the financial statements.

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	
	2021	2020
	£m	£m
At 30 September	**50**	73

The table below represents the wholly-owned subsidiary undertakings of the Group and Company as at 30 September 2021:

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	Jubilee House, Gosforth, Newcastle upon Tyne, NE3 4PL	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	Intermediate holding company	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
C.B. 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	Jubilee House, Gosforth, Newcastle upon Tyne, NE3 4PL	30 September
Yorkshire Bank PLC	Dormant	Ordinary	100%	England	Jubilee House, Gosforth, Newcastle upon Tyne, NE3 4PL	30 September
Northern Rock Limited	Dormant	Ordinary	100%	England	Jubilee House, Gosforth, Newcastle upon Tyne, NE3 4PL	30 September

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	31 March
Virgin Money Management Services Limited	Service company	Ordinary	100%	England	Jubilee House, Gosforth, Newcastle upon Tyne, NE3 4PL	31 March
Virgin Money Personal Financial Service Limited	Insurance Intermediary	Ordinary	100%	England	Jubilee House, Gosforth, Newcastle upon Tyne, NE3 4PL	30 September
Virgin Money Limited	Non-trading company	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. The Bank acts as guarantor for £1 and is also a 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 £12m as at 30 September 2021 (2020: £1,754m). 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 recoverable amount of Virgin Money Holdings (UK) PLC is £26m as at 30 September 2021.

The following assumptions are used in the VIU calculation:

- Discount rate: 14.1%
- 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.

6.2 Bank investments in controlled entities (continued)

The Bank also has an interest in a number of structured entities:

Other controlled entities as at 30 September 2021	Nature of business	Country of incorporation	Registered office	Financial year end
Clydesdale Covered Bonds No. 2 LLP	Acquisition of mortgage loans	England	Jubilee House, Gosforth, Newcastle upon Tyne, NE3 4PL	30 September
Eagle Place Covered Bonds LLP	Acquisition of mortgage loans	England	Jubilee House, Gosforth, Newcastle upon Tyne, NE3 4PL	30 September
Gosforth Funding 2015-1 PLC (in liquidation)	Issuer of securitised notes	England	1 St. Peters Square, Manchester, M2 3AE	31 December
Gosforth Funding 2016-1 PLC (in liquidation)	Issuer of securitised notes	England	15 Canada Square, London, E14 5GL	30 September
Gosforth Funding 2016-2 PLC (in liquidation)	Issuer of securitised notes	England	1 St. Peters Square, Manchester, M2 3AE	31 December
Gosforth Funding 2017-1 PLC	Issuer of securitised notes	England	Eighth Floor, 100 Bishopsgate, London, EC2V 4AG	30 September
Gosforth Funding 2018-1 PLC	Issuer of securitised notes	England	Eighth Floor, 100 Bishopsgate, London, EC2V 4AG	30 September
Gosforth Holdings 2015-1 Limited (in liquidation)	Holding company	England	1 St. Peters Square, Manchester, M2 3AE	31 December
Gosforth Holdings 2016-1 Limited (in liquidation)	Holding company	England	15 Canada Square, London, E14 5GL	30 September
Gosforth Holdings 2016-2 Limited (in liquidation)	Holding company	England	1 St. Peters Square, Manchester, M2 3AE	31 December
Gosforth Holdings 2017-1 Limited	Holding company	England	Eighth Floor, 100 Bishopsgate, London, EC2V 4AG	30 September
Gosforth Holdings 2018-1 Limited	Holding company	England	Eighth Floor, 100 Bishopsgate, London, EC2V 4AG	30 September
Gosforth Mortgages Trustee 2015-1 Limited (in liquidation)	Trust	England	1 St. Peters Square, Manchester, M2 3AE	31 December
Gosforth Mortgages Trustee 2016-1 Limited (in liquidation)	Trust	England	15 Canada Square, London, E14 5GL	30 September
Gosforth Mortgages Trustee 2016-2 Limited (in liquidation)	Trust	England	1 St. Peters Square, Manchester, M2 3AE	31 December
Gosforth Mortgages Trustee 2017-1 Limited	Trust	England	Eighth Floor, 100 Bishopsgate, London, EC2V 4AG	30 September
Gosforth Mortgages Trustee 2018-1 Limited	Trust	England	Eighth Floor, 100 Bishopsgate, London, EC2V 4AG	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

Notes to the consolidated financial statements (continued)
Section 6: Notes to the Bank financial statements (continued)

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%	Scale Space, 58 Wood Lane, London, W12 7RZ	31 December
Virgin Money Unit Trust Managers Limited[1]	JV	50% (plus one 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 and 100% of the share capital of Virgin Money Trustee Limited, a dormant company registered at Jubilee House, Gosforth, Newcastle upon Tyne, NE3 4PL.

Investments in JVs are recognised in the consolidated financial statements within other assets. Further details on the JV arrangements are provided in note 5.3.

Measuring financial performance - glossary

Financial performance measures

As highlighted in the Strategic report and the Risk report, the Group utilises a range of performance measures to assess the Group's performance. These can be grouped under the following headings: asset quality; and capital optimisation. The performance measures used are a combination of alternative and regulatory performance measures, with the type of performance measure used dependent on the component elements and source of what is being measured.

Alternative performance measures (A)
These are used when the basis of the calculation is derived from a non-GAAP measure – also referred to as APMs. Where a performance measure refers to an 'underlying' metric, the detail on how this measure is arrived at, along with management's reasoning for excluding the item from the Group's current underlying performance rationale, can be found on page 187, directly following this section. These adjustments to the Group's statutory results made by management are designed to provide a more meaningful underlying basis.

Regulatory performance measures (R)
These are used when the basis of the calculation is required and specified by the Group's regulators. Examples of this would be the leverage ratio and the Tier 1 ratio.

Descriptions of the performance measures used, including the basis of calculation where appropriate, are set out below:

Asset quality:

Term	Type	Definition
Impairment charge to average customer loans **(cost of risk)**	A	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).
Total provision to customer loans	A	Total impairment provision on credit exposures as a percentage of total customer loans at a given date.
Indexed loan to value **(LTV)** of the mortgage portfolio	A	LTV of the mortgage portfolio is defined as mortgage portfolio weighted by balance. The portfolio is indexed using the MIAC Acadametrics indices at a given date.

Capital optimisation:

Term		Definition
Common Equity Tier 1 **(CET1)** ratio	R	CET1 capital divided by RWAs at a given date.
Tier 1 ratio	R	Tier 1 capital as a percentage of RWAs.
Total capital ratio	R	Total capital resources divided by RWAs at a given date.
CRD IV Leverage ratio	R	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.
UK leverage ratio	R	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)**	R	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.
Minimum requirement for own funds and eligible liabilities **(MREL)** ratio	R	Total capital resources less ineligible AT1 and Tier 2 instruments at the year end of £5,294m (2020: £4,929m) plus senior unsecured securities issued by Clydesdale Bank PLC with greater than one year to maturity at the year end of £2,408m (2020: £2,002m) divided by RWAs at the period end of £24,194m (2020: £24,384m).
Net stable funding ratio **(NSFR)**	R	The total amount of available stable funding divided by the total amount of required stable funding, expressed as a percentage. The Group monitors the NSFR based on its own interpretations of current guidance available for CRD IV NSFR reporting. Therefore, the reported NSFR may change over time with regulatory developments. Due to possible differences in interpretation of the rules, the Group's ratio may not be directly comparable with those of other financial institutions.

Measuring financial performance - glossary (continued)

Underlying adjustments to the statutory view of performance

In arriving at an underlying basis, management have excluded certain items that are not considered to be reflective of the Group's continuing operations. These items are all significant and are typically one-off in nature. All underlying adjustments were subject to agreement as such by the Board Audit Committee. 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	**2021 £m**	2020 £m	Reason for exclusion from the Group's current underlying performance
Integration and transformation costs	**(146)**	(139)	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 generally restructuring in nature.
Acquisition accounting unwinds	**(88)**	(113)	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 (£79m charge) and other smaller items amounting to £9m. 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	**(76)**	(26)	These costs are historical in nature and are not indicative of the Group's current practices.
Other:			
SME transformation	**(1)**	(11)	These costs related to the transformation of the Group's Business banking proposition and mainly comprised costs associated with the RBS incentivised switching scheme.
UTM transition costs	**(6)**	(8)	These costs relate to UTM's transformation costs principally for the build of a new platform for administration and servicing.
Internally developed software adjustments	**(68)**	-	These costs relate to the write-off of WIP balances held on the balance sheet as a result of a reassessment of the Group's practices on capitalisation against the backdrop of the new digital first strategy and the move to an agile project delivery.
Total other	**(75)**	(19)	

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 (or in a state of delinquency) when they fail to adhere to their contractual payment obligations resulting in an outstanding loan that is unpaid or overdue. When a customer is in arrears, the total outstanding loans on which payments are overdue are said to be delinquent.
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 were losing revenue, and seeing their cash flow disrupted as a result of COVID-19, enabling them to 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.
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.
Code	The 2018 UK Corporate Governance Code
collateral	The assets of a borrower that are used as security against a loan facility.
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/or 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 were losing revenue, and seeing their cash flow 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 were suffering disruption to their cash flow 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 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	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.

Main Glossary (continued)

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 the Group from NAB which took effect on 8 February 2016 pursuant to which all of the issued share capital of CYB Investments Limited was transferred to Virgin Money UK PLC (formerly CYBG PLC) by NAB in consideration for the issue and transfer of Virgin Money UK PLC (formerly CYBG PLC) shares to NAB in part for the benefit of NAB (which NAB subsequently sold pursuant to the Company's IPO) and in part for the benefit of NAB shareholders under a scheme of arrangement under part 5.1 of the Australian Corporations Act.
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.
effective interest rate **(EIR)**	The carrying value of a certain financial instrument 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.
IFRS 9 transitional adjustments-dynamic	That part of the transitional adjustments on regulatory capital arising from the increase in impairment provisions (on non-credit impaired exposures) from the date of initial adoption of IFRS 9 to the reporting date.
IFRS 9 transitional adjustments-static	That part of the transitional adjustments on regulatory capital arising from the increase in impairment provisions on initial adoption of IFRS 9 from those calculated under IAS 39.
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.
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.

Main Glossary (continued)

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 UK 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)**	A minimum requirement for institutions to maintain equity and eligible debt liabilities, to help ensure that if an institution fails the resolution authority can use these financial resources to absorb losses and recapitalise the continuing business.
net interest income **(NII)**	The amount of interest received or receivable on assets, net of interest paid or payable on liabilities.
operational risk	The risk of loss resulting from inadequate or failed internal processes, people strategies and systems or from external events.
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 excluding mortgage lending which is reported separately.
PPI redress	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.
Relationship deposits	Current account and linked savings balances
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 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.

Main Glossary (continued)

specific impairment provision	A specific provision relates to a specific loan, and represents the estimated shortfall between the carrying value of the asset and the estimated future cash flows, including the estimated realisable value of securities after meeting securities realisation costs.
standardised approach	In relation to credit risk, a method for calculating credit risk capital requirements using External Credit Assessment Institutions 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 entity **(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)	A scheme 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 (as defined by CRD IV) 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 Group	Virgin Money UK PLC. 'Virgin Money' is also used throughout this report when referring to the acquired business of Virgin Money Holdings (UK) PLC and its controlled entities or subsequent integration of the acquired business within the enlarged Group.

Abbreviations

AFD	Approaching financial difficulty
AGM	Annual General Meeting
ALCO	Assets and Liability Committee
APM	Alternative Performance Measure
AT1	Additional Tier 1
ATM	Automated teller machine
BBLS	Bounce back loan scheme
BCBS	Basel Committee on Banking Supervision
BCR	Banking Competition Remedies
BoE	Bank of England
bps	Basis points
BTL	Buy-to-let
CBILS	Coronavirus business interruption loan scheme
CCyB	Countercyclical Capital Buffer
CET1	Common Equity Tier 1 Capital
CLBILS	Coronavirus large business interruption loan scheme
CPI	Consumer Price Index
CRD	Capital Requirements Directive
CRR	Capital Requirements Regulation
CSRBB	Credit spread risk in the banking book
DEP	Deferred Equity Plan
DPD	Days past due
DTR	Disclosure Guidance and Transparency Rules
EAD	Exposure at default
EBA	European Banking Authority
ECL	Expected credit loss
EIR	Effective interest rate
ESG	Environmental, Social and Governance
FCA	Financial Conduct Authority
FIRB	Foundation internal ratings based
FPC	Financial Policy Committee
FRC	Financial Reporting Council
FSMA	Financial Services and Markets Act 2000
FVOCI	Fair value through other comprehensive income
FVTPL	Fair value through profit or loss
GAAP	Generally Accepted Accounting Principles
G-SII	Global Systemically Important Institution
GDP	Gross Domestic Product
GDPR	General Data Protection Regulation
HMRC	Her Majesty's Revenue and Customs
HPI	House Price Index
HQLA	High-Quality Liquid Asset
IAS	International Accounting Standard
IASB	International Accounting Standards Board
IBOR	Inter Bank Offered Rate
ICAAP	Internal Capital Adequacy Assessment Process
IFRS	International Financial Reporting Standard
ILAAP	Internal Liquidity Adequacy Assessment Process
IRB	Internal ratings-based
IRRBB	Interest rate risk in the banking book
ISA	International Standards on Auditing
ISDA	International Swaps and Derivatives Association
ISR	Information security and resilience
JV	Joint Venture
KMP	Key management personnel
LCR	Liquidity coverage ratio
LGD	Loss given default
LIBOR	London Interbank Offered Rate
LTIP	Long-term incentive plan
LTV	Loan to value
MGC	Model Governance Committee
MREL	Minimum Requirement for Own Funds and Eligible Liabilities
NII	Net interest income
NSFR	Net stable funding ratio
PPI	Payment protection insurance
PSD2	Payment Services Directive 2
PD	Probability of Default
PIE	Pension Increase Exchange
PMA	Post-model adjustment
POCI	Purchased or originated credit impaired
PRA	Prudential Regulation Authority
RAF	Risk Appetite Framework
RAS	Risk Appetite Statement
RFR	Risk free rate
RLS	Recovery loan scheme
RMBS	Residential mortgage-backed securities
RMF	Risk Management Framework
RPI	Retail Price Index
RWA	Risk-weighted asset
SE	Structured entity
SICR	Significant increase in credit risk
SIP	Share Incentive Plan
SME	Small or medium-sized enterprises
SMF	Sterling Monetary Framework
SONIA	Sterling Overnight Index Average
SRB	Systemic Risk Buffer
SST	Solvency Stress Test
STIP	Short-term incentive plan
TCFD	Taskforce for Climate-related Financial Disclosures
TFSME	Term Funding Scheme with additional incentives for SMEs
UTM	Virgin Money Unit Trust Managers Limited
VAA	Virgin Atlantic Airways Limited
VaR	Value at Risk
VIU	Value-in-use
VMG	Virgin Money Giving Limited
WIP	Work-in-progress
YBHL	Yorkshire Bank Home Loans Limited

Other information

Country by Country Reporting

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.

	2021
	UK
Average FTE employees (number)	**7,415**
Total operating income (£m)	**1,487**
Profit before tax (£m)	**416**
Corporation tax paid (£m)	**27**
Public subsidies received (£m)	**-**
Return on assets (%)	**0.59%**

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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