Annual report and consolidated financial statements

Clydesdale Bank PLC

For the year ended 30 September 2022

Company Number: SC001111

Clydesdale Bank PLC

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Overview

Clydesdale Bank PLC ('the Bank'), together with its subsidiary undertakings (which together comprise 'the Group'), operate under the Clydesdale Bank, Yorkshire Bank 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 2022.

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 195.

Officers and professional advisers

Board Chair	David Bennett
Senior Independent Non-Executive Director	Tim Wade
Independent Non-Executive Directors	Geeta Gopalan Darren Pope Elena Novokreschenova
Non-Executive Director	Sara Weller CBE (appointed 3 October 2022)
Executive Director	David Duffy Clifford Abrahams
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 2022.

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	**2022 £m**	2021 £m
Customer loans	**72,558**	71,990
Other financial assets	**17,544**	15,035
Other non-financial assets	**1,908**	2,191
Total assets	**92,010**	89,216
Customer deposits	**(65,360)**	(66,870)
Wholesale funding	**(17,043)**	(13,609)
Other liabilities	**(3,196)**	(3,155)
Total liabilities	**(85,599)**	(83,634)
Ordinary shareholders' equity	**(5,749)**	(4,910)
Additional Tier 1 (AT1) equity	**(662)**	(672)
Equity	**(6,411)**	(5,582)
Total liabilities and equity	**(92,010)**	(89,216)

Summary income statement – underlying and statutory basis(1) for the year ended 30 September	**2022 £m**	2021 £m
Net interest income	**1,592**	1,415
Non-interest income	**160**	155
Total operating income	**1,752**	1,570
Total operating and administrative expenses	**(914)**	(901)
Operating profit before impairment losses	**838**	669
Impairment (losses)/credit on credit exposures	**(52)**	131
Underlying profit on ordinary activities before tax	**786**	800
Restructuring charges	**(82)**	(146)
Acquisition accounting unwinds	**(35)**	(88)
Legacy conduct	**(8)**	(76)
Other items	**(71)**	(74)
Statutory profit on ordinary activities before tax	**590**	416
Tax (expense)/credit	**(70)**	116
Statutory profit attributable to equity holders	**520**	532

(1) The summary income statement is presented on a statutory and underlying basis. Management exclude certain items from the Group's statutory position to arrive at an underlying performance basis. A reconciliation from the underlying results to the statutory basis is shown on page 5 and rationale for the adjustments is shown on page 188.

Strategic report (continued)

Business review (continued)

We performed strongly in FY22, delivering higher statutory profit before tax, positive financial momentum and increased capital returns despite a challenging and uncertain backdrop. The Group has made significant strategic and financial progress as it drives towards becoming the UK's best digital bank. Since we set our targets a year ago the economic backdrop has changed significantly, with a lower GDP outlook, higher unemployment expectations, and higher cost of living set to impact the economy. Despite the more difficult near-term backdrop, our strategy remains the right one and I'm confident we are well placed to adapt to recent changes, while we continue to support our customers and deliver for all our stakeholders.

Well managed balance sheet

Overall lending balances returned to growth in the year finishing up 1% at £72.6bn. We achieved strong growth in our target segments of Unsecured and BAU Business lending, and returned the mortgage book to growth in the second half of the year. Deposit balances reduced 2% to £65.4bn but with relationship deposits increasing by 13%, to 53% of deposits, we continued to improve the mix of our deposit base, and optimise our cost of funds.

Robust credit quality maintained

The Group recognised an impairment charge of £52m (2021: £131m credit) during the year, driven by a prudent IFRS 9 scenario weighting that incorporates a conservative economic outlook and refreshed post model adjustments (PMAs). There are currently limited signs of credit concerns across our key portfolios and our arrears performance remains low and stable. We continue to monitor our customers closely for signs of financial difficulty and remain on hand to support customers.

Higher statutory profit before tax delivered

The execution of our strategy and improved backdrop has seen statutory profit before tax for the year strengthen to £590m (FY21: £416m), benefiting from increased pre-provision profit, continued benign impairments and lower costs. Underlying income increased 12% supported by higher interest rates over the course of the year, and strategic actions to grow in higher-yielding product lines, while continuing to optimise our funding mix with higher relationship deposits. Underlying operating costs of £914m increased 1% on the prior year, reflecting inflationary pressures and higher investment, offset in part by efficiency savings.

Robust capital, liquidity and funding position

During 2022, the Group maintained a strong capital position with a CET1 ratio (IFRS 9 transitional basis) of 14.9% (2021: 14.9%) and a total capital ratio of 21.9% (2021: 21.9%). The Group therefore retains a significant CET1 management buffer in excess of its Capital Requirements Directive IV (CRD IV) minimum CET1 requirement of 6.3%.

Funding and liquidity

The Group has maintained a strong funding and liquidity position. The Group's liquidity surplus continues to comfortably exceed both regulatory requirements and our more prudent internal risk appetite metrics, ensuring a substantial buffer in the event of any outflows, with a Liquidity Coverage Ratio (LCR) of 138% as at 30 September 2022 (2021:149%). Net stable funding ratio (NSFR) was 136% at 30 September 2022 (2021: 134%).

Outlook

The Group is well positioned to deliver a digital-led future of profitable growth, greater cost-efficiency, improved customer service and sustainable shareholder returns as we target our ambition of becoming the UK's best digital bank. It is encouraging to see our strategy, and an improving rate environment, combining to drive stronger financial performance. Looking forward, we will continue to focus our efforts on improving customer experience and driving digitisation through the Group.

The macroeconomic outlook has become more uncertain over the course of the year. Following a positive recovery in expectations post-COVID, recent events have seen forecasts deteriorate. As we enter a more volatile environment, with higher inflation and rates, we are carefully monitoring for any impacts. We enter this phase with a prudently underwritten loan book, strong coverage, and a defensive asset mix. We are ready and able to continue supporting the customers, colleagues and communities we serve.

Overall, we have the right strategy and are executing on the key components that will underpin our delivery of improved returns and profitable growth over the coming years.

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 Bank'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 103.

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 188:

2022 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	**1,576**	**-**	**16**	**-**	**-**	**1,592**
Non-interest income	**135**	**-**	**16**	**-**	**9**	**160**
Total operating income	**1,711**	**-**	**32**	**-**	**9**	**1,752**
Total operating and administrative expenses before impairment losses	**(1,069)**	**82**	**3**	**8**	**62**	**(914)**
Operating profit before impairment losses	**642**	**82**	**35**	**8**	**71**	**838**
Impairment losses on credit exposures	**(52)**	**-**	**-**	**-**	**-**	**(52)**
Profit on ordinary activities before tax	**590**	**82**	**35**	**8**	**71**	**786**

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

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 Group's principal risk categories are broadly the same as those outlined in the Group's Annual Report & Accounts 2021, with the exception of Climate risk, which has been reclassified from a cross-cutting risk to a principal risk due to its increasing relevance and materiality to the Group's risk profile. Operational resilience is now included within Operational and resilience risk. Technology risk has been renamed Technology and cyber risk, to recognise not only the risks involved with maintaining the Group's technology process and infrastructure, but also the growing risk surrounding cyber security.

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

<table>
<tr><th>Principal risks</th><th>Key mitigating actions</th><th>Future focus</th></tr>
<tr><td>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 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.</td><td>• 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 RWA and capital.</td><td>• 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.</td></tr>
<tr><td>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.</td><td>• 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 BoE SST.
• Board-approved risk appetite measures ensure funding and liquidity levels are monitored and managed in accordance with internal and regulatory requirements and in support of the Group's strategy.
• Market risks (interest rate and foreign exchange risks) are monitored and managed in line with established policies and allocation of capital.
• 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.</td><td>• 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 and current cost of living crisis.
• The economic environment creates uncertainty with interest rates, which presents potential for adverse operational impacts, changes to customer behaviour and competitor 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 towards the end of 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.
• The manner in which climate risk can be incorporate into capital models will be a growing focus area of attention.
• The growth of digital currencies, particularly any developments in Central Bank Digital Currency will be assessed for potential impacts on financial disintermediation.</td></tr>
</table>

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.	• The increased use of Machine Learning creates new risks and opportunities. Our Model Risk Management framework is actively considering the risk associated with these models in our policies, and incorporating them in our model risk practices in a proportionate way. The future use of models to support climate risk will also be a focus. • The Bank of England's (BoE) Consultation Paper (CP)6/22 Model Risk Management Principles for Banks, is an important development in the management of Model Risk in UK Financial Institutions. We will continue to monitor developments and fully recognise the importance of robust practices in the industry. • Model monitoring is an important part of our framework and will support our assessment of any long term effects from COVID-19 and risks from increased cost of living.
Regulatory and compliance risk is the risk of failing to comply with relevant laws and regulation, failing to implement new regulatory requirements, or not keeping the regulators informed of relevant issues or responding effectively to regulatory requests, leading to regulatory sanction.	• 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 and 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 the new Consumer Duty.
Conduct risk is the risk of undertaking business in a way that is contrary to the interests of customers, resulting in customer harm, regulatory censure, redress costs and reputational damage.	• Delivering good outcomes for our customers and consistent with the Group's Purpose, there is 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 monitoring 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 the current macroeconomic environment and vulnerable customer groups more generally, and in response to the FCA final rules and guidance for Consumer Duty.

Strategic report (continued)

Principal risks and mitigating actions (continued)

Principal risks	Key mitigating actions	Future focus
Operational and resilience risk is the risk of loss or customer harm resulting from inadequate or failed internal processes, people and systems or from external events, incorporating the inability to maintain critical services, recover quickly and learn from unexpected/adverse events.	• The Group has an established operational risk framework to identify, manage and mitigate operational risks. • An Operation Resilience framework exists which includes regular testing/enhancements to remain within agreed Important Business Service impact tolerances. • A change management framework is in place to govern the execution and safe delivery of business change. • The Third Party Risk Framework has been enhanced to ensure that supplier relationships and the procurement of service providers are controlled effectively. • Internal and external loss events are categorised using Basel II categories for 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.	• Implementation of a new risk management system, to improve risk data and support enhancements to the Operational Risk Framework, including more process driven control monitoring and testing. • Focus on management of resilience risks arising from the increasing change portfolio. Building on delivery of compliance with resilience regulations this year, which included mapping of Important Business Services and stress testing exercises. • Continued focus of supplier management to safeguard the provision, enablement and delivery of critical processes through third parties. • Enhancements to the change management framework in respect of the introduction of Agile methodology.
Technology and cyber risk is the risk of loss resulting from inadequate or failed information technology processes through strategy, design, build or run components internally or externally provisioned. It includes IT Resilience as well as Cyber and Information Security.	• 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.	• The move to an Azure cloud platform to host technology, supports the delivery of our strategy to simplify our IT estate. A programme of work is underway to move services to Azure, reduce the number of data centres and review core banking systems. To support this, the Bank has built and is implementing a Cloud Control Framework. • 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 products and services will be used to facilitate financial crime, resulting in harm to customers, the Group, or third parties. This includes money laundering, counter terrorist financing, sanctions, fraud and bribery and corruption.	• Safeguarding our customers and consistent with the Group's Purpose, there is an established financial crime and fraud risk framework, with clearly defined policy statements, standards and risk appetite measures reported 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. • The Group continues to invest in its financial crime and fraud capabilities and has become an approved signatory to the Contingent Reimbursement Model (CRM) Code and successfully implemented Confirmation of Payee, both supporting better outcomes for our customers.	• 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 and fraud prevention systems.
Strategic and enterprise risk is the risk of significant loss of earnings or damage 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. • The Group routinely reviews its change portfolio to ensure that investment is directed towards regulatory compliance, resilience of processes and systems, and meeting our growth plans and Digital-First strategy. • 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.
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.	• A new framework has been introduced – A Life More Virgin – which sets out policies to enhance our colleague proposition focused on well-being and colleague retention. • 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, Behaviours and a Code of Conduct, 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.	• We will continue to closely monitor the potential impacts of the Cost-of-Living crisis on colleague wellbeing. • 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. • Continued focus on creating a unique colleague proposition through A Life More Virgin, positioning us as an employer of choice and driving colleague engagement and retention. • 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)

Principal risks	Key mitigating actions	Future focus
Climate risk is the risk of exposure to physical and transition risks arising from climate change.	• A climate risk policy framework has been established to identify and manage exposure from climate risk with roles and responsibilities clearly defined across the Group. • Risk appetite measures are in place to monitor physical and transitional climate related risks. • The Group undertakes scenario analysis to assess possible future climate related risks and exposures that may impact the Group. • The Group continues to develop and embed its sustainability agenda in managing environmental and climate related risks.	• The Group will continue to develop capability to identify, manage and monitor climate risk. • Investment to further develop data capability to inform strategy and support customers transition to a low carbon economy. • Maintain focus on the Group's net zero ambitions.

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 or result in customer harm. The Group's emerging risks are continually reassessed and reviewed through a horizon scanning process, with escalation and reporting to the Board. The horizon scanning process fully considers all relevant internal and external factors and is designed to capture those risks which are current but have not yet fully crystallised, as well as those which are expected to crystallise in future periods.

Emerging risks are assigned an inherent and residual risk, based on expected impact and time to fully crystallise (from >12 months to 3+ years), in line with the definitions outlined in the RMF, and are subject to regular review across senior governance for a. Amendments have been made to the emerging risk classifications reported in the Group's 2021 Annual Report and Accounts, to reflect the evolving risk landscape.

External emerging risks	
Economic risk	Inflationary pressures in the UK are contributing towards a cost of living crisis which, combined with low economic growth, presents risks to the Group's strategic plan and ability to grow. In aggregate, these risks could impact customer resilience and consequently debt affordability. The Group maintains robust capital and liquidity levels, with stress testing against a range of severe but plausible market scenarios performed to understand and mitigate risks to financial resilience. Credit policies and risk appetite have been tightened to reflect the weak economic outlook and to de-risk new business. Portfolios are monitored closely to identify customers and sectors experiencing financial difficulty, with procedures in place to provide support and to ensure credit risk is managed appropriately.
Potential for Scottish Independence	UK political risks, in particular those linked to the potential for a Scottish Independence referendum, could have wide ranging financial, operational and regulatory impacts for the Group. Domestic political risks are closely monitored, with detailed planning and risk assessments carried out to ensure preparedness for a range of outcomes.
Geopolitical tensions	Geopolitical tensions, including the war in Ukraine, are creating volatility within domestic and global markets, leading to wide ranging impacts affecting global trade, consumer confidence and financial crime. Detailed portfolio reviews and controls are in place to monitor and mitigate second order impacts from market volatility, to manage exposures and to ensure compliance with sanctions requirements.
Regulatory change	The Group remains subject to high levels of oversight and an evolving programme of change from a number of different regulatory bodies, affecting a number of different areas, such as operational resilience, capital models, climate and consumer duty. The Group continues to monitor emerging regulatory initiatives and works with regulators to ensure it meets all obligations. Identified implications of upcoming regulatory activity are incorporated into the strategic planning cycle.

Strategic report (continued)

Emerging risks (continued)

External emerging risks	
ESG risk	Uncertainties around the exact nature and impact of climate change on the Group's strategy, performance and operating model continue to evolve alongside government policy, developments in climate science and technology advances. There are risks associated to the changing regulatory, societal and political scrutiny on how companies report the impact of their activities on the environment and on the social challenges to which company business models must respond. The Group continues to enhance its approach to ESG, adapting its operations and strategy considering risks and opportunities, in line with its Purpose-led strategy.
Third-party risk	The Group's accelerated digitisation strategy could lead to complex and significant dependencies on third party services required to maintain day-to-day operations without interruption, which could create vulnerabilities if not managed and affect the Group's ability to support our customers and meet regulatory expectations. Impact assessments for important business services are carried out to evaluate operational resilience and to identify and mitigate third-party dependency risks.
Internal emerging risks	
Technological change	The rapid pace of technological change, coupled with changing customer requirements, creates increasing demands on systems resilience and our people. This could be heightened by the Group's accelerated digital strategy as new service propositions and products are launched. The Group continues to invest in its technology infrastructure to ensure risks are managed, in support of its accelerated Digital First strategy.
Change risk	The Group manages a slate of complex change programmes which are required to support delivery of strategic priorities and regulatory obligations and can be subject to heightened execution risk given time and resource constraints. Failure to deliver key change projects could have wide-ranging impacts. Delivery of change sustainably, efficiently and in an agile way is a priority for the Group.
Data stewardship	The Group's accelerated digitisation strategy, combined with changing regulatory requirements and technological advancements such as Cloud solutions, places increasing importance on the effective and ethical use of data. Data is integral to the Group's operations and delivery of strategy and significant risks could arise if data is misused, incomplete, absent or not protected. The Group has a comprehensive framework of controls in place to manage and mitigate data risks, with continued investment into data management capabilities.
Changing skills and talent attraction	Skill shortages continue to affect the Group's ability to attract, develop and retain talent in certain sectors, with the backdrop of a highly competitive labour market and internal cost pressures adding to challenges. The Group's success is dependent on attracting and retaining skilled and highly performing personnel. Detailed resource planning and close monitoring of staff wellbeing and attrition levels is in place and we have introduced our 'A Life More Virgin Model' to help support colleagues and to strengthen our proposition in the market.

Risk report

Risk exists in everything we do, from day-to-day operational activities to strategic change initiatives; without risk we will never achieve our strategic goals but when taking risks, we must ensure we do so in an appropriate way.

Risk culture

Risk culture is focused on the Group's understanding of the risks it takes, which is key to enabling its strategy to be the UK's best digital bank.

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 retains focus on the assessment of risk culture, with Internal Audit providing an independent view to the Board Audit Committee through a risk and control related management awareness assessment, assigned to the majority of audits. The outcomes of these assessments are being used in the development of a risk culture framework, to support our existing RMF and processes.

Risk strategy

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

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

Risk report (continued)

Risk appetite

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

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

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

The Group's RAS is prepared by the Chief Risk Officer in close cooperation with the Chair of the BRC, 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 policies

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 management 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 Risk System, to drive a more efficient, simple and data driven process.

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 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 and well positioned to respond to an evolving landscape. The following Executive Committees have been established under the authority of the CEO:

Risk report (continued)

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:	
Operational Risk Committee	The Operational Risk Committee is responsible for overseeing the management of risks relating to operational risk, operational resilience, business continuity, third parties, IT, information security, payments and people, and emerging risks. The Committee also supports key operational risk management processes, including risk acceptance, risk and control self-assessment (RCSA), and the control effectiveness statement (CES).
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 use of models across the Group, specifically considering the fitness for purpose, usability and scalability of models.
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.
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.
Asset and Liability Committee	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 Environment Committee 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.

1st Line of Defence
Business Units - Take ownership, responsibility and accountability for directly identifying, assessing and mitigating risks and issues.

2nd Line of Defence
Risk Management - Designs and owns the Risk Management Strategy, RAS and the Risk and Policy Management Frameworks, monitoring and facilitating the implementation of risk management practices across the Group.

3rd Line of Defence
Internal Audit - Provides independent assurance over the risk management, governance and internal control processes.

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.

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 6 to 11 of the Strategic report.

Risk report (continued)
Credit risk

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A disciplined approach to credit risk management supports the Group's operations and has 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.

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. The emergence of the significant inflationary headwinds and cost of living pressures have the potential to affect customer resilience and debt affordability. The Group has taken a number of steps to support customers through this period of heightened affordability pressure, and ensure that its credit risk framework and associated policies remain effective and appropriate.

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 approach 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, timely changes to application scorecards and credit strategies, regular asset quality reviews and the independent oversight of credit decisions and portfolios.

The Group maintained a controlled approach to portfolio management and appetite for new lending origination as it continued to recognise some of the delayed impacts of COVID 19, with updates to underwriting criteria to reflect the uncertain economic environment and emerging inflationary headwinds. The FY23 RAS continues to consider the impact of those inflationary headwinds and cost of living pressures, and is focussed on supporting customers through this challenging period. Climate risk is an increasingly important component of the broader RMF and we have recognised this risk 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.

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 IRB capital calculation for the Mortgage and Business portfolios, and account management activity for all portfolios. Further information on the measurement and calculation of ECL and the Group's approach to the impairment of financial assets can be found on page 20.

Political and economic risk is an emerging risk for the Group and includes the future impact on 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 42 to 45.

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, asset quality, analysis of the performance of the various credit portfolios, and oversight of credit portfolios across the Group. Portfolio monitoring techniques include product, industry, geographic concentrations and delinquency trends, as well as considering layered risks where customers may have more than one higher risk characteristic.

There is regular analysis of borrower ability to meet interest and capital repayment obligations, with early support and mitigating steps taken where required. The Group has taken additional steps to update affordability assessments in response to the inflationary and cost of living pressures facing customers. 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 Unsecured customers. The approval process uses credit scorecards, credit strategies and affordability assessments, and involves a review of an applicant's previous credit history using information held by credit reference agencies. Manual underwriting assessments are also used as and when required. The Group also utilises quantitative thresholds, for example debt to income ratios, as well as 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 within Board approved risk appetite limits. Included within these is the maximum percentage LTV limit that is offered subject to loan size and customer income. Product availability may be altered depending on market conditions and outlook. Product types such as 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 that provide dedicated support for vulnerable customers experiencing financial or other types of difficulties. These specialists act within agreed delegated authority levels set in accordance with experience and capabilities.

Credit strategy and policy
Credit risks associated with lending are managed through the application of detailed lending policies and standards that 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 that 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 credit teams provide oversight of 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 that are used to manage portfolios, are regularly monitored, with portfolio monitoring reports provided 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 and monitored 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:

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

Master netting agreements
The Group further restricts its exposure to credit losses by entering into master netting arrangements with counterparties 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:

Residential mortgages
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. This valuation is applied using either a physical valuation, or another method that is not reliant on a physical inspection, but utilises data and modelled information, such as desktop, automated valuation model or indexed valuations (subject to policy rules and confidence levels).

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.

Commercial property
Commercial property is a source of collateral on business lending, and means of mitigating loss in the event of default (within the Stage 3 Business balance of £376m, £106m is collateralised on property), (2021: Stage 3 Business balance of £235m, with £117m collateralised on property). For 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.

Non-property related collateral
In addition to residential and commercial property based security, the Group also takes other forms of collateral when lending. This collateral 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.

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. It also determines and approves strategies to adjust the portfolio for changes in market conditions.
- *RAS measures:* Measures are reported monthly to ensure adherence to appetite. A formal annual review is carried out to ensure that the measures accurately reflect the Group's risk appetite, strategy and concerns relative to the wider macro environment. All measures are subject to extensive engagement with the Executive Leadership Team and the Board, and are subject to endorsement from executive governance committees prior to Board approval. Regulatory engagement is also scheduled as appropriate.
- *Risk concentration*: Concentration of risk is managed by counterparty, 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, as well as considering layered risks where customers may have more than one higher risk characteristic.
- *Single large exposure excesses*: Excesses on exposures under the delegated commitment authority of the Transactional Credit Committee are reported to the committee when above defined limits. All excess reports include a proposed route to remediation. Exposures are also managed in accordance with the large exposure reporting requirements of the CRR.
- *Portfolio Monitoring*: Continuous monitoring of the portfolio composition and performance is undertaken through weekly and monthly reviews.

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 EBA for financial reporting. Forbearance concessions include the granting of more favourable terms and conditions than those provided at drawdown of the facility, or conditions that 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 any assessment adequately captures and reflects the most recent customer behaviours and market conditions.

Measuring credit risk within asset portfolios
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. The Group adopts two approaches in the measurement of credit risk under IFRS 9:

Individually assessed
A charge is taken to the income statement when an individually assessed provision (IA) 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 approach is supplemented by management judgement in the form of post model adjustments (PMAs) where necessary.

ECL Methodology
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.

Exposures and ECLs are allocated to the following stages:

Stage	ECL assessment period	Description
1	12 month	An exposure that is not credit-impaired on initial recognition and has not experienced a significant increase in credit risk (SICR) since initial recognition.
2	Lifetime	An exposure that has experienced a SICR since initial recognition, but is not yet deemed to be credit impaired.
3	Lifetime	An exposure that is credit impaired.

In addition, purchased or originated credit-impaired (POCI) financial assets are those that 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 DPD backstop for classification as Stage 2, and 90 DPD for Stage 3. 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 approach 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.

During the year, refinements were made to the SICR criteria within the Group's Business portfolio to more closely reflect the level of credit risk. On adoption of IFRS 9 from 1 October 2018, the Group had selected eCRS based SICR triggers as one of the tools for monitoring the credit risk on Business customers. The effectiveness of all triggers were reviewed during the year, including overlaps with other causes of stage migration, and the Group concluded that its hard triggers based on internal credit risk rating were ineffective when used in conjunction with the PD deterioration threshold. In addition, the threshold definition has been simplified and is now set at a 50% increase in the annualised PD since origination, subject to a 100bps floor in the movement. The overall impact of this refinement has resulted in more of the Business portfolio remaining in Stage 1 in the current year. As this change represents a revision to model parameters rather than a change of policy, comparatives have not been restated.

The Credit Risk Committee provides 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 oversight to the ECL 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..

Accounting and regulatory credit loss frameworks

The approach to calculating credit losses differs between the accounting and regulatory frameworks applicable to the Group, 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. 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 losses assessed on a forward-looking view, with a lifetime loss calculated where appropriate. Credit losses are supplemented by management judgements in the form of PMAs, where required, under the accounting framework.

Both the accounting and regulatory definitions of default are materially aligned, with default being triggered at 90 DPD, with the exception of the heritage Virgin Money mortgage models, that apply a 180 DPD 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 the hybrid model adoption, which is anticipated in 2023.

Cure periods

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.

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 that follow are focused principally on customer lending.

The Group is also exposed to credit risk on its other banking and treasury-related activities, and holds £12.2bn (2021: £9.7bn) of cash and balances with central banks and £0.7bn (2021: £0.8bn) due from other banks at amortised cost, with a further £5.1bn (2021: £4.4bn) of financial assets at fair value through other comprehensive income (FVOCI). Additionally £11.0bn of cash is held with the BoE (2021: £8.3bn), and balances with other banks and financial assets at FVOCI are primarily held with senior investment grade counterparties. All other banking and treasury related financial assets are classed as Stage 1 with no material ECL provision held.

Maximum exposure to credit risk on financial assets and credit-related commitments (audited)
The following tables show the levels of concentration of the Group's financial assets and credit-related commitments:

	2022			2021		
	Gross loans and advances to customers £m	**Credit-related commitments £m**	**Total £m**	Gross loans and advances to customers £m	Credit-related commitments £m	Total £m
Mortgages	**58,464**	**4,200**	**62,664**	58,441	2,845	61,286
Unsecured	**6,513**	**11,057**	**17,570**	5,770	10,507	16,277
Business	**8,167**	**4,102**	**12,269**	8,338	3,769	12,107
Total	**73,144**	**19,359**	**92,503**	72,549	17,121	89,670
Impairment provisions on credit exposures[1]	**(454)**	**(3)**	**(457)**	(496)	(8)	(504)
Fair value hedge adjustment	**(941)**	**-**	**(941)**	(179)	-	(179)
Maximum credit risk exposure on lending assets	**71,749**	**19,356**	**91,105**	71,874	17,113	88,987
Cash and balances with central banks			**12,221**			9,711
Financial instruments at FVOCI			**5,064**			4,352
Due from other banks			**656**			800
Other financial assets at fair value			**72**			149
Due from related entities			**4**			4
Derivative financial assets			**342**			140
Maximum credit risk exposure on all financial assets[2]			**109,464**			104,143

(1) The total ECL provision covers both on and off-balance sheet exposures, which are reflected in notes 3.2 and 3.13 respectively. 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

In addition to the balance sheet position on the previous page, key metrics of relevance are as follows:

Group credit highlights (audited)	2022 £m	2021 £m
Impairment charge/(credit) on credit exposures		
Mortgage lending	**(30)**	(44)
Unsecured lending	**178**	(32)
Business lending	**(96)**	(55)
Total Group impairment charge/(credit)	**52**	(131)
Underlying impairment charge/(credit)[(1)] to average customer loans (cost of risk)	**0.07%**	(0.18%)

Key asset quality ratios		
% Loans in Stage 2	**7.76%**	14.09%
Loans in Stage 3	**1.41%**	1.32%
Total book coverage[(2)]	**0.62%**	0.70%
Stage 2 coverage[(2)]	**4.72%**	3.02%
Stage 3 coverage[(2)]	**11.24%**	9.59%

(1) Inclusive of gains/losses on assets held at fair value and elements of fraud loss.

(2) Excludes the guaranteed element of government-backed loan schemes.

The Group has continued to maintain a stable lending book, with gross lending to customers of £73.1bn at 30 September 2022 (2021: £72.6bn). While the Mortgage book remained relatively stable, a small 1.2% reduction in Business lending was more than offset by 12.9% growth in the Unsecured lending book, mainly driven by credit card growth of £0.9bn in FY22 despite having tightened underwriting criteria in the second half of the year in response to rising living costs.

Asset quality was robust in the period and most of the key asset quality ratios remained broadly stable. However, other significant economic and geopolitical factors have the potential to impact the short to medium term performance of the portfolio, with the most significant of these anticipated to be cost of living pressures. The Group continues to support customers through this challenging period, with a controlled risk appetite and focus on responsible lending decisions.

The selection of appropriate PMAs is a major component in determining the Group's ECL, with the following considered to be key factors for the Group's portfolio at that date :

- All PMAs relating to the COVID-19 pandemic, including the move of balances to Stage 2 for customers taking a payment holiday, have been fully released from Stages 1 and 2 as the risk of potential default within the portfolio is no longer considered to be directly attributable to specifically pandemic effects.
- Application of a £27m adjustment for the cost of living crisis and the impact it may have on customers' ability to absorb higher day-to-day costs within available finances. This adjustment impacts both the Mortgage (£6m) and Unsecured (£21m) portfolios and is held in Stage 1.
- Recognising that the Business portfolio continues to face an uncertain economic environment, with an economic resilience PMA of £30m being recognised and is primarily held in Stage 2.

As such, the Group has recorded a total impairment provision of £457m at 30 September 2022, reflecting a 9% reduction from £504m at 30 September 2021, and a corresponding reduction in coverage from 70bps to 62bps. Within this, the modelled and IA provision has increased to £372m (2021: £297m) driven by the updated macroeconomic inputs and growth in Unsecured lending. PMAs have reduced in the period to £85m (2021: £207m).

The net reduction in provision has been offset by the individually assessed impairment charge of £106m in the year (2021: £79m), resulting in a net charge to the income statement of £52m (2021: net credit of £131m), and an associated cost of risk of 7bps (2021: (18)bps).

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

2022	Mortgages		Unsecured: Cards		Unsecured: Loans and Overdrafts		Unsecured: Combined		Business[2]		Total[4]	
	£m	%	£m	%	£m	%	£m	%	£m	%	£m	%
Stage 1	54,791	93.7%	4,712	84.8%	612	64.1%	5,324	81.8%	6,270	76.7%	66,385	90.8%
Stage 2 – total	3,090	5.3%	774	13.9%	335	35.1%	1,109	17.0%	1,524	18.7%	5,723	7.8%
Stage 2: 0 DPD	2,763	4.7%	723	13.0%	327	34.3%	1,050	16.1%	1,497	18.4%	5,310	7.2%
Stage 2: < 30 DPD	158	0.3%	27	0.5%	3	0.3%	30	0.5%	9	0.1%	197	0.3%
Stage 2: > 30 DPD	169	0.3%	24	0.4%	5	0.5%	29	0.4%	18	0.2%	216	0.3%
Stage 3[3]	583	1.0%	72	1.3%	8	0.8%	80	1.2%	373	4.6%	1,036	1.4%
	58,464	**100.0%**	5,558	**100.0%**	955	**100.0%**	6,513	**100.0%**	8,167	**100.0%**	73,144	**100.0%**
ECLs												
Stage 1	10	17.9%	57	23.2%	6	15.8%	63	22.2%	12	10.3%	85	18.6%
Stage 2 – total	32	57.1%	156	63.4%	25	65.8%	181	63.7%	55	47.0%	268	58.6%
Stage 2: 0 DPD	28	49.9%	129	52.4%	22	57.9%	151	53.1%	55	47.0%	234	51.2%
Stage 2: < 30 DPD	2	3.6%	14	5.7%	1	2.6%	15	5.3%	-	0.0%	17	3.7%
Stage 2: > 30 DPD	2	3.6%	13	5.3%	2	5.3%	15	5.3%	-	0.0%	17	3.7%
Stage 3[3]	14	25.0%	33	13.4%	7	18.4%	40	14.1%	50	42.7%	104	22.8%
	56	**100.0%**	246	**100.0%**	38	**100.0%**	284	**100.0%**	117	**100.0%**	457	**100.0%**
Coverage												
Stage 1		0.02%		1.29%		1.06%		1.26%		0.22%		0.13%
Stage 2 – total		1.02%		21.94%		7.29%		17.22%		3.75%		4.72%
Stage 2: 0 DPD		1.02%		19.41%		6.41%		15.09%		3.76%		4.43%
Stage 2: < 30 DPD		0.81%		57.37%		33.67%		54.48%		3.57%		8.53%
Stage 2: > 30 DPD		1.25%		59.03%		52.92%		58.01%		1.47%		8.57%
Stage 3[3]		2.28%		50.96%		73.14%		53.51%		19.96%		11.24%
		0.09%		**4.81%**		**3.88%**		**4.66%**		**1.59%**		**0.62%**

2021	Mortgages		Unsecured: Cards		Unsecured: Loans and Overdrafts		Unsecured: Combined		Business[2]		Total[4]	
	£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%

(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 £56m for Mortgages and £1m for Unsecured (2021: £67m and £2m respectively); and ECL of (£1m) for Mortgages and (£2m) for Unsecured (2021: £Nil and (£2m) respectively).

(4) The COVID related PMAs held in 2021 were allocated across Stages 1 and 2 and have now been fully released. The cost of living PMAs are held in Stage 1 and the economic resilience PMA is primarily held in Stage 2.

Stage 2 balances (audited)

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:

	Mortgages		Personal						Business		Total[3]	
			Cards		Loans and Overdrafts		Combined					
2022	**£m**	**%**	**£m**	**%**	**£m**	**%**	**£m**	**%**	**£m**	**%**	**£m**	**%**
PD deterioration	**2,084**	**69%**	**401**	**52%**	**329**	**99%**	**730**	**66%**	**824**	**55%**	**3,638**	**64%**
Forbearance	**106**	**3%**	**9**	**1%**	**1**	**0%**	**10**	**1%**	**235**	**15%**	**351**	**6%**
AFD or Watch List[1]	**6**	**0%**	**-**	**0%**	**-**	**0%**	**-**	**0%**	**447**	**29%**	**453**	**8%**
> 30 DPD	**169**	**5%**	**24**	**3%**	**5**	**1%**	**29**	**3%**	**18**	**1%**	**216**	**4%**
Other[2]	**725**	**23%**	**340**	**44%**	**-**	**0%**	**340**	**30%**	**-**	**0%**	**1,065**	**18%**
	3,090	**100%**	**774**	**100%**	**335**	**100%**	**1,109**	**100%**	**1,524**	**100%**	**5,723**	**100%**
ECLs												
PD deterioration	**18**	**55%**	**73**	**47%**	**23**	**92%**	**96**	**53%**	**26**	**47%**	**140**	**53%**
Forbearance	**5**	**16%**	**3**	**2%**	**-**	**0%**	**3**	**2%**	**12**	**22%**	**20**	**7%**
AFD or Watch List[1]	**-**	**0%**	**-**	**0%**	**-**	**0%**	**-**	**0%**	**17**	**31%**	**17**	**6%**
> 30 DPD	**2**	**6%**	**13**	**8%**	**2**	**8%**	**15**	**8%**	**-**	**0%**	**17**	**6%**
Other[2]	**7**	**23%**	**67**	**43%**	**-**	**0%**	**67**	**37%**	**-**	**0%**	**74**	**28%**
	32	**100%**	**156**	**100%**	**25**	**100%**	**181**	**100%**	**55**	**100%**	**268**	**100%**

	Mortgages		Personal						Business		Total[3]	
			Cards		Loans and Overdrafts		Combined					
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%

(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 judgments and previous arrears, as well as a number of smaller value drivers.
(3) The COVID related PMAs held in 2021 allocated to Stage 2 have now been fully released. The economic resilience PMA is primarily held in Stage 2.

Risk report (continued)
Credit risk (continued)

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

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

		Stage 1		Stage 2		Stage 3[1]		Total[2]	
2022		**Lending £m**	**ECL £m**	**Lending £m**	**ECL £m**	**Lending £m**	**ECL £m**	**Lending £m**	**ECL £m**
Mortgages	**PD range**								
Strong	0 – 0.74	**52,184**	**6**	**1,864**	**10**	**-**	**-**	**54,048**	**16**
Good	0.75 – 2.49	**2,302**	**2**	**641**	**5**	**-**	**-**	**2,943**	**7**
Satisfactory	2.50 – 99.99	**305**	**2**	**585**	**17**	**-**	**-**	**890**	**19**
Default	100	**-**	**-**	**-**	**-**	**583**	**14**	**583**	**14**
Total		**54,791**	**10**	**3,090**	**32**	**583**	**14**	**58,464**	**56**
Unsecured									
Strong	0 – 2.49	**4,795**	**42**	**413**	**26**	**-**	**-**	**5,208**	**68**
Good	2.50 – 9.99	**524**	**20**	**459**	**72**	**-**	**-**	**983**	**92**
Satisfactory	10.00 – 99.99	**5**	**1**	**237**	**83**	**-**	**-**	**242**	**84**
Default	100	**-**	**-**	**-**	**-**	**80**	**40**	**80**	**40**
Total		**5,324**	**63**	**1,109**	**181**	**80**	**40**	**6,513**	**284**
Business									
Strong	0 – 0.74	**4,808**	**5**	**1,245**	**40**	**-**	**-**	**6,053**	**45**
Good	0.75 – 9.99	**1,455**	**7**	**223**	**8**	**-**	**-**	**1,678**	**15**
Satisfactory	10.00 – 99.99	**7**	**-**	**56**	**7**	**-**	**-**	**63**	**7**
Default	100	**-**	**-**	**-**	**-**	**373**	**50**	**373**	**50**
Total		**6,270**	**12**	**1,524**	**55**	**373**	**50**	**8,167**	**117**

		Stage 1		Stage 2		Stage 3[1]		Total[2]	
2021		Lending £m	ECL £m	Lending £m	ECL £m	Lending £m	ECL £m	Lending £m	ECL £m
Mortgages	PD range								
Strong	0 – 0.74	46,984	3	4,555	19	-	-	51,539	22
Good	0.75 – 2.49	3,313	1	1,888	21	-	-	5,201	22
Satisfactory	2.50 – 99.99	299	-	749	24	-	-	1,048	24
Default	100	-	-	-	-	653	19	653	19
Total		50,596	4	7,192	64	653	19	58,441	87
Unsecured									
Strong	0 – 2.49	4,730	28	85	9	-	-	4,815	37
Good	2.50 – 9.99	411	12	325	54	-	-	736	66
Satisfactory	10.00 – 99.99	7	1	143	55	-	-	150	56
Default	100	-	-	-	-	69	35	69	35
Total		5,148	41	553	118	69	35	5,770	194
Business									
Strong	0 – 0.74	3,298	13	505	53	-	-	3,803	66
Good	0.75 – 9.99	2,374	53	1,821	40	-	-	4,195	93
Satisfactory	10.00 – 99.99	-	-	105	27	-	-	105	27
Default	100	-	-	-	-	235	37	235	37
Total		5,672	66	2,431	120	235	37	8,338	223

(1) Stage 3 includes POCI for gross loans and advances of £56m for Mortgages and £1m for Unsecured (2021: £67m and £2m respectively); and ECL of (£1m) for Mortgages and (£2m) for Unsecured (2021: £Nil and (£2m) respectively).
(2) The COVID related PMAs held in 2021 were allocated across Stages 1 and 2 and have now been fully released. The cost of living PMAs are held in Stage 1 and the economic resilience PMA is primarily held in Stage 2.

In terms of credit quality, 97% (2021: 97%) of the loan commitments and financial guarantee contracts were classed as either 'Good' or 'Strong' under the Group's internal PD rating scale.

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)**		**Total**	
	Gross loans	**ECL**	**Gross loans**	**ECL**	**Gross loans**	**ECL**	**gross loans**	**Total provisions(4)**
2022	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Opening balance at 1 October 2021	**61,416**	**111**	**10,176**	**302**	**957**	**91**	**72,549**	**504**
Transfers from Stage 1 to Stage 2	**(8,287)**	**(45)**	**8,227**	**294**	**-**	**-**	**(60)**	**249**
Transfers from Stage 2 to Stage 1	**10,218**	**27**	**(10,282)**	**(145)**	**-**	**-**	**(64)**	**(118)**
Transfers to Stage 3	**(91)**	**-**	**(562)**	**(84)**	**650**	**101**	**(3)**	**17**
Transfers from Stage 3	**42**	**-**	**137**	**8**	**(187)**	**(12)**	**(8)**	**(4)**
Changes to model methodology	**443**	**1**	**(442)**	**(8)**	**-**	**-**	**1**	**(7)**
New assets originated or purchased(2)	**22,162**	**187**	**2,055**	**159**	**187**	**32**	**24,404**	**378**
Repayments and other movements(3)	**(3,434)**	**(42)**	**(155)**	**(65)**	**56**	**(15)**	**(3,533)**	**(122)**
Repaid or derecognised(3)	**(16,084)**	**(154)**	**(3,431)**	**(193)**	**(498)**	**(101)**	**(20,013)**	**(448)**
Write-offs	**-**	**-**	**-**	**-**	**(129)**	**(129)**	**(129)**	**(129)**
Recoveries	**-**	**-**	**-**	**-**	**-**	**30**	**-**	**30**
Individually assessed impairment charge	**-**	**-**	**-**	**-**	**-**	**107**	**-**	**107**
Closing balance at 30 September 2022	**66,385**	**85**	**5,723**	**268**	**1,036**	**104**	**73,144**	**457**

	Stage 1		Stage 2		Stage 3(1)		Total	
	Gross loans	ECL	Gross loans	ECL	Gross loans	ECL	gross loans	Total provisions(4)
2021	£m	£m	£m	£m	£m	£m	£m	£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)
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

(1) Stage 3 includes POCI for gross loans and advances of £56m for Mortgages and £1m for Unsecured (2021: £67m and £2m respectively), and ECL of (£1m) for Mortgages and (£2m) for Unsecured (2021: £Nil and (£2m) respectively). Nil for Business in both periods.

(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.

(4) The COVID related PMAs held in 2021 were allocated across Stages 1 and 2 and have now been fully released. The cost of living PMAs are held in Stage 1 and the economic resilience PMA is primarily held in Stage 2.

In addition to the above on-balance sheet position, the Group also has £19,359m of loan commitments and financial guarantee contracts (2021: £17,121m) of which £18,454m (95.3%) are held under Stage 1, £865m in Stage 2 and £40m in Stage 3 (2021: £16,001m (93.5%) held under Stage 1, £1,090m in Stage 2 and £30m in Stage 3). ECLs of £3m (2021: £8m) are included in the table above, of which £1m (2021: £2m) is held under Stage 1 and £2m (2021: £6m) under Stage 2.

Against the backdrop of a deteriorating UK economy, credit quality has remained solid throughout the year, with the overall portfolio performing well and no significant individually assessed provisions raised.

During the second half of 2022, refinements to the staging criteria in the Business portfolio were implemented to further enhance the calculation and align it more closely to the underlying level of credit risk inherent within the Business portfolio. The impact moved c. £443m of loans from stage 2 to stage 1, leading to a modelled ECL release of c. £7m, and an approx. 22% reduction in the balance of business loans in Stage 2.

The contractual amount outstanding on loans and advances that were written off during the reporting period, or still subject to enforcement activity was £4.3m (2021: £2.6m). The Group has not purchased any lending assets in the year (2021: none). Further information on staging profile is provided at a portfolio level in the respective portfolio performance section on the following pages.

Mortgage credit performance

The table below presents key information on 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 (audited)

2022	Gross lending £m	Modelled & IA ECL £m	PMA £m	Total ECL £m	Net lending £m	Coverage %	Average LTV %
Residential – capital repayment	**36,417**	**13**	**5**	**18**	**36,399**	**0.05%**	**54.2%**
Residential – interest only	**7,041**	**3**	**1**	**4**	**7,037**	**0.05%**	**45.4%**
BTL	**15,006**	**6**	**28**	**34**	**14,972**	**0.22%**	**52.4%**
Total Mortgage portfolio	**58,464**	**22**	**34**	**56**	**58,408**	**0.09%**	**52.7%**
2021							
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%

Mortgage lending has remained flat on a net basis at £58.5bn (2021: £58.4bn) as the Group continued to prioritise margin in an increasingly competitive environment.

The portfolio continues to evidence solid underlying credit performance, with the majority (98%) of lending not yet past due at the balance sheet date (2021: 98%), and 94% of loans held in Stage 1 (2021: 87%). The successful return to normal payment patterns of customers taking advantage of COVID-19 payment holiday arrangements last year, drove the migration in balances from Stage 2 to Stage 1. A significant proportion of the portfolio is rated Strong at the balance sheet date (92% compared to 88% at 30 September 2021), and the volume and value of loans in forbearance has reduced to 4,636/£640m from 6,743/£830m, primarily due to customers successfully completing the forbearance reporting probation period and returning to fully performing status.

Stage 3 balances have remained low at 1.0% (2021: 1.1%) and 93% of the portfolio has an LTV of less than 75% (2021: 87%), with the weighted average LTV further reducing in the year to 52.7% (2021: 55.3%). All of these key metrics evidence a high quality mortgage portfolio, with relatively low risk of default, driven by sound lending decisions and underwriting criteria. Further detail on LTV bandings and forbearance measures is provided on the following pages.

The stability in the Mortgage portfolio metrics together with the improvement in the economic assumptions, such as house prices, have contributed to a release of £9m in the modelled ECL, taking the total modelled and IA provision to £22m (2021: £33m). Total PMAs have similarly reduced in the period, as detailed below, from £54m to £34m. The total Mortgage portfolio impairment provision is £56m (2021: £87m).

The Group had previously introduced a PMA for payment holidays in 2020 at the outset of the COVID-19 pandemic; this PMA, which was £22m at 30 September 2021, has now been fully released as customers have successfully exited payment holiday arrangements and returned to normal repayment patterns. Due to the uncertain macroeconomic environment, however, a new PMA of £6m has been introduced in response to the cost of living crisis, to reflect the potential impact on debt affordability from rising base rates and other inflationary impacts. The PMA reflects the potential impact on ECL in the event of a monthly payment shock to household finances, applied to customers in Stage 1 that are not currently, or otherwise showing signs of financial difficulty.

Asset quality metrics for the BTL mortgage book remain robust, but the Group continues to hold a prudent level of provisioning for this customer cohort, with the related PMA held broadly stable at £25m (2021: £28m). Other small PMAs totalling £4m (2021: £4m) have been retained, taking total PMA's held to £34m, down from £54m at 30 September 2021.

The release of modelled provisions and PMAs has resulted in an impairment credit of £30m in the income statement (2021: credit of £44m) and associated cost of risk of (4)bps (2021: (7)bps). While the total book coverage has reduced in the year to 9bps, it remains higher than the pre-pandemic level of 7bps.

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)

2022	**Stage 1**			**Stage 2**			**Stage 3[(2)]**			**Total[(3)]**		
	Loans		**ECL**	**Loans**		**ECL**	**Loans**		**ECL**	**Loans**		**ECL**
LTV[(1)]	**£m**	**%**	**£m**	**£m**	**%**	**£m**	**£m**	**%**	**£m**	**£m**	**%**	**£m**
Less than 50%	**23,069**	**43%**	**2**	**1,659**	**54%**	**3**	**288**	**49%**	**2**	**25,016**	**43%**	**7**
50% to 75%	**27,452**	**50%**	**5**	**1,270**	**41%**	**19**	**242**	**42%**	**2**	**28,964**	**50%**	**26**
76% to 80%	**2,412**	**4%**	**1**	**103**	**3%**	**3**	**17**	**3%**	**1**	**2,532**	**4%**	**5**
81% to 85%	**1,108**	**2%**	**1**	**26**	**1%**	**1**	**11**	**2%**	**1**	**1,145**	**2%**	**3**
86% to 90%	**547**	**1%**	**1**	**25**	**1%**	**1**	**6**	**1%**	**-**	**578**	**1%**	**2**
91% to 95%	**154**	**0%**	**-**	**4**	**0%**	**1**	**8**	**1%**	**1**	**166**	**0%**	**2**
96% to 100%	**16**	**0%**	**-**	**-**	**0%**	**-**	**3**	**1%**	**-**	**19**	**0%**	**-**
Greater than 100%	**33**	**0%**	**-**	**3**	**0%**	**4**	**8**	**1%**	**7**	**44**	**0%**	**11**
	54,791	**100%**	**10**	**3,090**	**100%**	**32**	**583**	**100%**	**14**	**58,464**	**100%**	**56**

2021	Stage 1			Stage 2			Stage 3[(2)]			Total[(3)]		
	Loans		ECL	Loans		ECL	Loans		ECL	Loans		ECL
LTV[(1)]	£m	%	£m	£m	%	£m	£m	%	£m	£m	%	£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

(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 £56m (2021: £67m) of POCI gross loans and advances and (£1m) ECL (2021: £Nil).

(3) The payment holiday PMA held in 2021 was allocated to Stage 2 and has now been fully released. The cost of living PMA is held in Stage 1.

The Mortgage portfolio remains highly secured with 92.3% of mortgages, by loan value, having an indexed LTV of less than 75% (2021: 86.8%), and an average portfolio LTV of 52.7% (2021: 55.3%).

New lending has increased the value of loans in Stage 1 with an LTV between 91% to 95%.

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 there has been a SICR, or if an impairment or default event has occurred, and then applies tailored forbearance measures 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 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	
2022	**Number of loans**	**Gross carrying amount £m**	**% of total portfolio**	**Impairment allowance £m**	**Coverage %**
Formal arrangements	**1,145**	**137**	**0.23**	**8.6**	**6.23**
Temporary arrangements	**518**	**82**	**0.14**	**4.4**	**5.38**
Payment arrangement	**1,211**	**133**	**0.23**	**0.6**	**0.49**
Payment holiday	**381**	**47**	**0.08**	**0.1**	**0.27**
Interest only conversion	**1,193**	**225**	**0.39**	**0.8**	**0.35**
Term extension	**66**	**5**	**0.01**	**-**	**0.45**
Other	**14**	**1**	**-**	**-**	**0.92**
Legal	**108**	**10**	**0.02**	**0.3**	**2.42**
Total mortgage forbearance	**4,636**	**640**	**1.10**	**14.8**	**2.31**
2021					
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	1,436	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

As at 30 September 2022, forbearance totalled £640m (4,636 customers), a decrease from the 30 September 2021 position of £830m (6,743 customers). This represents 1.10% of total mortgage balances (2021: 1.43%) with the decrease primarily driven by customers successfully completing the forbearance reporting probation period and returning to fully performing status.

When all other avenues of resolution, including forbearance, have been explored, the Group will take steps to repossess and sell underlying collateral. In 2022, there were 73 repossessions of which 7 were voluntary (2021: 33 including 13 voluntary). The number of repossessions has increased as court proceedings resume following the suspension during the COVID-19 pandemic. The Group remains committed to supporting the customer and places the right outcome for them at the centre of this strategy.

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]		Total	
	Gross loans	ECL	Gross loans	ECL	Gross loans	ECL	gross loans	Total provisions[4]
2022	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Opening balance at 1 October 2021	**50,596**	**4**	**7,192**	**64**	**653**	**19**	**58,441**	**87**
Transfers from Stage 1 to Stage 2	**(5,854)**	**(1)**	**5,821**	**55**	**-**	**-**	**(33)**	**54**
Transfers from Stage 2 to Stage 1	**8,820**	**3**	**(8,851)**	**(55)**	**-**	**-**	**(31)**	**(52)**
Transfers to Stage 3	**(49)**	**-**	**(191)**	**(5)**	**238**	**4**	**(2)**	**(1)**
Transfers from Stage 3	**29**	**-**	**108**	**5**	**(140)**	**(3)**	**(3)**	**2**
Changes to model methodology	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
New assets originated or purchased[2]	**9,971**	**1**	**7**	**-**	**1**	**-**	**9,979**	**1**
Repayments and other movements[3]	**(2,484)**	**4**	**(154)**	**(23)**	**(26)**	**(3)**	**(2,664)**	**(22)**
Repaid or derecognised[3]	**(6,238)**	**(1)**	**(842)**	**(9)**	**(142)**	**(2)**	**(7,222)**	**(12)**
Write-offs	**-**	**-**	**-**	**-**	**(1)**	**(1)**	**(1)**	**(1)**
Recoveries	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Individually assessed impairment charge	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Closing balance at 30 September 2022	**54,791**	**10**	**3,090**	**32**	**583**	**14**	**58,464**	**56**

	Stage 1		Stage 2		Stage 3[1]		Total	
	Gross loans	ECL	Gross loans	ECL	Gross loans	ECL	gross loans	Total provisions[4]
2021	£m	£m	£m	£m	£m	£m	£m	£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[2]	9,662	2	76	2	2	-	9,740	4
Repayments and other movements[3]	(2,141)	(11)	(405)	(36)	(38)	(3)	(2,584)	(50)
Repaid or derecognised[3]	(6,162)	(2)	(1,004)	(13)	(118)	(2)	(7,284)	(17)
Write-offs	-	-	-	-	(1)	(1)	(1)	(1)
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

(1) Stage 3 includes POCI for gross loans and advances of £56m (2021: £67m) and ECL of (£1m) (2021: £Nil).
(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.
(4) The payment holiday PMA held in 2021 was allocated to Stage 2 and has now been fully released. The cost of living PMA is currently held in Stage 1.

Despite economic uncertainty, the Mortgage portfolio continues to evidence strong performance and has benefited from positive house price movements. Coupled with the successful exit from payment holiday arrangements for those customers that took advantage of those measures during the pandemic, there has been a shift in balances from Stage 2 to Stage 1. The level of mortgage lending classed as Stage 1 increased from 86.6% in 2021 to 93.7%, with a corresponding decrease of assets in Stage 2 from 12.3% to 5.3%. Within the Stage 2 category, 4.7% of balances are not yet past due at the balance sheet date (2021: 11.9%), but falls within the Stage 2 classification predominantly due to PD deterioration. The proportion of mortgages classified as Stage 3 remains modest at 1.0% (2021: 1.1%).

These conditions have also contributed to an increase in assets classed as 'Strong' from 88% at 30 September 2021 to 92.4% at 30 September 2022, with over 97% (2021: 97%) of the Mortgage portfolio classed as 'Good' or 'Strong'.

The sustained quality in the internal PD ratings and high quality of collateral underpinning the book are key factors supporting the lower level of provision coverage.

Unsecured credit performance

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

Breakdown of Unsecured credit portfolio (audited)

2022	Gross lending £m	Modelled ECL £m	PMA £m	Total ECL £m	Net lending £m	Coverage %
Credit cards	**5,558**	**216**	**30**	**246**	**5,312**	**4.81%**
Personal loans	**925**	**32**	**2**	**34**	**891**	**3.57%**
Overdrafts	**30**	**4**	**-**	**4**	**26**	**12.57%**
Total Unsecured lending portfolio	**6,513**	**252**	**32**	**284**	**6,229**	**4.66%**
2021						
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 Unsecured lending portfolio	5,770	159	35	194	5,576	3.80%

Unsecured gross lending balances increased to £6.5bn (2021: £5.8bn) predominantly due to growth in credit card portfolio, while the personal loan portfolio continued to contract. The credit quality of the Unsecured portfolio remains high overall, with 97.9% of the portfolio in Stage 1 or Stage 2 not past due (2021: 98.1%) and a 1.2% in Stage 3 (2021: 1.2%). The level of customers in forbearance similarly remains low at 1.12% of the portfolio (2021: 1.30%).

Credit cards

Growth in the number of credit card accounts in the year of 20% has driven an increase in the lending balance of £0.9bn (21%). Average balances have remained fairly static throughout the year, as has the average level of facility utilisation. The credit quality of the cards portfolio remains high with 97.8% (2021: 98.2%) in stage 1 and stage 2 not past due, and a modest 1.3% in Stage 3 (2021: 1.2%).

While there has been minimal evidence of a deterioration in credit quality across the portfolio, as evidenced by these key metrics, the downturn in the broader UK economy has been reflected through the economic scenarios, resulting in an increase of £74m in modelled ECL. Coverage of 481bps is consequently up 102bps from FY21, and is 139bps higher than pre-pandemic levels of 342bps.

The payment holiday PMAs introduced in response to COVID-19, which amounted to £4m for the cards book at 30 September 2021, have now been fully released. A new PMA has been established for cost-of-living shocks that are not yet fully observed and incorporated in the modelled ECL. This has been applied to a cohort of credit card customers who are susceptible to a payment shock, and has resulted in a £20m PMA. This has been allocated to Stage 1. A small number of previously held PMAs totalling £10m (2021: £14m) have also been retained.

Personal loans

While the personal loan portfolio represents only a small portion of our Unsecured and total Group portfolio, staging has shifted during the year with a reduction in Stage 1 balances from 94.0% to 64.1%, and a corresponding increase in Stage 2 not past due balances from 5.0% to 35.1%, . This movement has had an impact on the staging profile for the whole Unsecured portfolio. This movement relates to personal lending made via the Group's JV arrangement with Salary Finance Loans Limited (Salary Finance) which has a cohort of customers who can be more susceptible to being impacted earlier, and harder, by cost of living shocks. During the year, the joint venture experienced an increased number of customers not maintaining scheduled loan repayments. Consequently, the Group has assessed the credit risk for this specific cohort of customers, and has now classified all lending with the JV (£318m) in Stage 2 (2021: £223m within Stage 1), together with an associated ECL of £19m (2021: £Nil).

Loan payment holiday PMAs, which were £8m at 30 September 2021, were fully released in the year. A new PMA of £1m has been established for cost-of-living shocks. Other PMAs have fallen from £9m in the prior year to £1m at the balance sheet date.

Taking the modelled provisions and PMAs together for the full Unsecured portfolio, the total ECL provision increased to £284m at 30 September 2022 (2021: £194m), resulting in a charge to the income statement in the year of £178m (2021: credit of £32m) and an increase in coverage ratio of 86bps to 466bps (2021: 380bps).

Credit risk (continued)

Forbearance (audited)

The table below summarises the level of forbearance in respect of the Group's Unsecured 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	
2022	**Number of loans**	**Gross carrying amount £m**	**% of total portfolio**	**Impairment allowance £m**	**Coverage %**
Credit cards arrangements	**15,872**	**62**	**1.19%**	**24.3**	**39.47%**
Loans arrangements	**638**	**3**	**0.56%**	**1.4**	**40.33%**
Overdraft arrangement	**56**	**0**	**0.04%**	**0.0**	**30.76%**
Total Unsecured lending forbearance	**16,566**	**65**	**1.12%**	**25.7**	**39.51%**
2021					
Credit cards arrangements	14,151	60	1.39%	23.9	39.88%
Loans arrangements	1,174	6	0.78%	3.3	49.61%
Overdraft arrangement	280	1	2.55%	0.4	51.89%
Total Unsecured lending forbearance	15,605	67	1.30%	27.6	40.98%

At 30 September 2022, credit cards forbearance totalled £62m (15,872 accounts), an increase from the 30 September 2021 position of £60m (14,151 accounts). This represents 1.19% of total credit cards balances (2021: 1.39%).

The level of impairment coverage on forborne credit cards is stable at 39.5% (2021: 39.9%). Limited forbearance is exercised in relation to personal loans and overdrafts, with a reduction to £3m (0.54%) in the personal loans and overdrafts portfolio from £7m (0.85%) at 30 September 2021.

IFRS 9 staging (audited)

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

	Stage 1		**Stage 2**		**Stage 3**[1]			
2022	**Gross loans £m**	**ECL £m**	**Gross loans £m**	**ECL £m**	**Gross loans £m**	**ECL £m**	**Total gross loans £m**	**Total provisions**[4] **£m**
Opening balance at 1 October 2021	**5,148**	**41**	**553**	**118**	**69**	**35**	**5,770**	**194**
Transfers from Stage 1 to Stage 2	**(1,051)**	**(31)**	**1,059**	**210**	**-**	**-**	**8**	**179**
Transfers from Stage 2 to Stage 1	**504**	**16**	**(523)**	**(62)**	**-**	**-**	**(19)**	**(46)**
Transfers to Stage 3	**(19)**	**-**	**(116)**	**(69)**	**139**	**83**	**4**	**14**
Transfers from Stage 3	**1**	**-**	**2**	**1**	**(8)**	**(7)**	**(5)**	**(6)**
Changes to model methodology	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
New assets originated or purchased[2]	**1,708**	**20**	**11**	**4**	**7**	**5**	**1,726**	**29**
Repayments and other movements[3]	**(508)**	**26**	**166**	**(8)**	**104**	**(4)**	**(238)**	**14**
Repaid or derecognised[3]	**(459)**	**(9)**	**(43)**	**(13)**	**(117)**	**(72)**	**(619)**	**(94)**
Write-offs	**-**	**-**	**-**	**-**	**(114)**	**(114)**	**(114)**	**(114)**
Recoveries	**-**	**-**	**-**	**-**	**-**	**26**	**-**	**26**
Individually assessed impairment charge	**-**	**-**	**-**	**-**	**-**	**88**	**-**	**88**
Closing balance at 30 September 2022	**5,324**	**63**	**1,109**	**181**	**80**	**40**	**6,513**	**284**

2021	Stage 1		Stage 2		Stage 3[1]			
	Gross loans £m	ECL £m	Gross loans £m	ECL £m	Gross loans £m	ECL £m	Total gross loans £m	Total provisions[4] £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[2]	1,319	17	38	6	1	-	1,358	23
Repayments and other movements[3]	(493)	(28)	(217)	(98)	15	(52)	(695)	(178)
Repaid or derecognised[3]	(226)	(6)	(55)	(14)	(29)	(25)	(310)	(45)
Write-offs	-	-	-	-	(99)	(99)	(99)	(99)
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

(1) Stage 3 includes POCI for gross loans and advances of £1m (2021: £2m) and ECL of (£2m) (2021: (£2m)).
(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.
(4) The payment holiday PMA held in 2021 was allocated to Stage 2 and has now been fully released. The cost of living PMA is held in Stage 1.

The balance of unsecured lending in Stage 2 increased by 7.4% to 17.0% (2021: 9.6%), driven primarily by the observed deterioration of the Salary Finance JV lending. Of the Stage 2 category, 16.1% is not yet past due at the balance sheet date, but falls into the Stage 2 classification predominantly due to PD deterioration.

There has been a corresponding reduction in Stage 1 from 89.1% to 81.7%, while Stage 3 remains stable at 1.2% (2021: 1.2%).

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 (audited)

2022	Core lending £m	Government[(1)] £m	Gross lending £m	Modelled & IA ECL £m	PMA £m	Total ECL £m	Net lending £m	Coverage[(2)] %
Agriculture	**1,392**	**66**	**1,458**	**5**	**1**	**6**	**1,452**	**0.45%**
Business services	**980**	**286**	**1,266**	**22**	**4**	**26**	**1,240**	**2.53%**
Commercial Real Estate	**597**	**10**	**607**	**3**	**-**	**3**	**604**	**0.54%**
Government, health and education	**1,008**	**54**	**1,062**	**8**	**2**	**10**	**1,052**	**0.95%**
Hospitality	**652**	**78**	**730**	**4**	**1**	**5**	**725**	**0.80%**
Manufacturing	**640**	**109**	**749**	**23**	**3**	**26**	**723**	**3.96%**
Resources	**133**	**8**	**141**	**3**	**1**	**4**	**137**	**2.37%**
Retail and wholesale trade	**330**	**128**	**458**	**7**	**1**	**8**	**450**	**2.51%**
Transport and storage	**291**	**56**	**347**	**4**	**1**	**5**	**342**	**1.44%**
Other	**1,087**	**262**	**1,349**	**20**	**4**	**24**	**1,325**	**2.11%**
Total Business portfolio	**7,110**	**1,057**	**8,167**	**99**	**18**	**117**	**8,050**	**1.59%**
2021								
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%

(1) Government includes all lending provided to business customers under UK Government schemes including Bounce back loan scheme, Coronavirus business interruption loan scheme, Coronavirus large business interruption loan scheme and Recovery loan scheme (RLS). This excludes £66m (30 September 2021: £Nil) of guarantee claim funds received from British Business Bank

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

Gross Business lending reduced to £8.1bn (2021: £8.3bn) driven by reductions in government-guaranteed lending schemes as borrowers continued to repay balances, which more than offset underlying portfolio growth in the year. Excluding the government lending, core lending balances grew slightly as business activity, which had been generally subdued during the pandemic, grew in line with broader economic activity and improved business confidence. Growth is targeted to sectors and sub sectors where the Group has a well established expertise. Book mix remained fairly constant year on year as sector focused strategy was maintained, with lending to the agriculture, business services and government, health and education sectors continuing to account for almost half of the total book, at 46% in both years.

Business lending credit performance remained resilient, with balances in Stage 1 and Stage 2 not past due representing 95.1% of the portfolio (2021: 96.7%). The percentage of loans in Stage 1 increased to 76.8% (2021: 68.0%) largely due to changes applied to the SICR criteria (outlined on pages 46 - 47) which, resulted in these customers migrating back to Stage 1. Across the portfolio 95% of lending was rated 'Strong' or 'Good' (2021: 96%). The previous Government interventions, including the ongoing loan schemes, continue to result in fewer customers entering forbearance; low levels were maintained with only 5.16% of the total portfolio being forborne at 30 September 2022 (2021: 5.82%).

Notwithstanding the strength of the portfolio, ongoing economic and political upheaval creates uncertainty over the potential for default occurring in the future. Key asset quality metrics continue to be monitored closely and a cautious approach to provisioning is being maintained. Stage 3 loans have increased to 4.6% driven primarily by bounce back loans (2021: 2.8%).

Despite these uncertainties, the refreshed macroeconomic scenarios have resulted in a small reduction of £6m in modelled provisions to £99m. At 30 September 2021, the Group recognised PMAs for sector stress (£80m) and PD neutralisation (£34m) together with other minor factors (£4m); each of these PMAs has been reviewed in the current year. While the removal of all COVID-19 restrictions is seen as a move away from the downside impact of the pandemic and is a rationale for a reduction in some sector stress, more recent geopolitical events in Ukraine and the cost of living crisis in the UK contribute to ongoing uncertainty over the impact that these broader economic conditions could have on UK businesses.

Recognising that the models used to estimate ECL have been built and tested on the past two recessions, neither of which included the combination of historically high price inflation nor the significant shock to primary commodities and energy which are leading to economic stagnation at a time of modest interest rates and unemployment. Therefore, a new economic resilience PMA of £30m has been introduced. A small negative PMA of £12m is also held pending introduction of the Business LGD model which will be implemented in the coming year and other technical adjustments.

The above results in an overall provision of £117m (2021: £223m) and an impairment credit in the income statement of £96m for the year (2021: credit of £55m). Portfolio coverage has reduced to 159bps (2021: 306bps), reflecting the high quality of the portfolio and little evidence of deterioration in asset quality to date

Forbearance (audited)

Forbearance is considered to exist where customers are experiencing, or are 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, based on 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	
2022	**Number of loans**	**Gross carrying amount £m**	**% of total portfolio**	**Impairment allowance £m**	**Coverage %**
Term extension	**154**	**118**	**1.36**	**4.9**	**4.18**
Payment holiday	**81**	**193**	**2.23**	**32.6**	**16.86**
Reduction in contracted interest rate	**2**	**1**	**0.01**	**-**	**1.33**
Alternative forms of payment	**-**	**-**	**-**	**-**	**-**
Debt forgiveness	**2**	**1**	**0.01**	**0.5**	**97.05**
Refinancing	**9**	**2**	**0.02**	**0.1**	**5.14**
Covenant breach/reset/waiver	**41**	**133**	**1.53**	**5.4**	**4.03**
Total Business forbearance	**289**	**448**	**5.16**	**43.5**	**9.71**

2021					
Term extension	188	196	2.27	10.2	5.19
Payment holiday	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

Business portfolio forbearance has reduced from £502m (332 customers) at 30 September 2021 to £448m (289 customers) at 30 September 2022. Forbearance remains an important metric, reflecting the volume and value of concessions granted to customers on a non-commercial basis. Changes to forbearance levels 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 5.16% (2021: 5.82%) with impairment coverage slightly increasing to 9.71% (2021: 8.31%). Most forbearance arrangements relate to term extensions allowing customers a longer term to repay obligations in full than initially contracted.

Customers within the forbearance portfolio have received £26m of COVID-19 related support loans: £13m CBIL, £4m BBL and £9m 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 2022 is £4.7m (2021: £5.3m), representing 0.05% of the total business portfolio (2021: 0.06%). The credit risk adjustment on these amounts totalled £0.1m (2021: £0.1m). Coverage is 2.99% (2021: 2.32%).

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 are presented in the tables below.

	Stage 1		Stage 2		Stage 3[3]		Total	
	Gross loans	ECL	Gross loans	ECL	Gross loans	ECL	gross loans	Total provisions[4]
2022	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Opening balance at 1 October 2021	**5,672**	**66**	**2,431**	**120**	**235**	**37**	**8,338**	**223**
Transfers from Stage 1 to Stage 2	**(1,382)**	**(13)**	**1,347**	**29**	**-**	**-**	**(35)**	**16**
Transfers from Stage 2 to Stage 1	**894**	**8**	**(908)**	**(28)**	**-**	**-**	**(14)**	**(20)**
Transfers to Stage 3	**(23)**	**-**	**(255)**	**(10)**	**273**	**14**	**(5)**	**4**
Transfers from Stage 3	**12**	**-**	**28**	**2**	**(39)**	**(2)**	**1**	**-**
Changes to model methodology	**443**	**1**	**(443)**	**(8)**	**-**	**-**	**-**	**(7)**
New assets originated or purchased[1]	**10,483**	**166**	**2,037**	**155**	**179**	**27**	**12,699**	**348**
Repayments and other movements[2]	**(442)**	**(72)**	**(167)**	**(34)**	**(22)**	**(8)**	**(631)**	**(114)**
Repaid or derecognised[2]	**(9,387)**	**(144)**	**(2,546)**	**(171)**	**(239)**	**(27)**	**(12,172)**	**(342)**
Write-offs	**-**	**-**	**-**	**-**	**(14)**	**(14)**	**(14)**	**(14)**
Recoveries	**-**	**-**	**-**	**-**	**-**	**4**	**-**	**4**
Individually assessed impairment charge	**-**	**-**	**-**	**-**	**-**	**19**	**-**	**19**
Closing balance at 30 September 2022	**6,270**	**12**	**1,524**	**55**	**373**	**50**	**8,167**	**117**

	Stage 1		Stage 2		Stage 3		Total	
	Gross loans	ECL	Gross loans	ECL	Gross loans	ECL	gross loans	Total provisions[4]
2021	£m	£m	£m	£m	£m	£m	£m	£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[1]	8,295	187	1,507	150	129	22	9,931	359
Repayments and other movements[2]	(321)	(20)	(311)	(6)	7	(17)	(625)	(43)
Repaid or derecognised[2]	(6,920)	(159)	(2,481)	(191)	(229)	(28)	(9,630)	(378)
Write-offs	-	-	-	-	(26)	(26)	(26)	(26)
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

(1) Includes assets where the term has ended, and a new facility has been provided.
(2) '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.
(3) This excludes £66m (2021: £Nil) of guarantee claim funds received from British Business Bank.
(4) The COVID related PMAs held in 2021 were allocated to Stages 1 and 2 and have now been fully released, the remaining Business PMA are predominantly held in Stage 2.

The level of Business lending classed as Stage 1 has increased to 76.8% (2021: 68.0%), with a corresponding decrease of 10.5% in Stage 2 to 18.7% (2021: 29.2%), primarily driven by the revisions to the SICR triggers.

The majority (98%) of the portfolio in Stage 2 is not past due and is primarily in Stage 2 due to PD deterioration, in addition to proactive management measures such as early intervention, heightened monitoring and forbearance concessions. Stage 3 loans have increased to 4.6% driven primarily by bounce back loans (2021: 2.8%).

The proportion of assets classed as 'Strong' has increased to 68% (2021: 46%), with assets classed as 'Strong' or 'Good' now 95% (2021: 96%).

Other credit risks

Non-property related collateral (audited)

The following table shows the total non-property collateral held at 30 September 2022 in terms of cash, guarantees (guarantees are predominantly in relation to government-backed COVID-19 loans) and netting. The exposure amount shown below is the total gross exposure (net of credit provisions) for arrangements that have some form of associated collateral and is not the total exposure for each asset class, as this balance is disclosed elsewhere in this section.

2022	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	**7**	**970**	**237**	**-**	**464**	**501**	**2,179**	**2,397**
Cash and balances with central banks	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Due from other banks	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Total	**7**	**970**	**237**	**-**	**464**	**501**	**2,179**	**2,397**
Of which: Stage 3								
Loans and advances to customers								
Business	**-**	**127**	**-**	**-**	**1**	**11**	**139**	**140**

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

The removal of cash collateral reflected within central governments or central banks is due to a change in reporting following CRR II implementation, where the Term Funding Scheme is now reported under CCR rules. The debt securities collateral previously reported within due from other banks was in relation to a sale and repurchase agreement (repo) which is no longer held by the Group.

Lending backed by government guarantees in response to COVID-19 are detailed 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 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 held for these exposures.

Risk report (continued)
Credit risk (continued)

Offsetting of financial assets and liabilities

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

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

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

Group

				Net amounts not offset on balance sheet		
2022	Gross amounts £m	Gross amounts offset on balance sheet[1] £m	Net amounts presented on balance sheet £m	Subject to master netting agreements £m	Cash collateral pledged/ received[2] £m	Net amount[3] £m
Assets						
Derivative financial instruments[4]	**3,340**	**(2,998)**	**342**	**(46)**	**(182)**	**114**
Liabilities						
Derivative financial instruments[4]	**1,797**	**(1,469)**	**327**	**(46)**	**(32)**	**250**
Securities sold under repurchase agreement	**703**	**-**	**703**	**(703)**	**-**	**-**
2021						
Assets						
Derivative financial instruments[4]	413	(273)	140	(76)	(1)	63
Liabilities						
Derivative financial instruments[4]	678	(469)	209	(76)	(50)	83

(1) The net balance of £1,529m (2021: £196m) relates to variation margin offset under IAS 32 and reflected on other balance sheet lines.
(2) Cash collateral amounts not offset under IAS 32 in respect of derivatives with other banks are included within due from and due to other banks. Cash collateral amounts not offset under IAS 32 in respect of derivative with central clearing houses is included within other assets and other liabilities.
(3) 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 £594m (2021: £274m). This is not offset under IAS 32 or presented as collateral on the balance sheet.
(4) Derivative financial instruments comprise both trading and hedging derivative assets and liabilities.

Offsetting of financial assets and liabilities (continued)

Bank

2022	Gross amounts £m	Gross amounts offset on balance sheet[3] £m	Net amounts presented on balance sheet[1] £m	Net amounts not offset on balance sheet: Subject to master netting agreements £m	Net amounts not offset on balance sheet: Cash collateral pledged/ received[4] £m	Net amount £m
Assets						
Derivative financial instruments[2]	**3,307**	**(2,998)**	**310**	**(43)**	**(182)**	**84**
Liabilities						
Derivative financial instruments[2]	**1,661**	**(1,469)**	**192**	**(43)**	**(31)**	**118**
Securities sold under repurchase agreement	**703**	**-**	**703**	**(703)**	**-**	**-**

2021	Gross amounts £m	Gross amounts offset on balance sheet[3] £m	Net amounts presented on balance sheet[1] £m	Net amounts not offset on balance sheet: Subject to master netting agreements £m	Net amounts not offset on balance sheet: Cash collateral pledged/ received[4] £m	Net amount £m
Assets						
Derivative financial instruments[2]	361	(273)	87	(47)	(1)	39
Liabilities						
Derivative financial instruments[2]	630	(469)	160	(47)	(65)	48

Macroeconomic assumptions, scenarios, and weightings

The Group's ECL allowance at 30 September 2022 was £457m (2021: £504m).

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 outcome. The macroeconomic assumptions were provided by Oxford Economics on 1 September 2022 and changes in macroeconomic assumptions between 1 September 2022 and 30 September 2022 have been considered as part of the PMAs. 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 gradually recovered from the impact of COVID-19, the outlook continues to be as uncertain than it was at this point in 2021. Recent (and further anticipated) bank base rate rises, concerns over rising energy prices (despite recent UK Government announcements on the assistance it will provide customers), the increase in national insurance contributions, and the headwinds from higher inflation have all had an impact on household incomes in 2022. The potential impact on the UK economy of the Russian invasion of Ukraine remains uncertain, but as the Group has no direct lending in that region, it is hoped that any impact will be modest and short term. Against this fast moving and evolving 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 quarterly 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)	**2022 (%)**	2021 (%)
Upside	**10**	15
Base	**55**	50
Downside	**35**	35

The Group continue to select three scenarios, with the largest weighting applied to the base scenario. In the current year, there is a 5% shift in the weightings from the Upside scenario towards the Base scenario, reflecting a lesser degree of confidence in the Upside scenario over the short to medium term as a result of the updated macroeconomic assumptions. The Group's current weighting applied to the Downside scenario is appropriate when considered in the context of the overall scenario weightings applied and remains unchanged from the previous year.

Upside (10%)[1]

- GDP increased sharply by 8.7% in the first quarter of 2022 (Q1 2022 v Q1 2021), before slowing down to a c.2.0%-3.0% increase in each of the remaining quarters in 2022 against the 2021 positions. Overall year-on-year growth in 2022 is forecast at 3.9%, with a slight decrease to 2.8% in 2023, before rising slightly in 2024 and 2025 and reverting to a more modest increase in 2026.
- Inflation rises steeply and peaks at 12.9% in Q4 2022 (and lasting into Q1 2023) from a low base of 0.6% at Q1 2021. Inflation reverts back but remains high for the remainder of 2023, falling to 2.0% in Q2 2024 and sub 2.0% from the following quarter for the remaining forecast period.
- BoE base rate rises are anticipated throughout 2022 and are expected to continue into 2023, peaking at 3.0% in Q2 2023 and remaining there for the rest of 2023. Slight declines are expected throughout 2024, reaching 2.3% in Q4 2024 and continue at that rate for the remainder of the forecast period.
- HPI Q4 annual growth of 8.3% in 2022, declining to (2.3%) in 2023, before rising again over the next three years finishing in 2026 with a year on year growth of 6.5%.
- Unemployment peaks in Q3 2023, at 4.3%, and drops gradually to 3.8% by Q4 2024. From then, there is no significant movement over the remaining forecast period, reaching 3.6% in Q1 2026 where it remains until the end of 2026.

Base (55%)

- GDP increased sharply by 8.7% in the first quarter of 2022 (Q1 2022 v Q1 2021) before contracting in Q2 2022, with overall year-on-year growth in 2022 forecast at 3.6%, and falling to 0.3% in 2023. GDP recovers over the remaining forecast period at between 2.1% and 2.7%.
- Inflation peaks at 12.7% in Q4 2022 before recovering and reverting to under 1% by Q1 2024. Inflation rises slightly but remains under 2% from Q1 2026 for the remaining forecast period.

Macroeconomic assumptions (continued)

- BoE base rate hits a high of 2.5% in Q1 2023 and steadily declines over the forecast period reaching 1.8% in Q4 2023 and remaining there until the end of 2025. A further reduction to 1.7% is anticipated in Q1 2026 and remains at that level for the remainder of the year.
- HPI steadily rises to Q4 2022 before modestly reverting from then until Q4 2024 when it rebounds slowly each quarter thereafter until the end of the forecast period. Overall, HPI Q4 2022 annual growth of 6.8%, which regresses to (4.6%) in 2023 and remains negative into 2024, before reverting to positive growth in 2025 and finishing 2026 back up at 6.7%.
- Unemployment peaks at 4.7% in Q3 2023 and drops to 4.1% by Q4 2024. From then, there is no significant movement with unemployment averaging just under 4% in 2025, and steadily declining and reaching 3.7% for the final two quarters of 2026

Downside (35%)

- GDP increased sharply to 8.7% (Q1 2022 v Q1 2021) before turning negative for the final quarter of 2022 to (2.8%) (Q4 2022 v Q4 2021), and remains sluggish over the remaining forecast period. The overall year-on-year growth is 2.6% in 2022, falling to (8.9%) in 2023, before reverting to sluggish growth of 0.8% in 2024, rising to 2.1% for the remaining forecast period.
- Inflation hits 11.9% in Q4 2022 before declining and turning negative by Q4 2023, and remains negative for the first three quarters of 2024. From there, inflation rises steadily each quarter reaching 1.7% in Q3 2026 and remains at this level for Q4 2026.
- The BoE base rate reaches 2.3% in Q4 2022 before steadily falling back to 0.5% by Q3 2024 where it stays for the remaining forecast period.
- HPI falls steadily and deeply from Q4 2022 to Q3 2025, but then experiences modest increases in each quarter until the end of the forecast period, but finishes well below the levels experienced in 2021. Overall, HPI in Q4 2023 is forecast decline annually (13.3%), with a slight improvement to (11.6%) in 2024, and not turning positive until 2026.
- Unemployment rises steadily and peaks at 7.4% in Q3 2025 and improves slightly over remainder of the forecast period. Overall, unemployment averages at 4.0% in 2022, rising to 7.3% by 2025, before improving modestly to finish at 7.1% in 2026.

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

Base case–2022 v 2021 (audited)[1]

The following table shows how the Group's base case assumptions have changed from those used at 30 September 2022:

Year	Assumption	2021 %	2022 %	2023 %	2024 %	2025 %	2026 %
30 September 2022	Base rate		1.4	2.2	1.8	1.8	1.7
	Unemployment		3.9	4.6	4.4	3.8	3.8
	GDP		3.6	0.3	2.1	2.7	2.1
	Inflation		9.4	7.5	0.6	0.7	1.5
	HPI		6.8	(4.6)	(3.0)	4.4	6.7
30 September 2021	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	

(1) Macroeconomic assumptions provided by Oxford Economics on 1 September 2022 and reported on a calendar year basis unless otherwise stated. The changes in macroeconomic assumptions between 1 September 2022 and 30 September 2022 have been considered as part of the PMAs.

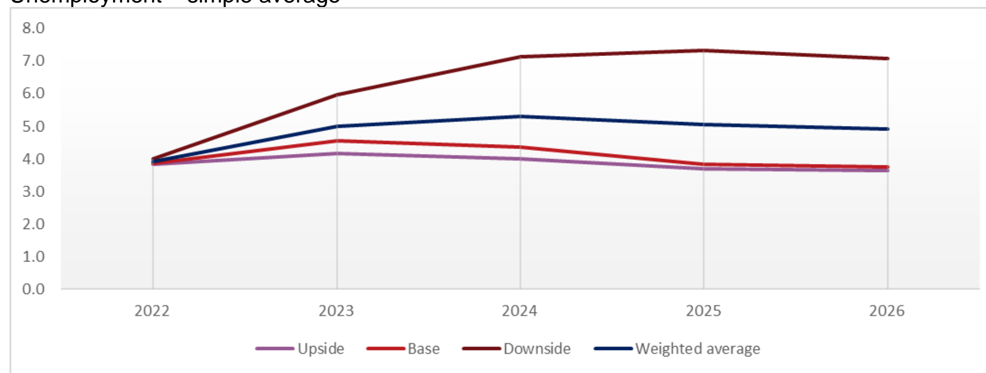
The base case macroeconomic estimates and assumptions used at 30 September 2021 reflected the forward-looking view at that time, which recognised the impact of the further lockdown measures introduced in Q4 2020, together with the successful vaccine roll-out programme which resulted in much more positive base case assumptions. The headwinds of inflation and cost of living crisis, and the resultant actions of the BoE to curb inflation dominated much of 2022 and resulted in the significant changes to assumptions over the relatively short term.

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

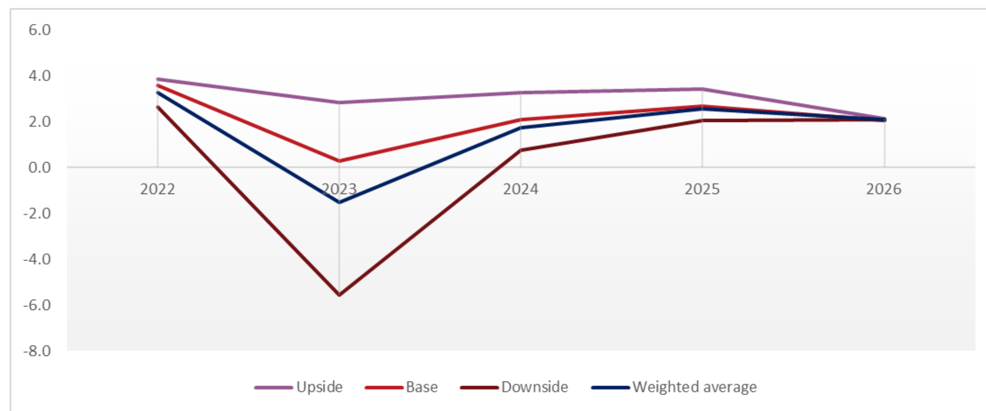
2022	**Unemployment %**	**GDP %**	**HPI %**
Upside	**3.9**	**3.1**	**3.3**
Base	**4.1**	**2.1**	**2.0**
Downside	**6.3**	**0.4**	**(3.4)**
2021			
Upside	3.9	4.6	4.6
Base	4.3	3.8	2.1
Downside	6.5	2.1	(5.8)

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

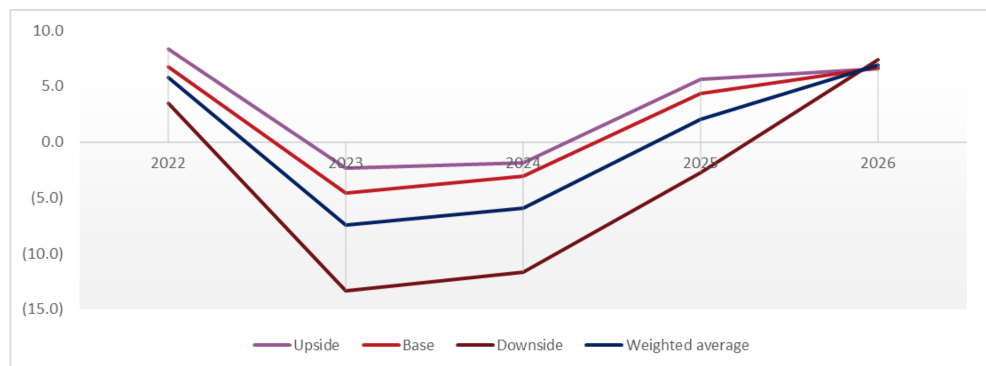
Unemployment – simple average



GDP – year-on-year movement

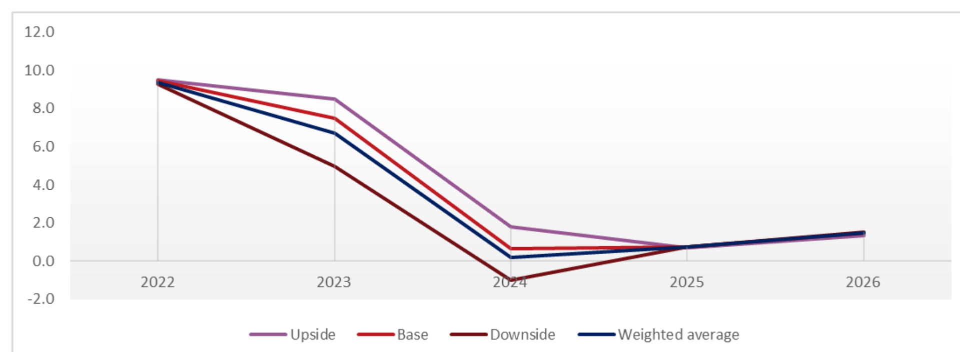


HPI – year-on-year movement



Risk report (continued)
Credit risk (continued)

While there are inflationary pressures at present that are impacting the Group's ECL calculations, the following graph demonstrates the expected relatively short-term nature of these over the forecast period (year-on-year movement):



The full range of the key macroeconomic assumptions is included in the table on page 49.

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:

2022 (audited)	**Probability Weighted(1) £m**	**Upside £m**	**Base £m**	**Downside £m**
Mortgages	**15**	**12**	**13**	**23**
Unsecured of which:	**251**	**236**	**237**	**279**
Cards	**216**	**209(4)**	**208**	**233**
Personal loans and overdrafts(3)	**35**	**27**	**29**	**46**
Business(2)	**53**	**39**	**43**	**97**
Total	**319**	**287**	**293**	**399**

(1) In addition to the probability weighted modelled provision shown in the table, the Group holds £85m relative to PMAs (2021: £207m) and £38m of individually assessed provision (2021: £31m).
(2) Business and total ECLs in the above table have been calculated using the new LGD model and while not fully implemented in the year, the impact of this was incorporated into the total Business ECLs via the use of PMAs. Consequently, the probability weighted Business and total ECLs reported in the above table are £15m lower than the actual figures for the year.
(3) Salary Finance contributes more that 50% of the combined Personal Loans and overdrafts ECL.
(4) Due to a minor model interaction effect, the 100% ECL for Upside is marginally higher than the Base case.

2021 (audited)	Probability Weighted £m	Upside £m	Base £m	Downside £m
Mortgages	24	16	19	37
Unsecured 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

One of the criteria for moving exposures between stages is the lifetime 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 47.

Within each portfolio, the following are the macroeconomic inputs that 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

Unsecured: Unemployment

Business: Unemployment and HPI

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

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

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

(audited)	**2022** **£m**	2021 £m
Mortgages +10%	**(1)**	(2)
Business +10%	**(1)**	(2)
Mortgages -10%	**2**	3
Business -10%	**2**	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)	**2022** **£m**	2021 £m
Mortgages +1%	**1**	1
Unsecured +1%	**15**	4
Business +1%	**4**	6
Mortgages -1%	**(1)**	(1)
Unsecured -1%	**(15)**	(4)
Business -1%	**(3)**	(4)

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

Judgement is required in determining the point at which a SICR has occurred, as it 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 assessment 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 that 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.

Refinements were made to the application of SICR on the Group's Business portfolio in the year. Please refer to pages 20 and 35 for further detail.

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 approach with reference to the Group's Mortgage, Unsecured (credit cards) and Business 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:

(audited)		Origination PD	SICR Trigger
Mortgages	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)	**2022 £m**	2021 £m
A 10% movement in the mortgage portfolio from Stage 1 to Stage 2[(1)]	**+9**	+6
A 10% movement in the credit card portfolio from Stage 1 to Stage 2[(1)]	**+87**	+69
A 10% movement in the business portfolio from Stage 1 to Stage 2[(1)]	**+18**	+13
A PD stress which increases PDs upwards by 20% for all portfolios	**+106**	+94

(1) The comparative has been restated in line with the 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

PMAs were £85m in 2022 (2021: £207m) and are included within the total ECL provision of £457m (2021: £504m).

These are management judgements that impact the ECL provision by increasing (or decreasing) the collectively assessed modelled output, where not all the known risks identified in a particular product segment have been necessarily reflected within the models. This also takes into account any time lag between the dated the macroeconomic assumptions were received and the reporting date. Key PMAs are described below:

Mortgages: the Group continue to monitor the level of ECL held on BTL mortgages due to uncertainty of the impact on landlords and tenants and have maintained the PMA for this cohort of customers. A new PMA was introduced to reflect an impact on debt affordability as a result of rising energy prices and other inflationary effects.

Unsecured: a new PMA was introduced for debt affordability as a reaction to the reduction in customers' reduced disposable incomes. Other PMAs are also held with the most material being £10m for the potential impact on the sale or future recovery value of Unsecured written-off debt, which can fluctuate in the current environment.

Business: the current uncertain economic environment is also impacting the Business portfolio, where higher prices, wage inflation pressure and rising interest rates are all headwinds faced by customers. The Group has recognised these pressures and introduced an economic resilience PMA accordingly.

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

(audited)	Mortgages	Unsecured	Business	Total
2022	**£34m**	**£33m[(1)]**	**£18m**	**£85m**
% of total ECL	**70%**	**11%**	**21%**	**20%**
Coverage – total	**0.09%**	**4.66%**	**1.59%**	**0.62%**
Coverage – total ex PMAs	**0.02%**	**4.13%**	**0.93%**	**0.45%**
2021	£54m	£35m	**£118m**	£207m
% of total ECL	62%	18%	**53%**	41%
Coverage – total	0.15%	3.80%	3.06%	0.70%
Coverage – total ex PMAs	0.06%	3.11%	1.44%	0.41%

(1) The actual value £32.47m has been rounded up to ensure the table casts.

The reduction in PMAs in the year of £122m predominantly reflects the removal of (i) sector specific PMAs in the Business portfolio (£80m) that were necessary as the UK economy continued to feel the effects of Covid-19 and the outlook for businesses remained uncertain, and (ii) the impact of payment holidays on the Mortgage portfolio (£20m) as Covid-19 related support was withdrawn.

PMAs are primarily held in 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 portfolio 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

Annual macroeconomic assumptions used over the five-year forecast period in the scenarios and their weighted averages are as follows:[1]

2022

Scenario	VMUK weighting	Economic measure[2]	2022 %	2023 %	2024 %	2025 %	2026 %
Upside	10%	Base rate	**1.4**	**3.0**	**2.5**	**2.3**	**2.3**
		Unemployment	**3.8**	**4.2**	**4.0**	**3.7**	**3.6**
		GDP	**3.9**	**2.8**	**3.2**	**3.4**	**2.1**
		Inflation	**9.5**	**8.5**	**1.8**	**0.7**	**1.3**
		HPI	**8.3**	**(2.3)**	**(1.8)**	**5.7**	**6.5**
Base	55%	Base rate	**1.4**	**2.2**	**1.8**	**1.8**	**1.7**
		Unemployment	**3.9**	**4.6**	**4.4**	**3.8**	**3.8**
		GDP	**3.6**	**0.3**	**2.1**	**2.7**	**2.1**
		Inflation	**9.4**	**7.5**	**0.6**	**0.7**	**1.5**
		HPI	**6.8**	**(4.6)**	**(3.0)**	**4.4**	**6.7**
Downside	35%	Base rate	**1.3**	**1.7**	**0.6**	**0.5**	**0.5**
		Unemployment	**4.0**	**6.0**	**7.1**	**7.3**	**7.1**
		GDP	**2.6**	**(5.6)**	**0.8**	**2.1**	**2.1**
		Inflation	**9.3**	**5.0**	**(1.0)**	**0.7**	**1.5**
		HPI	**3.5**	**(13.3)**	**(11.6)**	**(2.7)**	**7.4**
Weighted average		Base rate	**1.4**	**2.1**	**1.4**	**1.4**	**1.4**
		Unemployment	**3.9**	**5.0**	**5.3**	**5.0**	**4.9**
		GDP	**3.3**	**(1.5)**	**1.7**	**2.5**	**2.1**
		Inflation	**9.4**	**6.7**	**0.2**	**0.7**	**1.5**
		HPI	**5.8**	**(7.4)**	**(5.9)**	**2.0**	**6.9**

2021

Scenario	VMUK weighting	Economic measure[2]	2021 %	2022 %	2023 %	2024 %	2025 %
Upside	15%	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	35%	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

(1) Macroeconomic assumptions provided by Oxford Economics on 1 September 2022 and reported on a calendar year basis unless otherwise stated. The changes in macroeconomic assumptions between 1 September 2022 and 30 September 2022 have been considered as part of the PMAs.

(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

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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%	111%	138%

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 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 participates in wholesale markets, and uses financial instruments 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 strategy of sustainable growth. Capital risk is the risk that the Group has or forecasts insufficient capital and other loss-absorbing debt instruments to operate effectively, this includes 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 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 outputs are used to inform cut-off models that drive the lending decisions;
- Pricing – Outputs and estimates are used in the assessment of new products and portfolio pricing reviews;
- Risk appetite – Parameters are included in the assessment of models and are analysed to inform the Group's risk capacity and appetite; and
- Asset quality – 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.

<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 requirements relating to compliance with updates to definition of default and mortgage IRB models were extended. The Group did not adopt hybrid mortgage models in FY22 and intends to do so in FY23.

As part of the Group's implementation of mortgage IRB models (including Hybrid PD), we will consider the need to apply an overlay to increase RWAs in advance of formal approval of models. A final figure has not yet been determined although this may be in the range of £1-1.5bn of RWAs.

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.

<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 covered a range of revisions in the areas of counterparty credit risk, large exposures, LCR, NSFR and reporting and disclosure among other changes. These standards became effective in the UK from 1 January 2022 and did not materially impact capital requirements.

Policy Statement 22/21 confirmed the PRA's treatment to fully deduct software assets from CET1 capital, applicable from 1 January 2022. The PRA's view is that intangible assets are not sufficiently loss absorbent on a going concern basis to warrant recognition as CET1 capital.

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. There are a number of areas within Basel 3.1 subject to national discretion and choice. The PRA is due to publish a Consultation Paper on UK implementation in the forth quarter of 2022, with the final reforms expected to become effective on 1 January 2025 (delayed from 2023), subject to a five-year transitional period. 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 of potential outcomes to assist with planning.

Solvency Stress Test

The Group was a participant in the BoE Solvency Stress Test (SST) in 2021. This was the first time the Group had been involved in the BoE's stress testing for major banks. The Group will be an on-going participant in the BoE's Annual Cyclical Scenario (ACS). Results from the SST were published by the BoE at the end of 2021 and were 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. The Group's results on both a transitional and non-transitional basis were in excess of the published reference rates and was not required to take any additional capital actions or to submit a revised capital plan.

Annual Cyclical Scenario Stress Test

The 2022 (ACS) was postponed due to the uncertainty caused by the Russian invasion of Ukraine. The delay was applied to enable lenders to focus on managing the financial markets disruption associated with the invasion. In July 2022, it was announced within the Financial Stability Report that the ACS stress test would commence in September 2022. The

BoE published the Key Elements of the 2022 Stress Test on 26 September 2022 and the Group is in the process of undertaking the 2022 ACS exercise. The scenario tests the resilience of the UK Banking system to deep simultaneous recessions in the UK and global economies, real income shocks, large falls in asset prices and higher global interest rates, as well as a separate stress of misconduct costs. The results will be published in summer 2023.

Resolvability Assessment Framework (RAF)

The BoE and has introduced a Resolvability Assessment Framework (RAF), with full Implementation required by 2022 to ensure major UK banks can be safely resolved. The Group has undertaken an assessment of its resolvability with disclosures published in June 2022. The BoE concluded that, upon their first assessment as resolution authority of the eight major banks, a major UK bank could enter resolution safely remaining open and continuing to provide vital banking services to the economy.

UK Leverage Ratio Framework

In October 2021 the FPC and PRA published their changes to the UK leverage ratio framework (Policy Statement 21/21). The changes, effective from 1 January 2022, have simplified the framework with the Group being subject to the UK leverage ratio only rather than the two leverage ratio definitions that previously existed. The Group exceeds the 3.25% leverage ratio requirement.

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 and ensuring that excessive leverage is not taken, so meeting regulatory requirements and managing the rating agencies' assessments of the Group.

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.

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 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.

Capital risk (continued)

In recent years, the PRA has also taken a thematic interest in the quality of regulatory reporting across the industry, specifically focusing on the completeness, accuracy and timing of regulatory reports. This has resulted in a number of s166 Skilled Person Reviews being commissioned over the governance, controls and processes supporting the regulatory reporting framework. The Group is subject to such a review which commenced this year and which will ultimately lead to enhancements to the governance and control framework of the Group's regulatory reporting. In May the Board approved that EY be recommended to the PRA as the preferred Skilled Person to undertake the review and the PRA subsequently approved EY's appointment. The review is scheduled to finalise towards the end of calendar year 2022.

Capital resources

The Group's capital resources position as at 30 September 2022 is summarised below:

Regulatory capital[1]	**2022**	2021
	£m	£m
Statutory total equity	**6,411**	5,582
CET1 capital: Regulatory adjustments[2]		
AT1 capital instruments	**(662)**	(672)
Defined benefit pension fund assets	**(650)**	(551)
Prudent valuation adjustment	**(5)**	(5)
Intangible assets	**(256)**	(208)
Goodwill	**(11)**	(11)
Deferred tax asset relying on future profitability[3]	**(417)**	(388)
Cash flow hedge reserve	**(699)**	(10)
AT1 coupon accrual	**(13)**	(14)
Foreseeable dividend on ordinary shares	**(106)**	(254)
Excess expected losses	**(100)**	-
IFRS 9 transitional adjustments	**114**	134
Total regulatory adjustments to CET1	**(2,805)**	(1,979)
Total CET1 capital	**3,606**	3,603
AT1 capital		
AT1 capital instruments	**662**	672
Total AT1 capital	**662**	672
Total Tier 1 capital	**4,268**	4,275
Tier 2 capital		
Subordinated debt	**1,020**	1,019
Total Tier 2 capital	**1,020**	1,019
Total regulatory capital	**5,288**	5,294

(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]	2022 £m	2021 £m
CET1 capital[2]		
CET1 capital at 1 October	**3,603**	3,508
Retained earnings and other reserves (including special purpose entities)	**150**	502
Prudent valuation adjustment	**-**	1
Amendment to software asset deduction rules[3]	**(151)**	151
Intangible assets	**103**	118
Deferred tax asset relying on future profitability	**(29)**	(173)
Defined benefit pension fund assets	**(99)**	(81)
AT1 distribution paid already deducted from CET1	**14**	-
Dividend paid already deducted from CET1	**254**	-
AT1 foreseeable distribution	**(13)**	7
Foreseeable dividend on ordinary shares	**(106)**	(254)
Excess expected losses	**(100)**	-
IFRS 9 transitional adjustments	**(20)**	(176)
Total CET1 capital at 30 September	**3,606**	3,603
AT1 capital		
AT1 capital at 1 October	**672**	672
AT1 instrument issued net of costs	**346**	-
AT1 instrument repurchased	**(356)**	-
Total AT1 capital at 30 September	**662**	672
Total Tier 1 capital at 30 September	**4,268**	4,275
Tier 2 capital		
Tier 2 capital at 1 October	**1,019**	749
Capital instruments issued: subordinated debt	**-**	298
Capital instruments purchased: subordinated debt	**-**	(30)
Amortisation of issue costs	**1**	2
Total Tier 2 capital at 30 September	**1,020**	1,019
Total capital	**5,288**	5,294

(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) The full deduction treatment for software assets was reinstated by the PRA in January 2022.

The Group's CET1 capital increased by £3m during the year. Statutory profit after tax of £520m drove an overall increase in retained earnings, which when offset against other reserves movements resulted in a net increase in CET1 capital of £150m. The Group used this surplus principally to fund capital returns in the year of £277m (comprising payments of £158m for interim dividends and distributions plus a final dividend and AT1 accrual for the current year of £119m) and further investment in digital software assets of £53m. In addition, £100m of CET1 capital was absorbed by the movement in excess expected losses, as releases in IFRS 9 provisions widened the gap between regulatory and accounting credit losses.

In June 2022, the Group successfully issued £350m of new AT1 securities, achieving significantly tighter pricing on a spread basis than prior issuances. Concurrently, the Group repurchased £377m of its existing AT1 securities that are callable in December of this year from Virgin Money UK PLC. The net impact reduced AT1 capital by £10m (after costs) as at 30 September 2022.

Subsequent to the report date, the Group announced its intention to redeem the remaining £73m of those AT1 securities on their call date in December 2022.

Capital risk (continued)

Risk weighted assets

Minimum capital requirements	2022 Exposure £m	2022 RWA £m	2022 Minimum capital requirement £m	2021 Exposure £m	2021 RWA £m	2021 Minimum capital requirement £m
Retail mortgages	**62,545**	**9,155**	**732**	61,146	10,010	801
Business lending	**11,957**	**6,194**	**496**	11,668	6,038	483
Other retail lending	**17,408**	**4,817**	**385**	16,201	4,311	345
Other lending	**18,160**	**272**	**22**	15,462	326	25
Other[1]	**578**	**623**	**50**	756	835	67
Total credit risk	**110,648**	**21,061**	**1,685**	105,233	21,520	1,721
Credit valuation adjustment		**258**	**21**		103	8
Operational risk		**2,624**	**210**		2,466	197
Counterparty credit risk		**185**	**15**		105	8
Total	**110,648**	**24,128**	**1,931**	105,233	24,194	1,934

(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 (in 2021 only), prepayments, other debtors and deferred tax assets that are not deducted.

RWA movements	2022 IRB RWA £m	2022 STD RWA £m	2022 Non-credit risk RWA[2] £m	2022 Total £m	2022 Minimum capital requirement £m	2021 IRB RWA £m	2021 STD RWA £m	2021 Non-credit risk RWA[2] £m	2021 Total £m	2021 Minimum capital requirement £m
Opening RWA	**15,698**	**5,822**	**2,674**	**24,194**	**1,934**	15,845	5,618	2,921	24,384	1,951
Asset size	**267**	**574**	**-**	**841**	**68**	(553)	157	-	(396)	(32)
Asset quality	**(960)**	**4**	**-**	**(956)**	**(75)**	(644)	19	-	(625)	(50)
Model updates[1]	**(64)**	**-**	**-**	**(64)**	**(5)**	1,086	-	-	1,086	87
Methodology and policy	**-**	**(160)**	**-**	**(160)**	**(13)**	(36)	151	-	115	9
Other	**-**	**(120)**	**393**	**273**	**22**	-	(123)	(247)	(370)	(31)
Closing RWA	**14,941**	**6,120**	**3,067**	**24,128**	**1,931**	15,698	5,822	2,674	24,194	1,934

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

RWA reduced c.£0.1bn to £24.1bn primarily due to the impact of improvements to the HPI offsetting the impact of higher lending and increased other non-credit RWAs.

As well as the HPI improvements of £1.5bn, the asset quality movement includes RWA increases relating to the increased risk weights associated with higher mortgage pipeline commitments.

Model updates include a reversal of the £344m in RWA specific to COVID-19 related PMAs, with a new PMA of £280m to account for increased RWAs arising from Forced Sale Discounts. A further PMA of £47m to the Business portfolio relating to the new definition of default was introduced in January 2022, and this was largely offset by a reduction of £46m RWAs following recalibration of PDs throughout the year.

Methodology and policy movement is largely driven by the removal of the £151m RWA uplift in relation to the CRR Quick Fix amendments in respect of intangible assets, which was removed from January 2022.

The other movement in standardised RWAs reflects reductions to exposures to fixed assets (£39m RWA), deferred tax assets (£37m RWA) and SPV deposits with other institutions (£58m RWA), partially offset by increases to other assets including prepayments and items in the course of collection.

Other non-credit risk RWA movements include an Operational Risk RWA uplift of £158m due to a higher proportion of revenue within Commercial Banking business line over the last three years, compared to the three years prior to September 2021. CCR and CVA RWAs have increased by £80m and £155m respectively, driven by the move to the more risk sensitive SA-CCR methodology per PS22/21 from 1 January 2022 and increased market volatility in recent months.

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.

	2022 (£m)	
Available capital (amounts)	**IFRS 9 Transitional basis**	**IFRS 9 Fully loaded basis**
CET1 capital	**3,606**	**3,492**
Tier 1 capital	**4,268**	**4,154**
Total capital	**5,288**	**5,174**
RWA (amounts)		
Total RWA	**24,128**	**24,036**
Capital ratios		
CET1 (as a percentage of RWA)	**14.9%**	**14.5%**
Tier 1 (as a percentage of RWA)	**17.7%**	**17.3%**
Total capital (as a percentage of RWA)	**21.9%**	**21.5%**
Leverage ratio		
Leverage ratio total exposure measure	**83,758**	**83,644**
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 75% in 2022, reducing to 50% in 2023 and 25% in 2024.

At 30 September 2022, £114m of IFRS 9 transitional adjustments (2021: £134m) have been applied to the Group's capital position in accordance with CRR: £7m of static and £107m of dynamic adjustments (2021: £10m static and £124m 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. The table below summarises the amount of capital in relation to RWA the Group is currently required to hold, excluding any PRA buffer.

	2022	
Minimum Requirements	**CET1**	**Total Capital**
Pillar 1[(1)]	**4.5%**	**8.0%**
Pillar 2A	**1.7%**	**3.1%**
Total Capital Requirement	**6.2%**	**11.1%**
Capital conservation buffer	**2.5%**	**2.5%**
UK countercyclical capital buffer	**0.0%**	**0.0%**
Total (excluding PRA buffer)[(2)]	**8.7%**	**13.6%**

(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.

The Group continues to maintain a significant surplus above its capital requirements. At September the Group maintained CET1 capital in excess of its requirements equal to 6.2% of RWAs (equivalent to £1.5bn).

The PRA sets a Group specific Pillar 2A requirement for risks which are not captured within the Pillar 1 requirement. Together Pillar 1 and Pillar 2A represent the Group's Total Capital Requirement or TCR, which is the minimum requirement which must be met at all times. During the year the PRA updated the Group's Pillar 2A requirement to £744m. This represents a material reduction in Pillar 2A from 30 September 2021 of £209m. At September 2022 this resulted in a TCR of 11.1% of RWAs (equivalent to £2,674m) of which 6.2% must be met with CET1 capital (equivalent to £1,504m).

Capital risk (continued)

In October 2022 the PRA communicated an update to the Group's Pillar 2A requirement setting it as 2.97% of RWAs, of which 1.67% must be met with CET1 capital. In line with previous guidance this requirement has been set as a percentage of RWAs, rather than the fixed nominal Pillar 2A requirements set during 2020 and 2021 in response to COVID-19. Applying this updated requirement as at 30 September 2022 would result in a modest reduction in total capital requirements of £27m and CET1 requirements of £15m.

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 and mitigate against firm specific and systemic risks. The UK has implemented the provisions on capital buffers outlined in CRD IV which introduced a combined capital buffer. This includes a Capital Conservation Buffer, a Countercyclical Capital Buffer (CCyB) and where applicable a Global Systemically Important Institution (G-SII) Buffer or an Other Systemically Important Institutions (O-SII) Buffer.

The Group's countercyclical capital buffer reflects an exposure weighted average of the CCyB rates applicable in the geographies the Group operates in. Currently this reflects only the UK. In December 2021, the FPC announced it felt that domestic risks to UK financial stability have returned to around their pre-COVID levels. It subsequently provided guidance that the UK CCyB rate would increase to 1%, effective December 2022, rising to 2% from July 2023 to align with its guidance for the CCyB rate under standard risk conditions. The FPC has noted the considerable uncertainties in relation to the economic outlook and will continue to monitor the situation and stands ready to vary the UK CCyB rate – in either direction – in line with the evolution of economic conditions, underlying vulnerabilities and the overall risk environment.

Currently, the Group does not meet the criteria for the application of either a global or domestic systemically important institution buffer.

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	**2022** **£m**	2021 £m
Total capital resources[(1)(2)]	**5,288**	5,294
Eligible senior unsecured securities issued by Clydesdale Bank PLC[(2)]	**2,423**	2,408
Total MREL resources	**7,711**	7,702
Risk-weighted assets	**24,128**	24,194
Total MREL resources available as a percentage of risk-weighted assets	**32.0%**	31.8%
UK leverage exposure measure	**83,758**	83,402
Total MREL resources available as a percentage of UK leverage exposure measure	**9.2%**	9.2%

(1) The capital position reflects the application of the transitional arrangements for IFRS9.
(2) Includes MREL instrument maturity adjustments; the add-back of regulatory amortisation and the deduction of instruments with less than one year to maturity. From September 2022, unamortised costs are also deducted from eligible senior unsecured securities.

CB is a material subsidiary of VMUK and as such the BoE in its capacity as the UK Resolution Authority can set an 'Internal MREL'. CB's internal MREL is set equal to the greater of two times its Total Capital Requirement (TCR) or 6.5% of its leverage exposure measure. In addition to MREL, CB must also hold any applicable capital buffers, which together with MREL represent CB's loss-absorbing capacity (LAC) requirement.

As at 30 September 2022 CB's MREL resources were £7.7bn (FY21: £7.7bn), equivalent to 32.0% of its RWAs (FY21: 31.8%). This provides prudent headroom of £1.7bn or 7.1% above LAC requirement of 24.9%.

Dividend

The Board has recommended a final dividend for the financial year ended 30 September 2022 of 0.85p per share.

Capital risk (continued)

Leverage

Leverage ratio	2022 £m	2021 £m
Total Tier 1 capital for the leverage ratio		
Total CET1 capital	**3,606**	3,603
AT1 capital	**662**	672
Total Tier 1 capital	**4,268**	4,275
Exposures for the leverage ratio		
Total assets as per published financial statements	**92,010**	89,216
Adjustment for off-balance sheet items	**3,204**	2,884
Adjustment for derivative financial instruments	**282**	91
Adjustment for securities financing transactions	**2,974**	2,235
Adjustment for qualifying central bank claims	**(11,955)**	(9,094)
Other adjustments	**(2,757)**	(1,930)
UK leverage ratio exposure[1]	**83,758**	83,402
UK leverage ratio[1][2]	**5.1%**	5.1%
Average UK leverage ratio exposure[3]	**83,919**	83,206
Average UK leverage ratio[3]	**5.0%**	5.0%

(1) As the UK leverage ratio is now the single leverage ratio exposure measure, the analysis of the CRD IV leverage ratio has been replaced with the UK equivalent for this period and the comparative.
(2) IFRS 9 transitional capital arrangements have been applied to the leverage ratio calculation.
(3) The transitional average leverage exposure measure is based on the daily average of on-balance sheet items and month-end average of off-balance sheet and capital items over the quarter (1 July 2022 to 30 September 2022).

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 PRA simplified the leverage framework from 1 January 2022 with UK banks now subject to a single UK leverage ratio exposure measure. The CRD IV leverage ratio is no longer applicable to UK banks.

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

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

- capital: Tier 1 capital defined on an 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 PRA regulations 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 UK leverage ratio of 5.1% (2021: 5.1%) exceeds the UK minimum ratio of 3.25%.

Funding and liquidity risk

Funding risk occurs when 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 TFSME, both schemes introduced to support the UK through periods of instability.

Funding risk exposures arise from an unsustainable or undiversified funding base, for example, a reliance on short-term wholesale deposits. The risk may result in deviation from funding strategy, 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 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 and TFSME. TFSME was launched in April 2020 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. During 2022, the Group repaid the remaining outstanding TFS amounts.

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 2022:

	2022 £m	2021 £m
Total assets	**92,010**	89,216
Less: Other liabilities[1]	**(6,332)**	(6,504)
Funding requirement	**85,678**	82,712
Funded by:		
Customer deposits	**65,434**	66,971
Debt securities in issue	**5,347**	4,241
Due to other banks	**8,486**	5,918
of which:		
Secured loans	***7,230***	*5,896*
Securities sold under agreements to repurchase	***1,205***	*-*
Transaction balances with other banks	***1***	*-*
Deposits with other banks	***50***	*22*
Equity	**6,411**	5,582
Total funding	**85,678**	82,712

(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 2022, the Group had a funding requirement of £85,678m (2021: £82,712m) 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 £65,434m (30 September 2021: £66,971m). Customer deposits comprise interest-bearing deposits, term deposits and non-interest-bearing demand deposits from a range of sources including Personal and Business customers. Throughout the year, funding has been managed at a level to support customer lending, with a higher proportion from wholesale, including usage of TFSME and reduced volumes of customer deposits.

Equity

Equity of £6,411m (2021: £5,582m) 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 decreased from 149% to 138% during the year and remains comfortably above regulatory and internal risk appetite.

LCR (audited)	2022 £m	Restated 2021[1] £m
Eligible liquidity buffer	**13,139**	10,996
Net stress outflows	**9,537**	7,369
Surplus	**3,602**	3,627
LCR	**138%**	149%

(1) In the prior year, certain business customer deposits were incorrectly classified as Corporates, as opposed to Financial Institutions. Due to the different liquidity outflow assumptions applied, this resulted in net outflows being understated by £80m and the LCR overstated by 2%. These deposits have been reclassified as Financial Institutions and the prior year comparative has been updated to align with the current year presentation.

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 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 2022, 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)	2022 £m	2021 £m	Change %	Average 2022 £m	Average 2021 £m
Level 1					
Cash and balances with central banks	**9,795**	7,060	**38.7**	**7,632**	7,232
UK Government treasury bills and gilts	**512**	771	**(33.6)**	**905**	779
Other debt securities	**2,827**	3,239	**(12.7)**	**2,993**	3,296
Total level 1	**13,134**	11,070	**18.6**	**11,530**	11,307
Level 2[2]	**117**	23	**408.7**	**32**	24
Total LCR eligible assets	**13,251**	11,093	**19.5**	**11,562**	11,331

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

Cash and balances with central banks of £12,211m, as per note 3.4, include: £2,094m of assets that are encumbered to support the issuance of Scottish bank notes (excluding notes not in circulation) and to support payments systems; £266m of mandatory central bank deposits; and £62m excluded from LCR to cover operating expenses.

Financial assets at FVOCI of £5,064m, as per note 3.7, include: £1,535m of encumbered UK government treasury bills and gilts, £317m of which is encumbered to support Operational Continuity in Resolution.

The NSFR was implemented by the PRA on 1 January 2022 based on Basel standards. The ratio as at 30 September 2022 is 136% (2021: 134%) comfortably in excess of the binding minimum requirement of 100%.

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. 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 TFSME scheme, 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)

2022	Assets encumbered with non Central Bank counterparties				Other assets					
						Assets not positioned at the Central Bank				
	Covered Bonds £m	Securitisations £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
Total loans and advances to customers	**4,268**	**4,620**	**-**	**8,888**	**14,879**	**28,648**	**17,051**	**2,353**	**62,931**	**71,819**
Cash and balances with central banks	**-**	**-**	**-**	**-**	**2,879**	**9,342**	**-**	**-**	**12,221**	**12,221**
Due from other banks	**67**	**305**	**269**	**641**	**-**	**-**	**15**	**-**	**15**	**656**
Derivative financial instruments	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**342**	**342**	**342**
Financial instruments at FVOCI	**-**	**-**	**1,535**	**1,535**	**-**	**3,529**	**-**	**-**	**3,529**	**5,064**
All other assets	**-**	**-**	**40**	**40**	**-**	**-**	**216**	**1,652**	**1,868**	**1,908**
Total	**4,335**	**4,925**	**1,844**	**11,104**	**17,758**	**41,519**	**17,282**	**4,347**	**80,906**	**92,010**

2021	Assets encumbered with non Central Bank counterparties				Other assets					
						Assets not positioned at the Central Bank				
	Covered Bonds £m	Securitisations £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
Total 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
All 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

Risk report (continued)
Financial risk (continued)

Funding and liquidity risk (continued)

The Group's total non-central bank asset encumbrance increased by £1,896m to £11,104m as at 30 September 2022. This was primarily due to an increase in encumbered mortgages, supporting Covered Bond funding.

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 2022	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Assets							
Financial assets at amortised cost							
Loans and advances to customers	**764**	**2,378**	**1,017**	**7,241**	**55,053**	**5,296**	**71,749**
Cash and balances with central banks	**11,015**	**-**	**-**	**-**	**-**	**1,206**	**12,221**
Due from other banks	**575**	**81**	**-**	**-**	**-**	**-**	**656**
Financial assets at FVTPL							
Loans and advances to customers	**-**	**2**	**1**	**21**	**46**	**-**	**70**
Derivative financial instruments	**2**	**46**	**71**	**190**	**33**	**-**	**342**
Other financial assets at fair value	**-**	**-**	**-**	**-**	**-**	**2**	**2**
Due from related entities	**-**	**4**	**-**	**-**	**-**	**-**	**4**
Financial assets at FVOCI	**-**	**620**	**602**	**1,917**	**1,925**	**-**	**5,064**
Other assets	**-**	**7**	**150**	**1**	**1**	**1,743**	**1,902**
Total assets	**12,356**	**3,138**	**1,841**	**9,370**	**57,058**	**8,247**	**92,010**
Liabilities							
Financial liabilities at amortised cost							
Customer deposits	**48,750**	**3,786**	**10,209**	**2,689**	**-**	**-**	**65,434**
Debt securities in issue	**-**	**466**	**599**	**3,974**	**308**	**-**	**5,347**
Due to other banks	**51**	**285**	**250**	**7,900**	**-**	**-**	**8,486**
Financial liabilities at FVTPL							
Derivative financial instruments	**3**	**9**	**29**	**253**	**33**	**-**	**327**
Due to related entities	**55**	**19**	**448**	**2,688**	**-**	**-**	**3,210**
Other liabilities	**1,822**	**135**	**134**	**54**	**59**	**591**	**2,795**
Total liabilities	**50,681**	**4,700**	**11,669**	**17,558**	**400**	**591**	**85,599**
Off balance sheet items							
Financial guarantees	**-**	**33**	**23**	**12**	**44**	**-**	**112**
Other credit commitments	**19,247**	**-**	**-**	**-**	**-**	**-**	**19,247**
Total off-balance sheet items	**19,247**	**33**	**23**	**12**	**44**		**19,359**

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

Funding and liquidity risk (continued)

Group 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	1,966	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)

Assets and liabilities by maturity (continued)

Bank 30 September 2022	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	**764**	**2,363**	**1,006**	**7,125**	**54,288**	**5,296**	**70,842**
Cash and balances with central banks	**11,015**	**-**	**-**	**-**	**-**	**1,206**	**12,221**
Due from other banks	**268**	**-**	**-**	**-**	**-**	**-**	**268**
Financial assets at FVTPL							
Loans and advances to customers	**-**	**2**	**1**	**21**	**46**	**-**	**70**
Derivative financial instruments	**2**	**14**	**71**	**190**	**33**	**-**	**310**
Other financial assets at fair value	**-**	**-**	**-**	**-**	**-**	**1**	**1**
Due from related entities	**868**	**11**	**169**	**-**	**-**	**49**	**1,097**
Financial assets at FVOCI	**-**	**620**	**602**	**1,917**	**1,925**	**-**	**5,064**
Other assets	**-**	**8**	**153**	**1**	**1**	**1,778**	**1,941**
Total assets	**12,917**	**3,018**	**2,002**	**9,254**	**56,293**	**8,330**	**91,814**
Liabilities							
Financial liabilities at amortised cost							
Customer deposits	**48,750**	**3,786**	**10,209**	**2,689**	**-**	**-**	**65,434**
Debt securities in issue	**-**	**4**	**13**	**3,611**	**-**	**-**	**3,628**
Due to other banks	**51**	**285**	**250**	**7,900**	**-**	**-**	**8,486**
Financial liabilities at FVTPL							
Derivative financial instruments	**3**	**9**	**29**	**118**	**33**	**-**	**192**
Due to related entities	**546**	**93**	**591**	**3,637**	**74**	**-**	**4,941**
Other liabilities	**1,822**	**134**	**127**	**54**	**59**	**590**	**2,786**
Total liabilities	**51,172**	**4,311**	**11,219**	**18,009**	**166**	**590**	**85,467**
Off balance sheet items							
Financial guarantees	**-**	**33**	**23**	**12**	**44**	**-**	**112**
Other credit commitments	**19,204**	**-**	**-**	**-**	**-**	**-**	**19,204**
Total off-balance sheet items	**19,204**	**33**	**23**	**12**	**44**		**19,316**

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

Risk report (continued)
Financial risk (continued)

Funding and liquidity risk (continued)

Assets and liabilities by maturity (continued)

Bank 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)

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

Group 2022	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	**48,750**	**3,801**	**10,291**	**2,732**	**-**	**-**	**65,574**
Debt securities in issue	**-**	**488**	**764**	**4,627**	**315**	**-**	**6,194**
Due to other banks	**51**	**288**	**492**	**8,793**	**-**	**-**	**9,624**
Financial liabilities at FVTPL							
Trading derivative liabilities	**-**	**12**	**40**	**63**	**14**	**-**	**129**
Hedging derivative liabilities							
Contractual amounts payable	**-**	**21**	**557**	**1,720**	**-**	**-**	**2,298**
Contractual amounts Receivable	**-**	**(6)**	**(459)**	**(1,477)**	**-**	**-**	**(1,942)**
Due to related entities	**55**	**33**	**531**	**3,238**	**-**	**-**	**3,857**
All other financial liabilities	**1,822**	**135**	**134**	**54**	**59**	**591**	**2,795**
Total liabilities	**50,678**	**4,772**	**12,350**	**19,750**	**388**	**591**	**88,529**

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

Funding and liquidity risk (continued)

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

Bank 2022	**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	**48,750**	**3,801**	**10,291**	**2,732**	**-**	**-**	**65,574**
Debt securities in issue	**-**	**16**	**127**	**3,967**	**-**	**-**	**4,110**
Due to other banks	**51**	**288**	**492**	**8,793**	**-**	**-**	**9,624**
Financial liabilities at FVTPL							
Trading derviative financial instruments	**-**	**12**	**40**	**63**	**14**	**-**	**129**
Hedging derivative liabilities							
Contractual amounts payable	**-**	**2**	**501**	**520**	**-**	**-**	**1,023**
Contractual amounts Receivable	**-**	**(6)**	**(448)**	**(466)**	**-**	**-**	**(920)**
Due to related entities	**546**	**111**	**714**	**4,343**	**76**	**-**	**5,790**
All other financial liabilities	**1,822**	**134**	**127**	**54**	**59**	**590**	**2,786**
Total liabilities	**51,169**	**4,358**	**11,844**	**20,006**	**149**	**590**	**88,116**

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							
Trading derivative financial instruments	-	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

The balances in the cash flow tables above do not agree directly to the balances in the balance sheets or the assets and liabilities by maturity tables presented above, as the tables incorporate 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 2022 £m	Total 2021 £m
Covered bonds	**4**	**13**	**3,450**	**-**	**3,467**	1,852
Securitisation	**462**	**586**	**524**	**308**	**1,880**	2,389
Total debt securities in issue	**466**	**599**	**3,974**	**308**	**5,347**	4,241

External credit ratings

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

	Outlook as at	As at	
Material risk for the Group	**30 Sep 2022**[(1)]	**30 Sep 2022**	30 Sep 2021
Virgin Money UK PLC			
Moody's	**Stable**	**Baa1**	Baa2
Fitch	**Stable**	**BBB+**	BBB+
Standard & Poor's	**Stable**	**BBB-**	BBB-
Clydesdale Bank PLC			
Moody's[(2)]	**Stable**	**A3**	Baa1
Fitch	**Stable**	**A-**	A-
Standard & Poor's	**Stable**	**A-**	A-

(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 March 2022, Standard & Poor's affirmed Virgin Money UK PLC's and Clydesdale Bank PLC's ratings with stable outlook, reflecting their view that the Group will maintain a sound capital position, deliver statutory profit for full-year 2022 and maintain strong asset quality metrics. This rating reflects the agencies view of the UK economy at the time, coupled with the Group's improving asset quality outlook, conservative risk appetite and robust provisioning.

In June 2022, Moody's upgraded the long-term ratings of Virgin Money UK PLC and Clydesdale Bank PLC by 1-notch, reflecting the closure of PPI, finalisation of integration, stable asset quality during the pandemic and strong allowance against loan losses, sound funding & liquidity position and new long-term CET1 target of 13-13.5%. At the same time Moody's reaffirmed the 'Stable' outlook on all of Virgin Money UK PLC's and Clydesdale Bank PLC's ratings.

In July 2022, Fitch affirmed the ratings of Virgin Money UK PLC and Clydesdale Bank PLC with 'Stable' outlook.

As at 20 November 2022, 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.

Exposures

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, for example, the right to repay borrowing in advance of contractual maturity dates.

The Group provides 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. 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.

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, value at risk (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 ten-year history set with a one-year holding period;
- economic value of equity is measured in line with the PRA Rulebook with all six interest rate shock scenarios assessed on a quarterly basis, including customer optionality stresses. Reporting is performed 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;
- credit spread risk in the Banking Book (CSRBB) is assessed through VaR applied to the Group's liquid asset buffer portfolio; and
- CSRBB is measured at a 99% confidence level based on daily spread movements over a ten-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. Treasury uses a number of techniques and products to manage market risks including interest rate swaps, cash flow netting and foreign exchange.

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 risk. The interest risk arises from variable interest rate assets and liabilities which are hedged using interest rate swaps. There were no transactions for which cash flow hedge accounting had to be discontinued in the year as a result of the highly probable cash flows no longer being expected to occur. The fair value of derivatives is disclosed 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[1]		Credit spread	
	2022	2021	**2022**	2021
Value at Risk (audited)	**£m**	£m	**£m**	£m
As at 30 September	**17**	2	**41**	45
Average value during the year	**19**	2	**48**	48
Minimum value during the year	**14**	1	**41**	45
Maximum value during the year	**27**	3	**52**	52

(1) The history set for duration risk VaR was increased from two years to ten years and the holding period increased from one day to one year from 1 October 2021 under internal methodology. This results in the significant increase in the reported risk positions year on year with the change in parameters resulting in larger rate shocks applied in the VaR analysis .

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 and +/-100 basis point shocks represents the primary NII sensitivity assessed internally, though a range of scenarios are assessed on a monthly basis.

12 months NII sensitivity	**2022 £m**	2021 £m
+ 25 basis point parallel shift	**18**	30
+ 100 basis point parallel shift	**66**	100
- 25 basis point parallel shift	**5**	(23)

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.

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:

	2022 £m	2021 £m	**Interest rate duration**	**Optionality**	**Basis**	**Credit Spread**	**Foreign Exchange**
Assets							
Financial assets at amortised cost							
Loans and advances to customers	**71,749**	71,874	●	●	●		●
Cash and balances with central banks	**12,221**	9,711	●		●		
Due from other banks	**656**	800	●		●		●
Financial assets at FVTPL							
Loans and advances to customers	**70**	133	●	●	●		●
Derivative financial instruments	**342**	140	●		●		●
Other financial assets	**2**	16	●				●
Financial instruments at FVOCI	**5,064**	4,352	●		●	●	●
Other assets	**1,906**	2,190	●				●
Total assets	**92,010**	89,216					
Liabilities							
Financial liabilities at amortised cost							
Customer deposits	**65,434**	66,971	●	●	●		●
Debt securities in issue	**5,347**	4,241	●		●		●
Due to other banks	**8,486**	5,918	●		●		●
Financial liabilities at FVTPL							
Derivative financial instruments	**327**	209	●		●		●
Other liabilities	**6,005**	6,295	●				●
Total liabilities	**85,599**	83,634					

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.

Group 2022	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	**7,293**	**8,796**	**13,234**	**41,514**	**1,699**	**(787)**	**71,749**
Cash and balances with central banks	**10,765**	**12**	**37**	**196**	**-**	**1,211**	**12,221**
Due from other banks	**656**	**-**	**-**	**-**	**-**	**-**	**656**
Financial assets at FVTPL							
Loans and advances to customers	**-**	**30**	**4**	**16**	**20**	**-**	**70**
Derivative financial instruments	**-**	**-**	**-**	**-**	**-**	**342**	**342**
Due from related entities	**4**	**-**	**-**	**-**	**-**	**-**	**4**
Financial instruments at FVOCI	**1,265**	**525**	**320**	**1,159**	**1,733**	**62**	**5,064**
Other assets	**40**	**38**	**113**	**604**	**-**	**1,109**	**1,904**
Total assets	**20,023**	**9,401**	**13,708**	**43,489**	**3,452**	**1,937**	**92,010**
Liabilities							
Financial liabilities at amortised cost							
Customer deposits	**7,026**	**18,725**	**13,449**	**26,077**	**-**	**157**	**65,434**
Debt securities in issue	**3,606**	**191**	**-**	**1,663**	**-**	**(113)**	**5,347**
Due to other banks	**8,438**	**12**	**-**	**-**	**-**	**36**	**8,486**
Financial liabilities at FVTPL							
Derivative financial instruments	**-**	**-**	**-**	**-**	**-**	**327**	**327**
Due to related entities	**-**	**-**	**432**	**3,023**	**-**	**(245)**	**3,210**
Other liabilities	**1,717**	**-**	**-**	**-**	**-**	**1,078**	**2,795**
Equity	**-**	**264**	**573**	**3,306**	**350**	**1,918**	**6,411**
Total liabilities and equity	**20,787**	**19,192**	**14,454**	**34,069**	**350**	**3,158**	**92,010**
Off balance sheet items							
Notional value of derivatives managing interest rate sensitivity	**16,448**	**(359)**	**(239)**	**(12,146)**	**(3,704)**	**-**	**-**
Total interest rate gap	**15,684**	**(10,150)**	**(985)**	**(2,726)**	**(602)**	**(1,221)**	**-**
Cumulative interest rate gap	**15,684**	**5,534**	**4,549**	**1,823**	**1,221**	**-**	**-**

Risk report (continued)
Financial risk (continued)

Market risk (continued)

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

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	-	-

Market risk (continued)

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

Bank 2022	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	**7,293**	**7,877**	**13,234**	**41,514**	**1,699**	**(775)**	**70,842**
Cash and balances with central Banks	**10,765**	**12**	**37**	**196**	**-**	**1,211**	**12,221**
Due from other banks	**268**	**-**	**-**	**-**	**-**	**-**	**268**
Financial assets at FVTPL							
Loans and advances to customers	**-**	**30**	**4**	**16**	**20**	**-**	**70**
Derivative financial instruments	**-**	**-**	**-**	**-**	**-**	**310**	**310**
Due from related entities	**-**	**1,109**	**-**	**-**	**-**	**(12)**	**1,097**
Financial instruments at FVOCI	**1,265**	**525**	**320**	**1,159**	**1,733**	**62**	**5,064**
Other assets	**40**	**38**	**113**	**604**	**-**	**1,097**	**1,892**
Investment in related entities	**-**	**-**	**-**	**-**	**-**	**50**	**50**
Total assets	**19,631**	**9,591**	**13,708**	**43,489**	**3,452**	**1,943**	**91,814**
Liabilities							
Financial liabilities at amortised cost							
Customer deposits	**7,026**	**18,725**	**13,449**	**26,077**	**-**	**157**	**65,434**
Debt securities in issue	**1,950**	**-**	**-**	**1,663**	**-**	**15**	**3,628**
Due to other banks	**8,438**	**12**	**-**	**-**	**-**	**36**	**8,486**
Financial liabilities at FVTPL							
Derivative financial instruments	**-**	**-**	**-**	**-**	**-**	**192**	**192**
Due to related entities	**1,656**	**191**	**432**	**3,023**	**-**	**(361)**	**4,941**
Other liabilities	**1,717**	**-**	**-**	**-**	**-**	**1,069**	**2,786**
Equity	**-**	**264**	**573**	**3,306**	**350**	**1,854**	**6,347**
Total liabilities and equity	**20,787**	**19,192**	**14,454**	**34,069**	**350**	**2,962**	**91,814**
Off balance sheet items							
Notional value of derivatives managing interest rate	**16,448**	**(359)**	**(239)**	**(12,146)**	**(3,704)**	**-**	**-**
Total interest rate gap	**15,292**	**(9,960)**	**(985)**	**(2,726)**	**(602)**	**(1,019)**	**-**
Cumulative interest rate gap	**15,292**	**5,332**	**4,347**	**1,621**	**1,019**	**-**	**-**

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	12,375	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)

LIBOR replacement

The Group's LIBOR cessation programme successfully met the 2021 GBP regulatory and industry milestones. Treasury proactively transitioned all external transactions across issuance, hedging and liquid assets and over 90% of Business Lending customer transactions also switched from LIBOR to alternative reference rates (ARRs), with numbers continuing to reduce.

The Group engaged with the BoE's Working Group on Sterling Risk Free Reference Rates and other industry forums in transitioning to SONIA/ARRs and ensured the risks of being unable to offer products with suitable reference rates are mitigated and that full consideration is given to the other risks, including legal, conduct, financial and operational risks, that may arise.

As at 30 September 2022, all market-facing derivative flows are executed against SONIA. The focus for 2023 is ongoing management of the small business lending tough legacy and USD cohort. Processes have been implemented to ensure continued effort to move customers off synthetic LIBOR to ARRs throughout 2022.

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

Amounts yet to be transitioned (audited)

30 September 2022	**Non derivative financial assets - carrying value[1][2] £m**	**Non derivative financial liabilities - carrying value £m**	**Derivatives - nominal amount[1][3] £m**
GBP LIBOR	**94**	**-**	**67**
Other[4]	**164**	**-**	**-**
Cross currency swaps			
GBP LIBOR to USD LIBOR			**-**
Total	**258**	**-**	**67**

30 September 2021	Non derivative financial assets - carrying value[1][2] £m	Non derivative financial liabilities - carrying value £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 undrawn loan commitments shown as GBP LIBOR. This is materially the case although some facilities allow drawdowns in a number of different currencies.
(4) Comprises financial instruments referencing other IBOR rates yet to transition to alternative benchmark rates (Euro, USD, AUD).

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 defined benefit 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.

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 3.9 of the Group's consolidated financial statements. The fair value of the assets was £3.2bn as at 30 September 2022 (2021: £4.6bn).

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.

The actual outcome on Scheme valuations will also be affected by hedging and investment decisions made by the Trustees and inflationary caps within the terms of the Scheme.

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.

Pension risk (continued)

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.

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 3.9 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, for example, approaches for hedging against longevity risk.

Monitoring

Information on the Scheme's current valuations, asset holdings and discount and inflation rate assumptions are presented 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.

The Scheme's de-risking plan has delivered resilience to stress-testing and continued improvements in Group and Trustee valuations.

Liability Driven Investment (LDI) portfolios are commonly used by pension schemes to protect against adverse movements in interest rates and inflation. In the case of interest rates, this protects against falls in rates which increase the value of a scheme's liabilities. The general trend since LDI strategies were introduced has been long-term interest rates falling, and LDI has helped schemes to maintain more stable and improved funding positions. However, when interest rates rise instead of fall, LDI derivatives require collateral to be posted in order to maintain the same level of interest rate and inflation protection. Therefore sufficient liquidity is needed to meet such a collateral call.

Within the Scheme's matching assets there is an LDI portfolio, which consists of both physical assets and derivatives. The Scheme uses a bespoke, segregated strategy which reflects, as far as possible, the specifics of the Scheme's liabilities in terms of exposure to movements in interest rates and inflation. As at 30 September 2022, the LDI portfolio was valued at £968m.

Over the year to 30 September 2022, gilt yields have risen significantly. The Scheme therefore posted additional collateral, resulting in there being net £335m collateral posted by the Scheme as at 30 September 2022 (compared to net £65m collateral posted by the counterparties as at 30 September 2021). As at 30 September 2022, the Scheme is still estimated to have sufficient collateral headroom available to meet further rises in interest rates of more than 3%. The Scheme also has over £1bn of further assets which could be liquidated within a week if needed to meet collateral calls.

Although increased collateral postings have been required, the Scheme's funding position for IAS 19 purposes has improved over the year to 30 September 2022. The IAS 19 position continues to drive the Group's Pillar 2A and regulatory stress testing processes.

The next Triennial Valuation is due to complete by end FY23 (effective date 30 September 2022). The Trustee funding position at 30 September 2022 is a surplus, indicating no further contributions will be required.

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 output that generates or supports decisions that impact customers directly or indirectly. This model definition also includes input data that are quantitative and/or qualitative in nature or expert judgement-based, and output that are quantitative or qualitative. It also considers broader aspects within the model environment which may represent distinct and separable entities or be intrinsically linked to model structures and are a sub-classification of the model definition.

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.

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. In turn, these factors could result in financial and reputational losses, as well as having a detrimental impact on customers or lead to the deterioration of the prudential position, non-compliance with required regulations, or to qualitative limitations such as the imposition of restrictions to business activities.

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 support the performance of models.

The Group's appetite for model risk is defined and articulated in the Group RAS. Model risk RAS metrics focus on model effectiveness and 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 Executive and Board Risk Committees 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, adopting the relevant regulating rules and guidance (e.g. Supervisory Statement SS11/13 Internal Ratings Based (IRB) approaches and the Capital Requirements Regulation - CRR). 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's model inventory contains information on all models and associated exposures. The inventory supports the prioritisation of business activities and informs senior management of the status of models with a particular focus on those models that can generate higher risk or have a greater impact.

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 model risk is assessed through RAS.

The Chief Risk Officer has been identified as the appropriate Senior Management Function role in line with the requirements set out in the Model Risk Management Policy Standard.

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 has been built in line with the policy, is implemented correctly and is used as intended or advising of exemptions. An annual attestation on IRB models is provided to the regulator.

The Model Risk Oversight function conducts independent 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 weaknesses or deficiencies 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 be limited.

Monitoring

Model monitoring functions perform periodic monitoring of model performance to ensure parameter estimates and model constructs remain fit for purpose 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, in line with the relevant monitoring frameworks.

MGC is the primary model approval authority and body, responsible for overseeing the framework used to manage model risk.

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.

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. 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 increase as consumer and regulatory expectations continue to rise and the country reacts to the macroeconomic outlook and associated cost of living pressures.

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 the new Consumer Duty;
- 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 monitoring framework, designed to monitor compliance with regulation and assess customer outcomes.
- continuing development of a customer-centric culture aligned to the Group's Purpose;
- ongoing review and tracking of known conduct issues and remediation actions being taken;
- a risk-based monitoring framework, designed to monitor compliance with regulation and assess customer outcomes; and
- a comprehensive plan, agreed by the Board, to implement the FCA's new Consumer Duty.

Monitoring

All three lines of defence consider conduct risk as part of their oversight and monitoring activities. A risk monitoring plan, approved annually by the Board Risk Committee, independently assesses the control framework underpinning the Group's conduct risk management to ensure customers are receiving good outcomes 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.

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 Group and its customers transition to digital channels, and with the significant changes in customer journeys and behaviours that evolved during the pandemic and the recent macro-economic environment. The FCA's new Consumer Duty, sets a new regulatory standard for conduct, which comes into force in July 2023.

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. 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 bodies;
- 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 monitoring framework, designed to monitor compliance with regulation and assess customer outcomes.
- a comprehensive plan agreed, agreed by the Board, to implement the FCA's new Consumer Duty regulation.

Monitoring

All three lines of defence consider conduct risk as part of their oversight and monitoring activities. A risk monitoring 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 receiving good outcomes 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.

Operational and resilience risk

Operational and resilience risk is the risk of loss or customer harm resulting from inadequate or failed internal processes, people and systems or from external events, incorporating the inability to maintain critical services, recover quickly and learn from unexpected/adverse 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 framework 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 and resilience risk, with oversight from the Risk function, and independent assurance activities undertaken by Internal Audit. A new Operational Risk Committee has been established to provide oversight of the Group's risks, risk appetite, policy compliance and risk management framework and to better support the Executive Risk Committee.

Operational resilience is an outcome that benefits from the effective management of operational risk. Activities this year have seen the identification and mapping of our 11 Important Business Services and setting of impact tolerances. Ongoing work will further refine mapping activity and stress testing requirements.

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 and resilience 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 and resilience 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 and resilience 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 significant and material 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 more 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 RMF and oversight approach, with ongoing performance management and assurance is undertaken, to ensure supplier relationships are controlled effectively..

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 93% of the total. This category’s higher volume of low-value events is in line with the industry and relates mainly to card fraud, online fraud and scams. ‘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	
	2022	2021	**2022**	2021
Business disruption and system failures[2]	**0.8%**	1.6%	**0.6%**	3.7%
Clients, products and business practices	**1.0%**	1.4%	**3.9%**	0.9%
Damage to physical assets(	**1.7%**	1.4%	**1.7%**	1.7%
Execution, delivery and process management	**2.6%**	9.4%	**8.0%**	24.8%
External fraud	**93.6%**	86.2%	**85.3%**	68.9%
Internal fraud	**0.3%**	-	**0.5%**	-

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

(2) Figures may not match those presented in 2021, as historical loss amounts can change due to recoveries made.

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 and resilience 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 and cyber risk

Technology risk, incorporating Information Security and Cyber Risk, is defined as the risk of loss resulting from inadequate or failed information technology processes through strategy, design, build or run components internally or externally provisioned. It includes IT Resilience as well as Cyber and Information Security.

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 & Resilience is responsible for ensuring robust cyber and information security policies and controls are in place and operating effectively. This includes threat intelligence, education and awareness; and assurance of controls within the Group and our third parties. Our Security Operations Centre provides 24/7 monitoring and alerting in order that any security threats are quickly detected and addressed.
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 Information Security & Resilience 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. The Group maintains and tests critical end-to-end business recovery and contingency plans in the event that there is a system outage.

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. Our strategic plan is to move to Payments as a Service which is being driven through the Payment Infrastructure Project. This will support successful implementation of required industry changes whilst improving the resilience of our 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.
Data management	Data underpins decision making at all levels of the organisation. Poor-quality data can lead to loss, customer disruption, potential misrepresentation in Regulatory Reporting 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 data management industry standards and GDPR requirements.

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, 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. During onboarding and throughout the customer relationship, financial crime risk is assessed and used to apply an appropriate level of due diligence.

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 application of the Group's Board-approved fraud risk management framework seeks to manage customer disruption and fraud exposure and to keep fraud losses within an acceptable risk appetite, which is approved by the Board.

Internal fraud
The Group has no appetite for internal fraud.

Exposures

Financial crime and fraud risks are 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, financial crime prevention manual, and supporting technical standards, the content of which is provided by financial crime and fraud risk team 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 the recent successful implementation of Confirmation of Payee for our customers;
- ongoing assessment of evolving regulatory policy requirements and ensuring the Group responds accordingly; and
- regular oversight and review of systems, controls and higher risk activities and customers takes place as part of a formal oversight plan

Monitoring

The three lines of defence play a key role in managing financial crime and fraud risk. This includes operational monitoring activities such as: financial crime screening and due diligence; fraud detection and customer support processes; independent oversight and risk monitoring of risk appetite and the effectiveness of the financial crime control framework; governance and standard setting; training; and reporting to the competent authorities, as well as through internal governance fora, such as Executive Risk Committee and the Board.

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.

Exposures

Inflationary pressures are contributing towards a cost of living crisis, which alongside low economic growth, could impact customer resilience and consequently debt affordability. These risks in aggregate present risks to the strategic plan and the Group's ability to grow. The Group has considered this uncertainty and potential challenges as part of the FY23 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, along with the 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. 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. Our Purpose of Making you happier about money underpins this activity. The planning process for FY23 projects are overseen by the Risk function to ensure a balanced portfolio within the funding available.

Monitoring

A range of financial and non-financial metrics, including RoTE, lending growth, customer acquisition, NIM, and others, are KPIs 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 are reported to the Board Risk Committee and the Board 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 'A Life More Virgin' programme brings our colleagues more choice, control and flexibility to live and work how they choose, while fostering a diverse culture. This engages and encourages colleagues to deliver customer-focused outcomes with a clear set of supporting Values and Behaviours and is an important element in mitigating people risk.

Risk appetite

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.

Climate risk

Climate risk is the exposure to physical and transition risks arising from climate change.

Risk appetite

The Group accepts a level of climate risk in conducting its business. The Group is building tools and increasing data capabilities to support climate risk assessment and, therefore, we expect risk appetite metrics and limits to continue to evolve.

Exposures

Physical risks arise from longer term changes in the climate and weather-related events, rising average temperatures, heatwaves, droughts, floods, storms, sea-level rise, coastal erosion and subsidence. They can potentially result in large financial losses in respect of the Group's own properties or disrupt operations as well as impairing asset values and the financial position of borrowers or key third-party suppliers.

Transition risks arise from the adjustment towards a low-carbon economy and could lead to changes in appetite, strategy, policy, technology, and sentiment. These changes could prompt a reassessment of the value of a large range of assets and create increased financial exposures for the Group as the costs and opportunities arising from climate change become apparent. Reputation risks may also arise from a failure to meet changing and more demanding societal, investor or regulatory expectations.

Measurement

Climate risks are measured against Board-approved RAS metrics in addition to a suite of key risk indicators which monitor risk against appetite set by the wider climate risk policy framework.

The Group has developed core climate change scenario analysis capability to enhance our ability to identify climate-related risks and opportunities, and to assess the resilience of our business model.

Working with specialist third party data providers the Group has developed capability to identify a range of physical and transitional climate related risks within the Group's lending portfolio which is assessed on a periodic basis. The Bank will continue to develop its data as climate risk thinking evolves.

Mitigation

During 2022 climate risk was elevated to a principal risk which has resulted in establishing a specific climate risk policy framework. The framework outlines the Group's approach to the identification, management and monitoring of climate risk. The framework clearly defines and documents roles and responsibilities across the Group.

Monitoring

Climate risk is monitored and reported on a regular basis in Executive and Board Committees. During 2022, an Environment Committee was established to oversee the management of Environmental and Climate Change matters across the Group and is chaired and sponsored by the Chief Financial Officer.

Periodic monitoring of metrics is measured against the climate policy framework and strategic Group objectives. Risk provides oversight of the Group's development of its processes and systems developed to monitor and mitigate climate 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 2022.

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 2022.

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 3 to 11.

Our Purpose – Making you happier about money – guides our strategy and the Board is committed to putting it at the heart of everything Virgin Money does as a business and an employer, ensuring that the Board's own decisions are Purpose-led. Throughout the year, the Board heard how Purpose is driving the development of customer and colleague propositions and how we engage with wider society. For example, in response to the war in Ukraine, the Board was updated on the steps taken to make our bank account opening process easier for Ukrainian nationals arriving in the UK including how essential account opening documents have been translated into Ukrainian and Russian. The Chief Commercial Officer reported on how our propositions are being developed with financial well-being in mind and the Group Chief People & Communications Officer kept the Board informed on how the A Life More Virgin colleague proposition is evolving aimed at enabling colleagues to live their best lives, by having flexibility over how, when and where they work. The Board also took part in a deep dive session focusing on how Purpose is driving our community strategy and ensuring Virgin Money is a force for good. The 'Levelling Up Impact Report' launched by Virgin Money and the Purpose Coalition in May 2022 highlighted how we are using our Purpose to improve business performance while driving wider impact. As well as highlighting the strengths, the report outlined recommendations to deliver even more purposeful outcomes for our customers, colleagues and the communities we serve and the Board will continue to monitor the progress being made over the coming year.

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"
As at 30 September 2022, the Board comprised the Board Chair, two Executive Directors and four independent Non-Executive Directors. Sara Weller CBE joined the Board on 3 October 2022 as a 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 and 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, ensures that an inclusive process is followed when recruiting Board members which includes ensuring that the selection process is based on the principles of fairness and respect, that all appointments are made on the basis of individual competence and merit measured against objective selection criteria and that when recruiting Board members due regard is given to the benefits of diversity and inclusion. This includes considering differences in knowledge, skills and experience and also in age, gender, ethnicity, disability, educational, professional and socio-economic background and other distinctions between Directors such as cognitive and personal strengths 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 as part of the Board's committment to continuously improve its performance. The 2022 evaluation was conducted internally following the same process and covering broadly similar topics to FY21 enabling the Board to track progress in its effectiveness over the year. 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 Board Chair's performance involving all Non-Executive Directors and taking into account the views of Executive Directors. The Board Chair, 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.

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 Board Chair and each Board Committee Chair is responsible, with support from the Group Company Secretary, for the provision to each meeting of accurate and timely information.

The Board Chair 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. During the year collective Board training included externally facilitated sessions on cybercrime and ransomware attacks and on cloud computing and internally facilitated training to test the Bank's resolvability capabilities in relation to the BoE's Resolvability Assessment Framework. The Group Company Secretary maintains a training and development log for each Director. All Directors who join the Board receive a comprehensive induction tailored to a Director's individual requirements which the Group Company Secretary plans in consultation with the Board Chair.

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 2022 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 103.

Profits and appropriations

The Group made a profit before tax for the year ended 30 September 2022 of £590m (2021: £416m). The profit attributable to the shareholders for the year ended 30 September 2022 amounted to £460m (2021: £473m). Interim dividends totalling 2.83p (2021: 0.16p) per ordinary share amounting to £352m (2021: £20m) were paid by the Bank in respect of the year ended 30 September 2022. A final dividend in respect of the year ended 30 September 2022 of 0.85p (2021: 0.12p) per ordinary share in the Bank amounting to £106m (2021: £14m) is subject to the Virgin Money UK PLC shareholders approving the Virgin Money UK PLC dividend at the 2023 Annual General Meeting (AGM). 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 2.

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. The following Directors retired during the year:

- Paul Coby (30 June 2022)
- Amy Stirling (5 May 2022)

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 while 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 Group'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 Bank 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 Group fulfils its obligations to those impacted by the business. The Group's key stakeholders are set out below along with some examples of how the Group engages with them.

Customers
Throughout the past 12 months the Board has focused on the Group's continued roll-out of new and improved digitally led propositions as we continue our journey to be the UK's best digital bank and has received updates on new product launches and key performance metrics to monitor how they are being received by customers.

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

Customers (continued)

The Board is acutely aware of the current uncertainty around the economic outlook, with rising interest rates and inflation and recognises that higher living costs have the potential to create affordability issues. The Group is ready to support customers in light of the cost-of-living concerns. Our credit and debit cards offer cashback and our credit card instalment repayment option allowing customers to spread the cost of large purchases was introduced in February 2022. In August 2022 we announced the launch of the new market-leading credit card product, Virgin Money Slyce, which will allow customers to enjoy the benefits of a traditional buy now, pay later product in a simple, safe and responsible way. The Board heard how Slyce has been designed and built with a 'Gen Z' audience in mind having taken into account the feedback from the target market about the issues when being new to credit and seeking to build a credit score for the future. Recognising consumer concerns about rising costs of food and fuel, the Board was kept updated by the Chief Commercial Officer on how our current account offering was being refreshed to provide new customers switching to Virgin Money the opportunity to earn 25% cashback on UK supermarket and fuel spend for a period.

During the year the Board was updated at each meeting by the Chief Customer Experience Officer on the headway being made in digitising the processes that impact customers and monitored progress against our target to have 40% of our processes digitised by the end of FY22 – we exceeded this target by achieving 43%. Key milestones included the launch in May 2022 of our best-in-class future focused Digital Experience Centre aimed at anticipating our customers needs and helping them self-serve in-app and online; increased use of Chatbot functionality allowing Personal customers to get instant responses to their questions and, following feedback from customers, we now direct all fraud related calls to our team of fraud specialists ensuring that customers receive the right help at first point of contact.

As part of the digitisation programme, three customer journeys were prioritised during the year for additional focus and the Board monitored the implementation and ongoing improvements to these journeys covering opening a personal current account in-app, moving money and answering general queries using Chatbot and live chat. In monitoring progress, the Board spent time looking into the primary reasons for customer complaints and feedback obtained from customers via the 'Smile Score' where after each interaction customers are asked to rate how easy it is to transact with Virgin Money and whether the experience was a happy one. With this context, the Board challenged on the pace of the improvements being made across both the prioritised customer journeys and other customer service areas to drive better customer experience outcomes more quickly. As a result of these discussions, and also taking into regulatory expectations and the latest CMA Service Quality Indicators published in August 2022, the Board supported a funded customer service recovery plan, including funding for increased resources, to drive an improvement in complaint resolution and customer experience and also supported the Chief Executive Officer's proposal to focus on a narrower set of priorities to ensure resources are fully focused on improving customer experience while continuing to deliver on our digitally-led strategy.

The Board continued to be consulted on a number of digital initiatives including the development of our Digital Wallet, in partnership with Global Payments, which included giving feedback on an early prototype and discussing with the development team the functionality that will be available when the first iteration of the wallet is launched. Having heard from the Chief Commercial Officer on plans to transform the end-to-end mortgage journey in view of feedback from customers and mortgage brokers, the Board approved the financial investment in technology to provide a unified digital platform for mortgage customers and intermediaries which will expand and optimise our digital processing capability, allowing automated case tracking, improved processing times and extended market reach.

For our business customers, the Board was provided with updates on the response to the launch of M-Track, the new free business banking service and Marketplace, a facility which offers access to five specially chosen Fintech partners to cover a range of small business needs from insurance to HR. These propositions are part of the ecosystem that Virgin Money is developing offering digital services to help customers run their businesses successfully, designed following research and consultation with customer groups on the digital solutions that SME customers need.

While the Group continues its digital journey the Board remains focused on the treatment of our more vulnerable customers. For example, in considering our future Store strategy, the Board has discussed with the Chief Customer Experience Officer the plans for preserving access to cash for consumers, particularly the elderly, vulnerable and small businesses, including our support for the Community Access to Cash Pilots and involvement in the UK Finance Cash Action Group which is one of the ways we engage to understand the needs of customers and communities. The Board was also updated on the outcomes of an analysis of the customer base, including business customers, to identify customers most likely to experience detriment or potential customer harm from our digital transformation and supported the plans to establish a dedicated Hub to provide these customers with additional support.

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

Customers (continued)

The Board receives updates at each meeting from our Chief Commercial Officer and Chief Customer Experience Officer to ensure that they are abreast of current and planned initiatives and have a good awareness of how customers are interacting and responding to our products and services. These reports highlight what's gone well during the period, areas of focus and customer frustrations, and improvement activities that are under way. A focused Customer Complaints report is reviewed and discussed by the Board on a quarterly basis to spotlight trends and causes of complaints and to track progress against rectifying the origination of these trends.

Our Customer Experience Committee held its inaugural meeting in September 2021 and was established to review customer experience performance across the Group, to oversee the delivery of the Customer Experience Strategy, review performance outcomes and agree optimisation of resources and investment to deliver on our strategic priorities and the Board receive ongoing updates through monthly reporting.

The Board was kept updated throughout the year on how Virgin Money will address the new FCA Consumer Duty which will set higher and clearer standards of consumer protection across financial services and will require firms to put their customers' needs first, which is discussed in more detail in the Government and Regulators section on pages 101 - 102.

Board decision spotlight – 'Digital Brand and Marketing strategy'

The Board provided support for a new digitally-led Brand and Marketing strategy and closely monitored the execution and significant progress made on this new strategy during the year. At the centre of the strategy is a transformative shift in Brand and Marketing philosophy from a more traditional campaign approach to an always-on, insight-led approach with continuous optimisation across digital channels. The Board reinforced that the new strategy was an opportunity to bring to life the Group's Purpose of Making you happier about money by creating memorable digital experiences for customers that are unmistakeably Virgin in how they look, talk and feel.

The new strategy required the Group to embrace new partners, solutions and ways of working. The Board recognised the importance of this new strategy with almost all personal current account and business current account sales generated through digital channels. The new strategy has seen increased engagement on social media in both the numbers of customers reached and their level of engagement with the content being shared. Awareness and consideration of the Virgin Money brand showing significant and sustained improvement since the start of FY21 with both measures reaching historic highs during the year. The Board will continue to monitor progress towards further digitising the Group's Brand and Marketing activities as the delivery of modern money experiences accelerate and escalate.

Colleagues

The Board regards engagement with colleagues as key to the delivery of the Group's strategy and ambitions and a means of gauging how Purpose is embedding throughout Virgin Money.

The Remuneration Committee, Governance and Nomination Committee, together with the Board, receive regular updates from the workforce engagement sessions held throughout the year including themes arising from colleague feedback which the Board takes into account in its decision making.

In last years' Virgin Money UK PLC Annual Report and Accounts we described how the Board had been engaged on the development of our A Life More Virgin (ALMV) colleague proposition which was fully launched in January this year, and the Board has been kept updated since then on how the proposition has been received including hearing directly from colleagues through the Workforce Engagement Programme. The results of our annual MyVoice colleague engagement survey, which were reported to the Board by the Group Chief People and Communications Officer, evidence that colleagues value the changes introduced driving an improvement in the Sustainable Engagement score to 79%, improved from 68% in FY21. When asked about the one thing that colleagues value most about Virgin Money, most comments related to flexibility, working hours and work life balance with 90% of colleagues reporting that ALMV allows sufficient flexibility to meet personal and family needs. The ALMV proposition was also seen to have improved colleague empowerment and energy levels and to underpin a strong collaborative culture.

In response to feedback from colleagues, a new Career Journey Framework was launched in August 2022 as a further part of the ALMV proposition. The Remuneration Committee discussed and received regular updates on the development and roll-out of the new Career Journey Framework which delivers a new consistent, transparent and simplified approach to salary management and career progression. Career progression had also been raised as an area of focus through our Pulse and MyVoice surveys which the Career Journey Framework addresses by providing colleagues with a clear view on their roles today and the different routes they could take in order to build new experiences for the future. In response to colleague feedback about career development we launched our Career Development Hub this year which provides tools for colleagues to use proactively to create their own development opportunities and experiences, recognising that careers are not always linear and empowering colleagues to take advantage of different learning opportunities. This focus on self-development is backed up with regular career aspiration conversations during quarterly check-ins that all colleagues have with their people leader. Responding to feedback about how to improve the recruitment experience for people leaders and colleagues joining Virgin Money, or changing roles, we also launched a new Recruitment Hub providing all of the tools required for the recruitment life cycle and to ensure we are innovative, fair and inclusive when it comes to attracting and retaining talent.

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

Colleagues (continued)
The Remuneration Committee and Board, conscious of colleague concerns about the cost of living increases, approved a one-off payment of £1,000 to be made to colleagues on a salary of £50,000 or less. This was additional support following the pay increase award in January 2022, the launch of new ALMV proposition and access to the range of financial wellbeing tools offered, such as our Employee Assistance Programme and Virgin Money Minded which helps colleagues to think about and understand their relationship with money. The Board heard how these measures have made a difference to colleagues with 62% reporting in the 2022 MyVoice survey that their total reward package meets their needs, a significant improvement from the previous year demonstrating that the Board and Remuneration Committee has listened to colleague feedback and taken meaningful action.

As we reported last year, the Remuneration Committee Chair and the Head of Reward and Employee Relations hosted focus groups with colleagues from a broad cross-section of the workforce, including a dedicated session with our Union, to hear directly from colleagues on remuneration related topics. The themes from these sessions included career progression and performance management, concerns about the length of time it has taken to move all colleagues onto one set of terms and conditions and challenges about the market competitiveness of particular areas of the Group's salary structures which was manifesting into both recruitment and attraction issues. The Remuneration Committee was kept updated throughout the year on the action taken in response to this feedback which included the harmonisation of terms and conditions and launch of the Career Journey Framework described above. The Board agrees that these focused sessions are a powerful way to understand in more detail the issue of concern for colleagues and therefore plans to host similar sessions on an annual basis with colleague feedback continuing to be reported to, and actions tracked by, the Remuneration Committee.

Recognising that having great leaders at every level of our business is essential to help us overcome obstacles and perform at our best, during the year the Group rolled out a new and improved Great Leadership programme entitled 'Leading in a Life More Virgin' which represents a significant investment in people leadership development to ensure our people leaders have the tools, support and confidence to lead our business towards its digital future. The programme was sponsored at an executive level by the Chief Customer Experience Officer and consists of sprint-based development which includes short challenges, digital support, externally-hosted workshops and an online Learning Hub that People Leaders can immerse themselves in. They are also encouraged to interact and share ideas and learnings from the programme in real-time with each other via a workspace app. The sprints, which are aligned to the qualities needed in great leaders, have this year focused on growing trust, stretching possibilities and an agile way of working.

Colleague feedback in the first Pulse survey following the introduction of ALMV showed that flexibility is of real importance to colleagues. As restrictions from the pandemic lifted colleagues and teams used ALMV to test and learn what worked for them as individuals, refining team rhythms and finding new ways to collaborate either in person in our new hubs or online. The first hybrid Straight Up colleague engagement event was held both online and in our Guildhall Collaboration Hub in July with 40 colleagues in the collaboration space and a further 100 colleagues attending virtually. The panel included both David Duffy and Clifford Abrahams and members of the Leadership Team and discussed ALMV, our digital strategy and customer propositions amongst other topics. The feedback from colleague engagement events together with other insights, for example from the MyVoice colleague engagement survey and Pulse updates, will help inform how we continue to evolve our colleague proposition and people strategy aligned to our Digital-First bank strategic ambition.

The Board receives updates on our culture twice a year and a Cultural Assessment is performed internally, the results of which are presented to the Board. The assessment provides the Board with a view of how the Purpose, Values and Behaviours of the organisation are embedded and where there is room for improvement to enable the Board to discuss and challenge on the actions that will be taken as a result.

Our colleague intranet site, VMx, continues to provide easy access to relevant information, guidance and news for colleagues including up to date information on our latest results, spotlights on colleagues working in various departments in our 'Whatcha Working on?' series and how their work aligns to our Purpose.

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

Colleagues (continued)

Board decision spotlight – 'An 'Agile' way of working'
The Board regularly discusses the Group's customer experiences and the initiatives to be implemented that aim to significantly improve the ways in which the Group supports its customers. One of these initiatives discussed and agreed by the Board at a deep dive session was for the Group to roll out an 'Agile' way of working across its colleague population as a new way of empowering people to find the best solutions. At its core, Agile sees a group of cross-functional specialists brought together to form a small, persistent 'squad'. The squad is then set a specific goal as part of a broader mission to deliver continuous customer value within a particular area. Each squad is part of a larger tribe of squads grouped together to collectively contribute to the broader objective and has the autonomy to decide for themselves how they achieve their outcomes. They'll then work in an iterative fashion to deliver an initial result that can be continuously tested and improved upon.

All colleagues will have a role to play in the new Agile organisation, either by working within an Agile team, supporting one, or helping bring new Agile-led propositions and processes to life for the Group's customers and stakeholders. Dedicated training and coaching is being provided for those colleagues who are first to adopt Agile and learning resources are being provided for all colleagues via the Learning in a Life More Virgin programme and the Virgin Money Learning Hub. The full roll-out of Agile across the Bank will run into 2024 and will ultimately allow the Group to deliver better outcomes at a faster pace.

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 2022.

Society
Our ambition at Virgin Money is to be a positive force for good in society and to demonstrate that commitment through everything we do. Our ESG strategy was created taking into account customer insight research and engagement with various stakeholders including colleagues and suppliers and continues to be refined and updated to align to both our aspirations and regulatory requirements. Our key FY22 targets in respect of our ESG strategy were approved by the Board to align to the Group's overall strategy and sets clear accountabilities to ensure the ESG principles and goals are embedded within the Group.

As part of the Board's engagement on ESG topics, two of our Non-Executive Directors hosted a Board Jam session with colleagues to hear their views and discuss the importance of ESG issues in a Purpose-driven organisation. The sessions covered which activities are particularly relevant within the financial services market and colleagues' awareness of ESG related activities. Colleagues agreed that ESG was an important factor for our business, our customers and across communities and that the Group should do more to highlight its activities in this area. They also raised that education was a significant factor in transitioning to low carbon and increased general awareness, understanding, calculators and tools, such as our Sustainable Business Coach app, helped customers to understand the issues further and take action. As a result of the Board Jam, it was agreed that communications should be reviewed with a view to promoting ESG awareness.

We engage with external rating agencies, including Sustainalytics, to track the progress against we are making in respect of ESG disclosures, including score ratings based on the information available in the public domain and interact with various industry bodies to assist us in assessing and disclosing the GHG emissions linked to our financing. The Board has been kept appraised of the progress being made on our Net-Zero Banking Alliance commitments, including the ongoing development of our net-zero targets and roadmaps. Our Environment Committee continues to support the Board in monitoring progress against these goals.

The Group is guided by our Purpose and we showcased our Purpose externally through partnering with the Purpose Coalition on a Levelling Up Impact Report setting out our contribution to the levelling up agenda in the UK. The report highlights the work Virgin Money is undertaking to deliver social impact by encouraging economic activity and sustainable practices to help create a shared prosperity within the framework of 14 levelling up goals. The goals focus on key life stages – from early years through to adulthood, alongside other barriers which may prevent people from achieving their potential. The framework also allows mapping of best practice and tracking the progress businesses are making to maximise the positive impact they have. The Levelling Up Impact Report brought to life Virgin Money's work on Purpose as well as using the 14 Levelling Up goals to create a framework to map best practice, track progress and ensure a maximum and measurable impact for our colleagues, customers and the communities we serve.

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

Society (continued)

The Board and Group remain committed to tackling the poverty premium, currently paid by about one fifth of the population, and aspire to no customers of the Group paying a poverty premium by 2030. Over the next five years the Group aims to measure the levels of exposure on our Customer book and with the help of partners implement solutions to help customers avoid energy, credit and payment-related premiums. The Group works with Smart Data Foundry to define a national measure of the poverty premium and, in partnership with Turn2Us, helps people across the UK to make sure they are not missing out on benefits they are entitled to. We continue to hold our 'FinInc' annual events where colleagues get the opportunity to hear from various contributors on the issues that financial exclusion can bring and provides them with the chance to be part of the solution by contributing their ideas to solve issues.

Our MacMillan Cancer Support year-long pilot scheme to provide financial support services to customers living with or affected by cancer has become a permanent feature for the Group and provides a two-way referral service for customers in financial difficulty. This works alongside our MacMillan Guides, who are Store colleagues trained to provide specialist support in guiding customers to sources of information and support both within and outside of the Group and our MacMillan Neighbours initiative which provides peer-to-peer support for our colleagues.

The Board and our colleagues recognise the contribution we can make to our communities through volunteering our time and skills. Our Community Team engages with colleagues highlighting volunteering opportunities which can be used for the two days a year that colleagues have to volunteer for causes that matter to them.

The Virgin Money Foundation, which supports grant making and other initiatives at a grassroots level, recently launched 'Leading the Way', an innovative community leadership programme developed in partnership with Power to Change, which sees 19 community leaders benefiting from a tailored learning programme to build their skills, confidence and networks to play a vital role in supporting their communities in the North of England and across Yorkshire and the Humber.

Board decision spotlight – 'Being a force for good'

As a purpose-led business, Virgin Money has a huge opportunity to drive positive social change through the way in which it operates and the Board is cognisant of this in its decision-making. During the year the Board took time to carefully consider the effects of the outbreak of war in Ukraine on the Group but also, importantly, the scale and impact of the resulting humanitarian crisis which led to the displacement of many Ukrainians across Europe. The Board was in agreement that the Group should make a donation of £300,000 to the Disasters Emergency Committee's (DEC) Ukraine Humanitarian appeal which brought together 15 leading UK aid charities to raise funds quickly and efficiently in the time of crisis. The appeal is supported by the British Government with matched funding up to £20m. The Board also helped shape the Group's colleague communications approach in relation to the war in Ukraine which saw stories shared across the business of colleagues who had giving up time or used volunteering days to get involved in local collections and fundraising activities for the Ukraine Humanitarian appeal or in some cases even provided a temporary home for Ukrainians who had been forced to flee their homeland. The Board was proud to show its support in this time of crisis and reinforce the Group's desire that important social matters are firmly on its strategic agenda.

Government and regulators

It is important to the Board and Leadership Team to continue to further our relationships with our regulators, ensuring they are strong, open and transparent and that communication is productive for all stakeholders involved . The Board ensures the Group's strategic aims align with regulatory requirements, including any new regulatory initiatives, by making it a priority at all levels within the Group.

The Board is kept appraised of regulatory interactions, initiatives and developments through the standing updates it receives at each Board meeting from the Board Risk Committee updates and Leadership Team reports, ensuring the Boards remains cognisant of the regulatory landscape and any key matters of relevance to the Group.

Directors and the Leadership team attend regular meetings with the both the FCA and PRA as part of the Continuous Assessment and Proactive Engagement meetings programme. Other topics of relevance that were discussed between the PRA and FCA during the year included the Resolvability Assessment Framework, updates on capital and liquidity matters, and financial results. These meetings also provide the opportunity to discuss the Group's approach to regulatory priorities and the overall regulatory agenda. The key points raised at these meetings are then shared with the Board to ensure they are aware of regulatory views and these are considered as part of decision making.

Our relationship with our regulators valued by the Board and is carefully monitored. It endeavours to proactively engage with the regulators priorities, extending to attendance at regulatory round tables with the Group's peers where key issues such as internal-ratings based approaches to credit risk are discussed. Combined these activities ensure the Board is abreast of the current and future regulatory considerations for the Group which is valuable due to the increased level of the regulatory agenda.

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

Government and regulators (continued)

In line with the new FCA Operational Resilience Regulation, and an overall increase focus on operational resilience both from the Board and regulator, the Board approved the Operational Resilience self-assessment noting that the Group was 'Year 1' compliant. The Board were provided an overview from an external subject matter expert on the Group's standing amongst peers against the regulations and noted the key areas of focus and that as the regulations evolved, further resilience measures would be implemented. The Group also reaffirmed its commitment to the Government's SME Finance Charter to ensure that SME customers are supported to grow and thrive.

Following the BoE rise in interest rates and inflation concerns overall, the FCA issued a letter to lenders in the financial sector, relating the rising cost of living and the behaviours and actions it expected lenders to take as a result of pressures on consumer budgets. The Board, cognisant of this, are receiving regular updates and are having ongoing discussions on matters that may arise as a result in order to take regulatory expectations into account for our planned customer support measures.

The Board were kept appraised of the ongoing development of the new FCA Consumer Duty rules, expected to be implemented in 2023, including the creation of a Head of Consumer Duty role in order to drive forward the work required and the development of an appropriate Group-wide reporting framework and Governance workstream.

Further to the Group's participation in the multi-firm review of the treatment of SMEs regarding collections and recoveries, the Board received a report on the points of remediation identified by the FCA and the Group provided an overview of a comprehensive plan to address the matters raised. As a result of the findings, the Group will review the collections and recoveries framework to identify and address any gaps and establish a plan for sustainable improvements, building on the framework already in place.

The Group is a member of the Cash Action Group, a collaboration between banks, consumer groups, the Post Office and LINK to ensure long-term cash availability across the UK through a hub network. Relevant updates are provided to the Board on this topic and the capability for providing this service is being evaluated.

The Board was encouraged to see the strong political attendance in Parliament to the Group's report in partnership with the Purpose Coalition and the publication of the HM Treasury Women in Finance Annual Review which provided the opportunity to engage with stakeholders.

Board decision spotlight – 'Resolvability Assessment

In March 2022, the Board was asked to approve the VMUK's Readiness for Resolution Public Disclosure document (disclosure). Resolution is the framework put in place after the last financial crisis to ensure that, in the event of a crisis, banks and banking groups can be recapitalised and restructured in a way that provides for the continued operation of important banking services to protect financial stability but without exposing public funds to losses. As part of the Resolvability Assessment Framework (RAF) all Tier 1 UK banks were required to publicly disclose the progress made in achieving three BoE resolvability outcomes. The Board reviewed and put questions to the Group Treasurer on aspects of the disclosure it felt needed additional explanation and clarity. It also heard of input provided by third-party advisers before ultimately approving the disclosure.

A Fire Drill exercise was held which was designed to test the resolvability capabilities of the Group as part of the BoE's RAF. The Board was presented with a scenario and challenges were posed in order to test the readiness, understanding and familiarity the Board had with the process and to capture any additional requirements that would support the Board in their decision making.

In June 2022, following the BoE's review of the disclosure, VMUK publicly announced its Resolvability Assessment in line with PRA guidance with the BoE also publishing its assessment of the resolvability of VMUK alongside the largest, systemically important firms in line with the RAF. The announcement confirmed that VMUK had taken robust steps to prepare for the unlikely event of resolution and had met the resolution expectations of the BoE Resolvability Assessment. Following the assessment and BoE feedback, the Group also announced its commitment that the Group will work to deliver further enhancements as it continues to develop and improve its resolvability capabilities.

Partners and suppliers

The Group's partners and suppliers are invaluable to us in delivering on our ambitions and meeting our customers and stakeholders' expectations driven by our Purpose.

We launched the online Marketplace for business customers to access through M-Track with five specially chosen Fintech partners to cover a range of small business needs including: an all-in-one platform for business expenses; a new take on invoice financing that allows businesses to grow both domestically and internationally through a unique and scalable platform; flexible monthly insurance allowing small businesses the freedom to adjust their cover as things change; tax management tools; and a simple HR platform helping them to become more digital.

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

Partners and suppliers (continued)
The Board considered and approved a partnership with Microsoft to further digitise customer journeys using their cloud infrastructure and cloud computing product-suite to enhance colleague collaboration. This was complemented by a 'Summer of Learning' for colleagues to enable them to make full use of the tools to collaborate, automate and ultimately work smarter. The Board held a deep dive session on cloud technology insights, including receiving an external presentation, to better understand developments in the industry, benefits, implementation and any potential pitfalls.

The Group partners with Virgin Red, the rewards club from Virgin and during the year the Board received updates from executives of the Virgin Group on Virgin companies including how they are recovering and evolving after the pandemic. These insights were useful inputs to Virgin Money's own strategy including the ongoing development of our digital wallet proposition.

As travel restrictions lifted, our Virgin Money travel insurance proposition was launched and we partnered with Hood Group, our new insurtech partner allowing us to make the most of their technological innovations and delivery of a fully digitised end-to-end proposition for our five-star Defaqto gold and silver travel insurances policies.

The Board was consulted and provided with updates on various supplier and partnership relationships during the year. One example was the extension of our current partnership arrangement with Experian, which provides critical data decisioning services to the Group. The Board considered the performance of the current contract and service levels received along with the costings before approving, based on its view, that the extension was in the best interests of the Group.

The Group recognises that our partners and suppliers have an important role in the delivery of the Group's operations. Our relationship managers across the business regularly engage with our suppliers on the areas critical to the Group including service; innovation; compliance and growth. We continue to utilise our 'Voice of the Supplier' approach in our supplier framework as it provides a method of providing formal feedback to the Group on our relationship with them outside of the regular ongoing discussions that take place as a matter of course.

The Board has a zero-tolerance attitude with respect to modern slavery in the Group's supply chain and during the year it approved the revised Corporate Statement on Modern Slavery, updated to align to the Group's Purpose and taking into account industry best practice. The topic is now included in an all-colleague compliance learning module.

Board decision spotlight – 'Auditor Tender Process'
One of the most significant new partnerships the Board provided input to during the year was the appointment of a new external auditor. Through the Audit Committee, regular updates were provided on progress throughout the external audit tender process which included approving the initial shortlist of firms that were to receive an 'Invitation to Tender'. The shortlist was created based on analysis which considered the scale and expertise to support a FTSE 350 banking audit, recent quality ratings from the annual FRC review cycle, and prior experience gained by the Group from a previous tender process carried out in 2015. Following a review of the tender offers received, the firms that were taken forward to the next stage provided detailed presentations to relevant senior colleagues within the Group, which included Board members. Thereafter, a final proposal was presented to the Board in July 2022 where approval was given for PricewaterhouseCoopers LLP (PwC) to be appointed as the new Group external auditor from 1 October 2023. On behalf of the Board, the Audit Committee will receive regular updates to oversee the external auditor transition plan led by PwC and member of the Group's Finance team and will monitor the transition of existing services provided by PwC elsewhere in line with the non-audit services requirements of the Group's External Auditor Independence Policy Standard.

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 (2021: £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.

Report of the Directors (continued)

Share capital

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

Research and development activities

The Group does not undertake formal research and development activities although it does invest in new platforms and products in each of its business lines in the ordinary course of business. In addition to new products and services the Group also invests in internally generated intangible assets including software and 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.

Events after the balance sheet date

There have been no significant events between 30 September 2022 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 AGM.

The Directors who were members of the Board at the time of approving the Report of the Directors are listed on page 2. 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
20 November 2022

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 UK-adopted International Accounting Standards (IAS). 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.

The Group financial statements have also been prepared with regard to the FCA's Disclosure Guidance and Transparency Rules.

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 Bank financial position and financial performance;
- in respect of the Group and Bank financial statements, state whether UK adopted IASs 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 Bank 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.

Under applicable law and regulations, the Directors are also responsible for preparing a Strategic report and Directors' report that comply with that law and those regulations. The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Bank's website.

Directors' responsibility statement (DTR 4.1)

The directors confirm, to the best of their knowledge:

- that the consolidated financial statements, prepared in accordance with UK adopted IASs, 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
20 November 2022

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 2022 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with UK adopted international accounting standards;
- the parent company financial statements been properly prepared in accordance with UK adopted international accounting standards 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 (the 'parent company') and its subsidiaries (collectively the 'Group') for the year ended 30 September 2022 which comprise:

Group	Parent company
Consolidated balance sheet as at 30 September 2022	Balance sheet as at 30 September 2022
Consolidated income statement for the year then ended	Statement of changes in equity for the year then ended
Consolidated statement of comprehensive income for the year then ended	Cash flow statement for the year then ended
Consolidated statement of changes in equity for the year then ended	Related notes 1 to 6.2 to the financial statements including a summary of significant accounting policies
Consolidated statement of cash flows for the year then ended	
Related notes 1 to 5.5 to the financial statements, including a summary of significant accounting policies	
Information identified as "audited" within the risk report	

The financial reporting framework that has been applied in their preparation is applicable law and UK adopted international accounting standards and as regards to 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 and parent company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard as applied to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

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

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 long-term forecasts with reference to the directors' historical forecasting accuracy and performed stress testing to consider the reasonableness of the trading volume and yield assumptions and considered how management initiatives and investments could impact the Bank's cost base.
- We used economic specialists to assess the forecast's macroeconomic assumptions through benchmarking to institutional, HM Treasury, and Bank of England forecasts.
- 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.
- We evaluated the results of management's stress testing, including reverse stress testing, to assess the economic assumptions and their impact on the Group's solvency and liquidity.
- 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.

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 method accounting
Materiality	• Overall Group materiality of £37m which represents 0.58% of equity.

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

Climate change

There has been increasing interest from stakeholders as to how climate change will impact Clydesdale Bank plc. The Group has determined that the most significant future impacts from climate change on their operations will be from physical and transitional risks and has concluded that these are medium to longer term in nature. These risks are explained on page 93 in the risk report which forms part of the "Other information," rather than the audited financial statements. Our procedures on these disclosures therefore consisted solely of considering whether they are materially inconsistent with the financial statements or our knowledge obtained in the course of the audit or otherwise appear to be materially misstated.

As explained in note 1.9 to the Annual Report and Accounts, the Group has made an assessment of the observable effect of the identified physical and transitional risks on the Group's lending portfolio, as well as other assets such as the deferred tax asset and the pension assets held by the Group's defined benefit pension scheme. Whilst the effects of climate change represent a source of material uncertainty, the Directors have concluded that the effects on estimates and judgements related to financial reporting arise in the longer term. The financial statements cannot capture all possible future outcomes as these are not yet known and the degree of certainty of these changes may also mean that they cannot be taken into account when determining asset and liability valuations and the timing of future cash flows under the requirements of UK adopted international accounting standards.

Our audit effort in considering climate change was focused on evaluating management's assessment of the impact of climate risk, physical and transitional, and ensuring that the effects of material climate risks disclosed in note 1.9 have been appropriately reflected in the areas of judgement and estimation where relevant. Details of our procedures and findings on this matter are included in our key audit matters below. We also challenged the Directors' considerations of climate change in their assessment of going concern and associated disclosures.

Whilst the Group has stated its commitment to the aspirations to achieve net zero emissions by 2050, the Group is currently unable to determine the full future economic impact on its business model, operational plans and customers to achieve this and therefore as set out above the potential impacts are not fully incorporated in these financial statements.

Key audit matters

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

Risk	Our response to the risk	Key observations communicated to the Audit Committee
Impairment of loans **Consolidated balance sheet impairment of loans - £457m (2021: £504m)** **Consolidated income statement charge - £52m (2021: £131m credit)** **Please refer to page 16 (credit risk report) and Note 3.2 (Impairment provisions on credit exposures note).** There is uncertainty in estimating expected credit losses (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 high inflation, high interest rates and indirect economic impact of the war in Ukraine. Such economic conditions have not been experienced for many years, which creates modelling difficulties due to existing models having been developed on data relating to different economic conditions. As a result there is a need for Management to exercise judgements and capture the risks through post model 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, an assessment of model performance and recalculating Probability of Default, Loss Given Default and Exposure at Default for a risk-based sample of portfolios.	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, House Price Index, Consumer Price Index and average earnings) and the base, downside and upside scenarios, together with weightings adopted by Management, were concluded to be reasonable. The risk not captured by the economic scenarios was appropriately addressed through post model adjustments. Our testing of post-model adjustments confirmed they had been accurately recorded, and we were satisfied that their use was complete and appropriate.

Risk	Our response to the risk	Key observations communicated to the Audit Committee
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 current economic conditions; - Completeness and valuation of post model adjustments including those required to address current economic conditions; - Measurements of individually assessed provisions, including the assessment of multiple scenarios, collateral valuations and workout strategies; and - Accuracy and adequacy of the financial statement disclosures.	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 assessed the economic scenario base case and alternative economic scenarios adopted by management utilising economic 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 economic specialists, we assessed whether forecast macroeconomic variables, such as GDP, unemployment, interest rates, House Price Index, Consumer Price Index and average earnings were appropriate loan loss provision drivers, and that the forecast variables were reasonable. We performed testing over material post model adjustments including those which were applied as a result of impact of the cost of living crisis. 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, where no specific provision was held to determine whether their stage classification was appropriate. We obtained management's assessment of climate risk and its impact on the recognition of ECL. We engaged our specialists to assess the completeness of the risks in management's risk assessment and the appropriateness of the conclusions made in respect of estimated amounts in respect of physical and transition risks and the timing of crystallisation of those risks. We also performed procedures on completeness and accuracy of data used in management's risk assessment. 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 the impact of current economic conditions.	We communicated that Management's climate risk assessment is appropriate and makes the necessary considerations in respect of the physical and transition risks and their impact on ECL and related disclosures. 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 captured the continued uncertainty in the overall economic environment as at year end. We communicated that the provisions for the retail and business portfolios are considered reasonable, albeit the business book provision is considered to be at the lower end of the range. We communicated that we are satisfied with the accuracy and adequacy of the disclosures made.

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

Risk	Our response to the risk	Key observations communicated to the Audit Committee
Revenue recognition – effective interest rate method **Total interest income: £2,215m (2021: £1,906m)** **Total EIR adjustments on balance sheet: Mortgage EIR: £201m, Cards EIR: £285m (2021: £210m and £273m)** **Please refer to note 2.2 Net Interest Income for the Group's disclosures in relation to EIR.** The Group records income on financial instruments under the effective interest rate ("EIR") method. Please refer to note 2.2 on pages 128 to 131. As set out in note 2.2, 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 recognised in the income statement under EIR accounting. The EIR method spreads the income statement recognition of income and expense cash flows that are, in substance, integral to the overall yield of the financial instrument over its modelled life. For both secured and unsecured lending the Group utilises models to calculate EIR adjustments based on forecast future cashflows. 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 cashflows (particularly in the context of uncertain future consumer behaviours and the impact of current economic volatility) 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 forecasts of customer behaviours and balance attrition rates to recent experience and historical trends within the associated lending portfolios. With respect to the amortisation of the fair value adjustments relating to the acquired portfolios, we assessed the key assumptions adopted by 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 outcomes using the Group's historical experience, our understanding of the industry, and our professional judgement. We assessed management's EIR adjustments in aggregate 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 as well as the appropriateness and consistency of the EIR calculators where required. We assessed the accuracy of the financial statement disclosures reported in respect of the key estimates within the EIR models, and their sensitivity to reasonable alternative assumptions. We compared the Group's EIR adjustments against peer benchmarks and our own expectations at a standback level to support our conclusions.	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 2022 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, particularly as a result of emerging economic volatility and the likely impacts on consumer spend and repayment. 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.

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 to be £37 million (2021: £37 million), which is 0.58% (2021: 0.66%) of equity. We believe that equity provides us with an appropriate measure as there remains uncertainty in the economy which may lead to income volatility.

We determined materiality for the Parent Company to be £37 million (2021: £37 million), which is 0.58% (2021: 0.67%) of equity.

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% (2021: 75%) of our planning materiality, namely £27.7m (2021: £27.5m). We have set performance materiality at this percentage due to 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 (2021: £1.8m), which is set at 5% of planning materiality, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds.

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

Other information

The other information comprises the information included in the annual report set out on pages 2 to 105, and 187 to 195 other than the financial statements and our auditor's report thereon. 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 this gives rise to 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, based on the work undertaken in the course of the audit:

- the information given in the strategic report and the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and

- the strategic report and directors' report have been prepared in accordance with applicable legal requirements.

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 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 105, 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.

- We obtained an understanding of the legal and regulatory frameworks that are applicable to the Group and determined that the most significant are the regulations, licence conditions and supervisory requirements of the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA).
- We understood how the Group is complying with those frameworks by making enquiries of management, internal audit and those responsible for legal and compliance matters.
- We also reviewed correspondence between the Group and UK regulatory bodies; reviewed minutes of the Board and Executive Risk Committee; and gained an understanding of the Group's approach to governance, demonstrated by the Board's approval of the Group's governance framework and the Board's review of the Group's risk management framework (RMF) and internal control processes.
- 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 internal and external 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.

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

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

Other matters we are required to address

- Following the recommendation of the NAB Group Audit Committee, we were appointed as external auditor at the AGM on 31 January 2005 to audit the financial statements for the year ending 30 September 2005 of the National Australia Bank Group of companies, which at the time included Clydesdale Bank PLC. The period of total uninterrupted engagement as auditors of Clydesdale Bank PLC including previous renewals and reappointments, is 18 years, covering the years ending 30 September 2005 to 30 September 2022.

- 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 (Senior statutory auditor)
for and on behalf of Ernst & Young LLP, Statutory Auditor
London
20 November 2022

Financial Statements
Consolidated income statement

For the year ended 30 September	Note	**2022** **£m**	2021 £m
Interest income		**2,215**	1,906
Other similar interest		**2**	4
Interest expense and similar charges		**(641)**	(550)
Net interest income	2.2	**1,576**	1,360
Gains less losses on financial instruments at fair value		**(22)**	(9)
Other operating income		**157**	136
Non-interest income	2.3	**135**	127
Total operating income		**1,711**	1,487
Operating and administrative expenses before impairment losses	2.4	**(1,069)**	(1,202)
Operating profit before impairment losses		**642**	285
Impairment (losses)/credit on credit exposures	3.2	**(52)**	131
Profit on ordinary activities before tax		**590**	416
Tax (expense)/credit	2.5	**(70)**	116
Profit for the year		**520**	532
Attributable to:			
Ordinary shareholders		**460**	473
Other equity holders		**60**	59
Profit for the year		**520**	532

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

The notes on pages 122 to 186 form an integral part of these financial statements.

Financial Statements
Consolidated statement of comprehensive income

For the year ended 30 September	Notes	**2022**	2021
		£m	£m
Profit for the year		**520**	532
Items that may be reclassified to the income statement			
Change in cash flow hedge reserve			
Gains during the year		**962**	99
Transfers to the income statement		**(13)**	24
Taxation thereon - deferred tax charge		**(260)**	(33)
	4.1.3	**689**	90
Change in FVOCI reserve			
Gains during the year		**15**	34
Transfers to the income statement		**(4)**	-
Taxation thereon - deferred tax charge		**(1)**	(11)
		10	23
Total items that may be reclassified to the income statement		**699**	113
Items that will not be reclassified to the income statement			
Change in defined benefit pension plan	3.9	**122**	54
Taxation thereon - deferred tax charge		**(50)**	(46)
Taxation thereon - current tax credit		**6**	21
Total items that will not be reclassified to the income statement		**78**	29
Other comprehensive income, net of tax		**777**	142
Total comprehensive income for the year, net of tax		**1,297**	674
Attributable to:			
Ordinary shareholders		**1,237**	615
Other equity holders		**60**	59
Total comprehensive income for the year, net of tax		**1,297**	674

The notes on pages 122 to 186 form an integral part of these financial statements.

Financial Statements
Balance sheets

As at 30 September	Note	Group 2022 £m	Group 2021 £m	Bank 2022 £m	Bank 2021 £m
Assets					
Financial assets at amortised cost					
Loans and advances to customers	3.1	**71,749**	71,874	**70,842**	70,922
Cash and balances with central banks	3.4	**12,221**	9,711	**12,221**	9,711
Due from other banks		**656**	800	**268**	146
Financial assets at FVTPL					
Loans and advances to customers	3.5	**70**	133	**70**	133
Derivative financial instruments	3.6	**342**	140	**310**	87
Other financial assets	3.5	**2**	16	**1**	1
Due from related entities	5.3	**4**	4	**1,097**	1,099
Financial assets at FVOCI	3.7	**5,064**	4,352	**5,064**	4,352
Property, plant and equipment		**211**	250	**211**	250
Intangible assets and goodwill	3.8	**267**	373	**267**	373
Investments in controlled entities and associates	6.2	**-**	-	**50**	50
Current tax assets		**-**	10	**3**	15
Deferred tax assets	2.5	**256**	497	**250**	493
Defined benefit pension assets	3.9	**1,000**	847	**1,000**	847
Other assets		**168**	209	**160**	200
Total assets		**92,010**	89,216	**91,814**	88,679
Liabilities					
Financial liabilities at amortised cost					
Customer deposits	3.10	**65,434**	66,971	**65,434**	66,971
Debt securities in issue	3.11	**5,347**	4,241	**3,628**	1,822
Due to other banks	3.12	**8,486**	5,918	**8,486**	5,918
Financial liabilities at FVTPL					
Derivative financial instruments	3.6	**327**	209	**192**	160
Due to related entities	5.3	**3,210**	3,450	**4,941**	5,485
Current tax liabilities		**7**	-	**-**	-
Deferred tax liabilities	2.5	**350**	296	**350**	296
Provisions for liabilities and charges	3.13	**50**	104	**50**	104
Other liabilities	3.14	**2,388**	2,445	**2,386**	2,445
Total liabilities		**85,599**	83,634	**85,467**	83,201
Equity					
Share capital and share premium	4.1	**2,792**	2,792	**2,792**	2,792
Other equity instruments	4.1	**662**	672	**662**	672
Other reserves	4.1	**743**	44	**747**	53
Retained earnings		**2,214**	2,074	**2,146**	1,961
Total equity		**6,411**	5,582	**6,347**	5,478
Total liabilities and equity		**92,010**	89,216	**91,814**	88,679

The Bank made a profit of £562m (2021: £491m) during the year.

The notes on pages 122 to 186 form an integral part of these financial statements.

These financial statements were approved by the Board of Directors on 20 November 2022 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

Statements of changes in equity

Group

	Share capital and share premium	Other equity instruments	Other reserves: FVOCI reserve	Other reserves: 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
As at 1 October 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 for the year	-	-	23	90	561	674
AT1 distributions paid	-	-	-	-	(59)	(59)
Dividends paid to ordinary shareholders	-	-	-	-	(20)	(20)
Settlement of Virgin Money Holdings (UK) Limited share awards	-	-	-	-	(3)	(3)
As at 30 September 2021	2,792	672	34	10	2,074	5,582
Profit for the year	-	-	-	-	520	520
Other comprehensive income, net of tax	-	-	10	689	78	777
Total comprehensive income for the year	-	-	10	689	598	1,297
AT1 distributions paid	-	-	-	-	(60)	(60)
Dividends paid to ordinary shareholders	-	-	-	-	(367)	(367)
Settlement of Virgin Money Holdings (UK) Limited share awards	-	-	-	-	(3)	(3)
AT1 issuance	-	346	-	-	-	346
AT1 redemption	-	(356)	-	-	(28)	(384)
At 30 September 2022	**2,792**	**662**	**44**	**699**	**2,214**	**6,411**

The notes on pages 122 to 186 form an integral part of these financial statements.

Financial Statements
Statements of changes in equity

Bank

	Share capital and share premium	Other equity instruments	Other reserves: FVOCI reserve	Other reserves: 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**
As at 1 October 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 profit for the year	-	-	23	82	521	626
AT1 distribution paid	-	-	-	-	(59)	(59)
Dividends paid to ordinary shareholders	-	-	-	-	(20)	(20)
At 30 September 2021	2,792	672	34	19	1,961	5,478
Profit for the year	-	-	-	-	562	562
Other comprehensive income, net of tax	-	-	10	684	78	772
Total comprehensive income	-	-	10	684	640	1,334
AT1 distribution paid	-	-	-	-	(60)	(60)
Dividends paid to ordinary shareholders	-	-	-	-	(367)	(367)
AT1 issuance	-	346	-	-	-	346
AT1 redemption	-	(356)	-	-	(28)	(384)
At 30 September 2022	**2,792**	**662**	**44**	**703**	**2,146**	**6,347**

The notes on pages 122 to 186 form an integral part of these financial statements.

Statement of cash flows

For the year ended 30 September	Notes	Group 2022 £m	Group 2021 £m	Bank 2022 £m	Bank 2021 £m
Operating activities					
Profit on ordinary activities before tax		**590**	416	**628**	370
Adjustments for:					
Non-cash or non-operating items included in profit before tax	5.2	**(1,306)**	(1,221)	**(1,268)**	(1,231)
Changes in operating assets	5.2	**1,213**	819	**1,183**	710
Changes in operating liabilities	5.2	**(240)**	(1,026)	**(330)**	(1,076)
Payments for short-term and low value leases		**(2)**	(1)	**(2)**	(2)
Interest received		**2,112**	2,088	**2,099**	2,097
Interest paid		**(378)**	(461)	**(492)**	(415)
Tax paid including group relief		**(59)**	(32)	**(57)**	(24)
Net cash provided by operating activities		**1,930**	582	**1,761**	429
Cash flows from investing activities					
Interest received		**47**	19	**47**	19
Proceeds from maturity of financial instruments at FVOCI		**479**	1,079	**479**	1,079
Proceeds from sale of financial assets at FVOCI		**194**	-	**194**	-
Purchase of financial assets at FVOCI		**(2,019)**	(521)	**(2,019)**	(521)
Purchase of shares in UTM previously held in Virgin Money Holdings (UK) Limited		**(4)**	(12)	**-**	(5)
Proceeds from sale of property, plant and equipment		**1**	6	**1**	6
Purchase of shares issued by UTM		**-**	-	**(4)**	(9)
Purchase of property, plant and equipment		**(13)**	(26)	**(13)**	(26)
Purchase and development of intangible assets		**(53)**	(80)	**(53)**	(80)
Net cash (used in)/provided by investing activities		**(1,368)**	465	**(1,368)**	463
Cash flows from financing activities					
Interest paid		**(246)**	(158)	**(246)**	(203)
Repayment of principal portion of lease liabilities	3.16	**(26)**	(28)	**(26)**	(28)
Redemption and principal repayment on RMBS and covered bonds	3.11	**(1,264)**	(1,543)	**-**	-
Redemption of AT1 securities		**(384)**	-	**(384)**	-
Proceeds from issuance of AT1 securities		**347**	-	**347**	-
Issuance of RMBS and covered bonds	3.11	**2,480**	-	**1,780**	-
Amounts drawn under the TFSME		**2,550**	3,350	**2,550**	3,350
Amounts repaid under the TFS		**(1,244)**	(2,864)	**(1,244)**	(2,864)
Net decrease in amounts due from related entities		**1**	9	**2**	64
Net increase/(decrease) in amounts due to related entities		**9**	705	**(121)**	(594)
Ordinary dividends paid	4.1.1	**(367)**	(20)	**(367)**	(20)
AT1 distributions	4.1.2	**(60)**	(59)	**(60)**	(59)
Net cash provided by/(used in) financing activities		**1,796**	(608)	**2,231**	(354)
Net increase in cash and cash equivalents		**2,358**	439	**2,624**	538
Cash and cash equivalents at the beginning of the year		**10,253**	9,814	**9,599**	9,061
Cash and cash equivalents at the end of the year	5.2	**12,611**	10,253	**12,223**	9,599

Movements in liabilities arising from financing activities

Group	Term funding schemes[1]	Restated debt securities in issue	Intercompany loans	Lease liabilities	Restated total
Notes	3.12	3.11	5.3	3.16	
	£m	£m	£m	£m	£m
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 and other associated adjustments[2]	12	(86)	-	-	(74)
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[2]	-	(67)	(28)	-	(95)
Unamortised costs	-	4	-	-	4
Other movements	-	-	(56)	-	(56)
At 1 October 2021	5,896	4,241	3,450	154	13,741
Cash flows:					
Issuances	-	2,480	-	-	2,480
Drawdowns	2,550	-	31	-	2,581
Redemptions	-	(1,264)	-	-	(1,264)
Repayment	(1,244)	-	(54)	(26)	(1,324)
Non-cash flows:					
Fair value and other associated adjustments	-	(121)	-	-	(121)
Additions to right-of-use asset in exchange for increased lease liabilities	-	-	-	4	4
Remeasurement/disposal	-	-	-	(4)	(4)
Movement in accrued interest	28	9	-	4	41
Unrealised foreign exchange movements	-	5	22	-	27
Unamortised costs	-	(3)	5	-	2
Other movements	-	-	(244)	-	(244)
At 30 September 2022	**7,230**	**5,347**	**3,210**	**132**	**15,919**

(1) This includes amounts drawn under the TFS and TFSME.
(2) The accumulated hedge adjustment on the hedged item on the debt securities in issue has been restated in the comparative year in line with the current year presentation. The restatement had no impact on the debt securities in issue balance, however fair value and other associated adjustments have increased in the comparative period by £37m from £49m to £86m and unrealised foreign exchange movements have decreased by £37m from £104m to £67m.

The notes on pages 122 to 186 form an integral part of these financial statements.

Financial statements
Statement of cash flows (continued)

Movements in liabilities arising from financing activities

Bank	Notes	Term funding schemes[1]	Debt securities in issue	Intercompany loans	Lease liabilities	Total
		3.12	3.11	5.3	3.16	
		£m	£m	£m		£m
At 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)
1 October 2021		5,896	1,822	5,485	154	13,357
Cash flows:						
Issuances		-	1,780	1,401	-	3,181
Drawdowns		2,550	-	92	-	2,642
Redemptions		-	-	(1,591)	-	(1,591)
Repayments		(1,244)	-	(24)	(26)	(1,294)
Non-cash flows						
Additions to right-of-use asset in exchange for increased lease liabilities					4	4
Remeasurement/disposal					(4)	(4)
Movement in accrued interest		28	7	(4)	4	35
Unrealised foreign exchange movements			22	-	-	22
Unamortised costs			(3)	6	-	3
Other movements				(424)	-	(424)
At 30 September 2022		**7,230**	**3,628**	**4,941**	**132**	**15,931**

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

The notes on pages 122 to 186 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 2022 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

On 1 October 2021, the Group transitioned to preparing consolidated financial statements under UK adopted International Accounting Standards (IAS) which is a change in accounting framework. This had no impact on the recognition, measurement or disclosure of financial information presented in the year.

The consolidated financial statements, which should be read in conjunction with the Strategic report and the Directors' report, have been prepared in accordance with UK adopted IASs. The comparative year financial statements were prepared and presented in accordance with IASs in conformity with the Companies Act 2006 and IFRSs adopted pursuant to regulation (EC) No 1606/2002 as it applied in the European Union. This also included the early adoption of 'Amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16 Interest Rate Benchmark Reform – Phase 2', which had been endorsed by the EU and UK in January 2021 and included in UK adopted IAS.

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 2022, the Directors have considered a number of factors, including the current balance sheet position (which reflected the Group's consideration of the potential impact of climate-related risks), 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 Bank 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.

1.5 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 instruments

Recognition and derecognition
Financial instruments are recognised 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.

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.

1.7 Financial instruments (continued)

Specific accounting policies for financial assets at FVTPL and FVOCI can be found 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.

Repurchase agreements
Securities sold subject to 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.

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

1.8 Property, plant and equipment

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

All items of property, plant and equipment are depreciated or amortised using the straight line method, at rates appropriate to their estimated useful life to the Group. The annual rates of depreciation or amortisation are:

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

Residual values and useful lives of assets are reviewed at each reporting date. Depreciation is recognised within operating expenses in the income statement. The policy for lessee accounting is provided in note 3.16.

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.

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

Area	Estimates	Judgements	Further detail
Impairment provisions on credit exposures	Asset lifetimes Economic scenarios	SICR Definition of default PMAs	Credit risk section of Risk report and note 3.2
EIR	Product life Post promotion attrition and yield	Standard variable rate Macro-economic factors Model risk reserve (MRR)	Note 2.2
Deferred tax		Period for the recoverability of deferred tax assets	Note 2.5
Retirement benefit obligations	Discount rate Inflation assumptions Mortality assumptions		Note 3.9

1.9 Critical accounting estimates and judgements (continued)

Critical accounting estimates and judgements related to climate change

In addition, management has also considered and reflected on the potential impact of climate-related risks on the Group's financial position and performance.

This involved undertaking an assessment over the Group's assets (both financial and non-financial) and evaluating whether the observable effects of physical and transition risk of climate change would have a material impact on the Group's financial position and performance in the current year. It is widely understood and appreciated that the effects of climate change will not be significant in the short term and that the inherent risks and uncertainties in quantifying the effect of climate change in the financial statements are considerable and more likely to impact in the medium to longer term.

The Group's customer lending is the most significant financial asset exposed to the potential impact of climate-related risks, primarily the ECL implications and the ability of the customer to meet their contractual payments. As a UK-based bank with no significant lending outside of the UK, the Group considers the potential for material ECLs to emerge as a result of climate change in the short term to be negligible.

Other non-financial assets that may be impacted include the Group's deferred tax asset and the pension assets held by the Group's defined benefit pension scheme. The Group assesses the recoverability of deferred tax assets over a six-year corporate planning time horizon which incorporates all aspects of the Group's future performance and expectations. The Trustee of the defined benefit pension scheme is responsible for all investment decisions, and these are made in accordance with a Statement of Investment Principles which incorporates climate change considerations. In addition, by necessity, the investment decisions made by the Trustees are normally medium to long term in nature.

Overall, while the effects of climate change represent a source of significant uncertainty, the Group does not consider there to be a material impact on its estimates and judgements from physical and transition risks of climate change in these financial statements.

1.10 New accounting standards and interpretations

The Group has adopted the following International Accounting Standards Board (IASB) pronouncements in the current financial year:

- Amendment to IFRS 16 and COVID-19 related rent concessions beyond June 2021 was issued in March 2021 and endorsed for use in the UK in May 2021. The original amendment (issued in May 2020 and effective for annual reporting periods beginning on or after 1 June 2020) introduced the optional practical expedient for lessees from assessing whether a rent concession related to COVID-19 is a lease modification. The IASB subsequently extended the period of application of the practical expedient to 30 June 2022, effective for annual reporting periods beginning on or after 1 April 2021. These pronouncements had no material impact on the Group's consolidated financial statements as it does not receive rent concessions.

The Group also acknowledges the decision by the IFRS Interpretations Committee (IFRIC) in April 2022, which concluded that certain demand deposits with restrictions should be presented as part of the cash and cash equivalents balance. The IFRIC agenda decision was considered but there are no impacts that would require a change in accounting policy for demand deposits.

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

The following changes took place during the year:

Hedge accounting
The Group and Bank have changed the presentation of certain items in the derivative financial instruments note to the financial statements (note 3.6), with the relevant sections of the note restated. These are presentational changes only and have no impact on the Group or Bank's primary financial statements or net asset position.

The restatement was necessary to correct the historic presentation of the foreign exchange component of the fair value hedge adjustment, with the following restatements made:

Derivative financial instruments – hedge accounting (note 3.6)
The spot foreign exchange element was previously excluded from the disclosures. This has been corrected and impacts both the hedging instrument and the hedged item. The impact of the restatement on the previous year disclosure is as follows:

	Group		Bank	
	Change in fair value of hedging instrument in the year used for ineffectiveness measurement		Change in fair value of hedging instrument in the year used for ineffectiveness measurement	
Hedging instrument	Original £m	Restated £m	Original £m	Restated £m
Fair value hedges				
Foreign exchange and interest rate risk				
Cross currency swaps	(12)	(86)	1	(27)
Total derivatives designated as fair value hedges	488	414	540	512

	Group				Bank			
	Accumulated hedge adjustment on the hedged item		Change in fair value of hedged items in the year used for ineffectiveness measurement		Accumulated hedge adjustment on the hedged item		Change in fair value of hedged items in the year used for ineffectiveness measurement	
Hedged item	Original £m	Restated £m	Original £m	Restated £m	Original £m	Restated £m	Original £m	Restated £m
Fair value hedges								
Fixed rate currency issuances	(13)	72	17	91	(3)	26	4	32
Total	(284)	(199)	(501)	(427)	(317)	(288)	(554)	(526)

Expected credit losses
During the year, the Group made refinements to the operation of the SICR criteria within the Business portfolio. Further detail can be found in the credit risk section within the Risk report, pages 20 and 35. These refinements do not require any change to the prior period reported position.

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

2.1 Segment information

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

The Group operates under four commercial lines: Mortgages, Unsecured, Business, and Deposits, which are 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

	2022	2021
	£m	£m
Net interest income	**1,576**	1,360
Non-interest income	**135**	127
Total operating income	**1,711**	1,487
Operating and administrative expenses	**(1,069)**	(1,202)
Impairment (losses)/credit on credit exposures	**(52)**	131
Segment profit before tax	**590**	416
Average interest earning assets	**86,275**	86,947

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, at the effective interest rate, 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 gross carrying value of the financial asset 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 deducting the ECL allowance from the gross lending) 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. The Group's policy on ECLs can be found in note 3.2.

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

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 over its expected life. Where these estimates are subsequently revised, a present value adjustment to the carrying value of the asset is recognised in profit or loss. Such adjustments can introduce income statement volatility and consequently the EIR method is a source of estimation uncertainty.

The Group considers that significant judgement is exercised over the mortgage and credit card portfolios. Due to the inherent judgement and estimation uncertainty that exists in determining the EIR adjustment, a MRR is held to mitigate this uncertainty.

Mortgages

For mortgage products the main accounting estimates and judgements when assessing the cash flows are the product life (including assumptions based on observed historic customer behaviour when in a standard variable rate (SVR) period) and the applicable SVR. As at 30 September 2022, a total EIR adjustment of £201m (2021: £210m) has been recognised for mortgages. This represented 0.3% (2021: 0.4%) of the balance sheet carrying value of gross loans and advances to customers for mortgage lending. The net impact of the mortgage EIR adjustments on the income statement in the year represented (0.7)% of gross customer interest income for mortgages (2021: 1.4%).

Product life

This primarily involves assumptions of customer behaviour when a fixed rate product comes to an end and reverts to the Group's SVR. The Group currently assumes that 85% (2021: 85%) of customers will have fully repaid or switched to a new product within two months of reverting to SVR.

SVR

Changes to the BoE base rate have an impact on the SVR charged to customers and consequently on the Group's interest income. The Group historically passes base rate changes through to the SVR in full but, on occasion, may choose not to do so.

2.2 Net interest income (continued)

Critical accounting estimates and judgements (continued)

The significant accounting estimates above are monitored on an ongoing basis to ensure they remain appropriate based on recent, observable customer behaviour, market data (such as market derived base rate forecasts) and take account of the competitive environment in which the Group operates. The Group also considers potential changes to future customer behaviour as a result of macroeconomic factors. There continues to be increased uncertainty in purchase and switching activity as a result of actual and anticipated bate rate rises. The Group has taken this into account when determining the EIR model assumptions.

Sensitivity analysis

As noted above, the calculation of the Group's EIR adjustment is sensitive to changes in product life and SVR assumptions. There are inter-dependencies between the assumptions which add to the complexity of the judgements the Group has to make. This means that no single factor is likely to move independently of others, however, the sensitivities disclosed below assume all other assumptions remain unchanged.

Sensitivity impact on the mortgage EIR adjustment	2022 (£m)	2021 (£m)
+/- 1 month change to the timing of customer repayments, redemptions and product transfers	**16 / (13)**	12 / (10)
50bps increase to the BoE base rate not passed through to the Group's SVR	**(46)**	(43)

Credit cards

An EIR adjustment arises on credit card products that have a low introductory rate, followed by a higher reversionary rate in future years when the promotional period expires. However, receipt of such interest income depends on the customer staying with the Group beyond promotional expiry and therefore significant judgement is involved in forecasting customer behaviour and estimating the future cash flows. Key behavioural assumptions include an estimation of the utilisation of available credit, transaction and repayment activity and the retention of the customer balance after the end of a promotional period. As at 30 September 2022, a total EIR adjustment of £285m (2021: £273m) has been recognised for credit cards. This represented 5.5% (2021: 6.4%) of the balance sheet carrying value of gross loans and advances to customers for credit cards. The impact of the net credit card EIR adjustments on the income statement in the year represented 3.3% of gross customer interest income for credit cards (2021: 24.3%).

Expected cash flows are estimated based on historical experience of similar products and are consistent with those used in product pricing models. The Group reviews and adjusts assumptions where necessary on an ongoing basis, using the most recent observable customer behaviour and market data. The Group also considers potential future changes to customer behaviour as a result of macroeconomic factors.

Post-promotional yield

The yield on a credit card following the post-promotional period is a significant estimate within the EIR assumptions. Yield is a function of the Interest Bearing Balance (IBB) and the APR charged to customers. IBB is impacted by customer behaviour and while there is evidence to support the expected IBB following the post-promotional period, there is inherent risk that this data may differ in the future. If the IBB differs to the Group's estimate it can have a material impact on the revised future cash flows. Based on recent experience, the Group has applied an average IBB of 55% (2021: 55%) following the end of the promotional period.

2.2 Net interest income (continued)

Critical accounting estimates and judgements (continued)

Post-promotional attrition

The level of repayment in the post-promotional period is a key sensitivity within the EIR assumptions. There is evidence to support the expected behaviour of customers after the end of promotional periods, however there is inherent risk that this data may not be indicative of actual future behaviour. If the proportion of customers who repay their balance post-promotion differs to the Group's estimate it can have a material impact on the revised future cash flows. Based on recent experience, the Group has applied a long run average attrition rate of 1.5% per month (2021: 1.5% per month) following the end of the promotional period.

Macroeconomic factors

When determining assumptions, the Group has considered the impact to customers of inflationary pressures including high energy and utility costs and the recent and anticipated future base rate rises. As a result, temporary adjustments have been made to assumptions. Post-promotional IBB has been decreased to 50% for 12 months and balance attrition has been increased to reflect a reduction in retail and balance transfer transaction activity for 12 months. If, however, the stress period was to increase to 24 months, the Group estimates it would result in a negative present value adjustment of approximately £35m, which would be recognised in the income statement.

Sensitivity analysis

As noted above, the calculation of the Group's EIR adjustment for credit cards is sensitive to changes in post-promotional yield and post-promotional attrition. There are inter-dependencies between the key assumptions which add to the complexity of the judgements the Group has to make. This means that no single factor is likely to move independently of others, however, the sensitivities disclosed below assume all other assumptions remain unchanged.

Sensitivity impact on the credit card EIR adjustment	**2022 £m**	2021 £m
+/- 5 ppts change to post-promotional IBB assumption[(1)] (9.1% relative increase/decrease)	34 / (28)	31 / (31)
+/- 0.5 ppts change to post-promotional monthly balance attrition rate (33% relative increase/decrease)	(20) / 23	(23) / 27

(1) Where the IBB assumption is already equal to or less than 50% IBB, no further adjustment has been made.

MRR

The complicated nature of EIR models means the Group exercises prudence on the modelled outcome and therefore chooses to hold a MRR in relation to both mortgages and credit cards to mitigate the risk of estimation uncertainty.

In arriving at the level of MRR, the Group assesses the judgements made within the EIR modelling and applies severe downside stress scenarios to quantify emerging or potential risks. This allows the Group to hold an appropriate level of MRR across both asset classes. The MRR is reviewed quarterly based on the conditions prevalent at the time and adjusted where necessary.

2.2 Net interest income (continued)

	2022 £m	2021 £m
Interest income		
Loans and advances to customers	**2,095**	1,880
Loans and advances to other banks	**70**	8
Financial assets at FVOCI	**50**	18
Total interest income	**2,215**	1,906
Other similar interest		
Financial assets at FVTPL	**5**	9
Derivatives economically hedging interest bearing assets	**(3)**	(5)
Total other similar interest	**2**	4
Less: interest expense and similar charges		
Customer deposits	**(342)**	(361)
Debt securities in issue	**(99)**	(44)
Due to other banks	**(70)**	(20)
Due to related entities	**(128)**	(122)
Other interest expense	**(2)**	(3)
Total interest expense and similar charges	**(641)**	(550)
Net interest income	**1,576**	1,360

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.
- 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 fee and commission income monthly, with amounts 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.

2.3 Non-interest income (continued)

	2022 £m	2021 £m
Gains less losses on financial instruments at fair value		
Held for trading derivatives	**6**	6
Financial assets at fair value[1]	**(21)**	3
Ineffectiveness arising from fair value hedges (note 3.6)	**43**	(13)
Amounts recycled to profit and loss from cash flow hedges[2] (note 3.6)	**(4)**	(5)
Ineffectiveness arising from cash flow hedges (note 3.6)	**(46)**	-
	(22)	(9)
Other operating income		
Net fee and commission income	**134**	124
Margin on foreign exchange derivative brokerage	**19**	16
Gains on disposal of FVOCI assets	**4**	-
Share of JV loss after tax	**(4)**	(5)
Other income	**4**	1
	157	136
Total non-interest income	**135**	127

(1) Included within financial assets at fair value is a credit risk gain on loans and advances at fair value of £1m (2021: £1m gain), and a fair value gain on equity investments of £Nil (2021: £15m gain).
(2) In respect of terminated hedges

The Group's unrecognised share of losses of joint ventures for the year was £8m (2021: £1m). For entities making losses, subsequent profits earned are not recognised until previously unrecognised losses are extinguished. The Group's unrecognised share of losses net of unrecognised profits on a cumulative basis of joint ventures is £9m (2021: £1m).

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

	2022	2021
- Current account and debit card fees	**102**	90
- Credit cards	**52**	38
- Insurance, protection and investments	**8**	10
- Other fees[1]	**26**	29
Total fee and commission income	**188**	167
Total fee and commission expense	**(54)**	(43)
Net fee and commission income	**134**	124

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

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 3.9 and 4.2 respectively.

	2022 £m	2021 £m
Staff costs	**435**	426
Property and infrastructure	**38**	89
Technology and communications	**119**	121
Corporate and professional services	**135**	159
Depreciation, amortisation and impairment	**179**	191
Other expenses	**163**	216
Total operating and administrative expenses	**1,069**	1,202

2.4 Operating and administrative expenses before impairment losses (continued)

Staff costs comprise the following items:

	2022 £m	2021 £m
Salaries and wages	**254**	248
Social security costs	**30**	30
Defined contribution pension expense	**50**	49
Defined benefit pension credit	**(24)**	(8)
Compensation costs	**310**	319
Equity based compensation[1]	**4**	8
Bonus awards	**27**	22
Performance costs	**31**	30
Redundancy and restructuring	**3**	29
Temporary staff costs	**13**	13
Other[2]	**78**	35
Other staff costs	**94**	77
Total staff costs	**435**	426

(1) Includes National Insurance on equity based compensation.
(2) Includes a one-off cost of living allowance of £7m (2021: £Nil).

The defined benefit pension credit in the current period includes a credit of £10m (2021: £5m) arising from the ongoing Pension Increase Exchange (PIE) exercise which will complete in calendar year 2023 (note 3.9). A PIE gives members the option to exchange future increases on their pensions for a one-off uplift to their current pension.

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

	2022 Number	2021 Number
Managers[1]	**2,574**	2,691
Clerical staff	**4,292**	4,724
	6,866	7,415

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

The average monthly number of employees was 7,829 (2021: 8,613). 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:

	2022 £'000	2021 £'000
Fees payable to the Bank's auditor for the audit of the Bank's financial statements	**4,327**	4,075
Fees payable to the Bank's auditor for the audit of the Bank's subsidiaries[1]	**237**	197
Total audit fees	**4,564**	4,272
Audit related assurance services	**30**	30
Other assurance services	**1,877**	330
Fees payable to the Bank's auditor in respect of associated pension schemes	**107**	79
Total fees payable to the Bank's auditor	**6,578**	4,711

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

Non-audit fees of £2.0m (2021: £0.4m) were paid to the auditor during the year for services including the skilled person reporting as required by the PRA, the review of the Interim Financial Report, PRA Written Auditor Reporting, comfort letters for the global medium-term note and covered bond programmes, TFSME assurance, client money reviews and profit attestations.

Out of pocket expenses of £13k (2021: £Nil) were borne by the Group during the year.

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.

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
In arriving at the Group's DTA balance of £256m (2021: £497m), significant judgement is exercised on the component of deferred tax assets that relate to tax losses carried forward of £417m (2021: £385m).

The Group has assessed the potential for the recovery of these tax losses carried forward for this component of deferred tax assets at 30 September 2022 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 were five years or seven years, the recognised deferred tax asset would be £225m or would remain at £256m respectively. If Group profit forecasts were 10% lower than anticipated, the deferred tax asset would be £250m. This is only £6m lower than the reported position as there is excess plan profit capacity for losses to be recognised; all historic tax losses are now recognised on the balance sheet. All tax assets arising will be used within the UK.

	2022 **£m**	2021 £m
Current tax		
Current year	**81**	65
Adjustment in respect of prior years	**5**	-
	86	65
Deferred tax		
Current year	**(10)**	(180)
Adjustment in respect of prior years	**(6)**	(1)
	(16)	(181)
Tax expense/(credit) for the year	**70**	(116)

2.5 Taxation (continued)

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

	2022	2021
	£m	£m
Profit on ordinary activities before tax	**590**	416
Tax expense based on the standard rate of corporation tax in the UK of 19% (2021: 19%)	**112**	79
Effects of:		
Disallowable expenses	**3**	12
Bank levy	**-**	1
Deferred tax assets recognised	**(83)**	(126)
Banking surcharge	**28**	20
Impact of rate changes	**22**	(90)
AT1 distribution	**(11)**	(11)
Adjustments in respect of prior years	**(1)**	(1)
Tax expense/(credit) for the year	**70**	(116)

In February 2022 legislation was enacted to reduce the banking surcharge from 8% to 3%, and to increase the threshold below which it is not chargeable to £100m (previously £25m). The changes are effective for current tax from 1 April 2023 but, in accordance with accounting standards, have effect for deferred tax in the current year. The impact is a reduction in the value of deferred tax assets, reflected within the £22m charge to the income statement above.

The Group has recognised deferred tax in relation to the following items in the balance sheet, income statement, and statement of other comprehensive income:

Movement in deferred tax (liability)/asset

Group	**Acquisition accounting adjustments**	**Cash flow hedge reserve**	**Gain on financial instruments at FVOCI**	**Tax losses carried forward**	**Capital allowances**	**Pension spreading**	**Other temporary differences**	**Total deferred tax assets**	**Defined benefit pension scheme surplus**	**Total deferred tax liabilities**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
At 1 October 2020	(10)	23	(4)	215	113	9	18	364	(253)	(253)
Income statement credit/(charge)	-	1	-	170	11	-	1	183	(3)	(3)
Other comprehensive income charge	-	(33)	(11)	-	-	(4)	(2)	(50)	(40)	(40)
At 30 September 2021	(10)	(9)	(15)	385	124	5	17	497	(296)	(296)
Income statement credit/(charge)	2	2	-	32	(13)	-	2	25	(9)	(9)
Other comprehensive income charge	-	(260)	(1)	-	-	(5)	-	(266)	(45)	(45)
At 30 September 2022	**(8)**	**(267)**	**(16)**	**417**	**111**	**-**	**19**	**256**	**(350)**	**(350)**

Bank	**Acquisition accounting adjustments**	**Cash flow hedge reserve**	**Gain on financial instruments at FVOCI**	**Tax losses carried forward**	**Capital allowances**	**Pension spreading**	**Other temporary differences**	**Total deferred tax asset**	**Defined benefit pension scheme surplus**	**Total deferred tax liabilities**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
At 1 October 2020	(10)	23	(4)	213	110	9	17	358	(253)	(253)
Income statement credit/(charge)	-	-	-	169	10	-	3	182	(3)	(3)
Other comprehensive income charge	-	(32)	(11)	--	-	(4)	-	(47)	(40)	(40)
At 30 September 2021	(10)	(9)	(15)	382	120	5	20	493	(296)	(296)
Income statement credit/(charge)	2	-	-	35	(14)	-	(1)	22	(9)	(9)
Other comprehensive income charge	-	(259)	(1)	-	-	(5)	-	(265)	(45)	(45)
At 30 September 2022	**(8)**	**(268)**	**(16)**	**417**	**106**	**-**	**19**	**250**	**(350)**	**(350)**

Other temporary differences include the IFRS 9 transitional adjustment of £11m and equity based compensation of £6m (2021: £15m and £9m respectively).

2.5 Taxation (continued)

The Group has deferred tax assets of £256m (2021: £497m), the principal components of which are tax losses of £417m (2021: £385m) and capital allowances of £111m (2021: £124m) offset by the cash flow hedge reserve deferred tax liability of £267m (2021: £9m). The Group also has deferred tax liabilities of £350m (2021: £296m) in relation to the defined benefit pension surplus.

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 year where they relate to payments of income tax to this tax authority.

Historic trade tax losses are now fully recognised (2021: unrecognised deferred tax asset of £112m representing trading losses with a gross value of £449m). The Group also has historic non-trading losses of £6m gross, tax value £1m; a deferred tax asset has not been recognised in respect of these losses as their use cannot be foreseen.

On 17 October 2022, the Chancellor of the Exchequer confirmed that the UK corporation tax rate will increase to 25% from 1 April 2023. On 17 November 2022 it was confirmed that the previously enacted reduction in Banking Surcharge to 3%, with an allowance of £100m, would proceed, also from 1 April 2023. In line with the requirements of IAS 12, these enacted tax rates have been used to determine the deferred tax balances at 30 September 2022.

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

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	
	2022	2021	**2022**	2021
	£m	£m	**£m**	£m
Gross loans and advances to customers	**73,144**	72,549	**72,234**	71,594
Impairment provisions on credit exposures[1] (note 3.2)	**(454)**	(496)	**(451)**	(493)
Fair value hedge adjustment	**(941)**	(179)	**(941)**	(179)
	71,749	71,874	**70,842**	70,922

(1) ECLs on off-balance sheet exposures of £3m (2021: £8m) are presented as part of the provisions for liabilities and charges balance (note 3.13)

The Group and Bank have a portfolio of fair valued business loans of £70m (2021: £133m) 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 £71,819m (2021: £72,007m) in respect of Group and £70,912m (2021: £71,055m) 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 £46m (2021: £9m) and £405m (2021: £301m) 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	**2022**	2021
	£m	£m
Less than 1 year	**269**	257
1-2 years	**170**	156
2-3 years	**117**	99
3-4 years	**66**	50
4-5 years	**46**	26
More than 5 years	**24**	26
	692	614
Unearned finance income	**(45)**	(30)
Net investment in finance lease and hire purchase receivables	**647**	584

Finance income recognised on the net investment in the lease was £21m (2021: £19m) 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.

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.

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.

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 at each reporting date. 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.

The Group has not made use of the low credit risk option under IFRS 9 for loans and advances at amortised cost. Further detail on the low credit risk option can be found in note 3.7.

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 a modelled ECL allowance at the indvidual financial instrument level. The modelled ECL output can be supplemented by management judgements in the form of PMAs where appropriate.

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 held at amortised cost is immaterial. ECLs relating to loan commitments and financial guarantees can be found in note 3.13.

Critical accounting estimates and judgements
ECL methodology requires the Group to apply estimates and exercise judgement when calculating an impairment allowance for credit exposures.

Further information on the chosen scenarios, macroeconomic assumptions, and scenario weightings used in the ECL calculation, including management's use of PMAs together with sensitivity analysis, is contained in the credit risk section of the Risk report on pages 42 to 49.

3.2 Impairment provisions on credit exposures (continued)

Movement in impairment provision on credit exposures

	Group		Bank	
	2022	2021	**2022**	2021
	£m	£m	**£m**	£m
Opening balance	**496**	735	**493**	729
Charge/(credit) for the year[(1)]	**57**	(132)	**57**	(130)
Amounts written off	**(129)**	(126)	**(129)**	(125)
Recoveries of amounts written off in previous years	**30**	26	**30**	26
Transfer of off-balance sheet ECLs to provisions (note 3.13)	**-**	(7)	**-**	(7)
Closing balance	**454**	496	**451**	493

(1) The £52m charge (2021: £131m credit) for impairment losses on credit exposures shown in the income statement also includes a £5m credit (2021: £1m charge) in respect of off-balance sheet ECLs (note 3.13).

Off-balance sheet ECLs are presented as part of the provisions for liabilities and charges balance (note 3.13)

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 3.11). 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 a bankruptcy remote limited liability partnership, Eagle Place Covered Bonds LLP, to provide a guarantee for the obligations payable on the covered bonds issued by the Bank.

The covered bond partnership is consolidated with the mortgage loans retained on the Group balance sheet and the covered bonds issued included within debt securities in issue (note 3.11). The covered bond holders have dual recourse: firstly, to the bond issuer on an unsecured basis; and secondly, to the 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 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 programme sponsor for the proceeds of the funding transaction.

Significant restrictions
Where the Group uses its financial assets to raise finance through securitisation 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	2022		2021	
	Loans and advances securitised	**Notes in issue**	Loans and advances securitised	Notes in issue
	£m	**£m**	£m	£m
Securitisation Programmes				
Lanark	**3,776**	**2,768**	4,383	3,396
Lannraig	**768**	**622**	921	693
Gosforth 2017-1	**-**	**-**	712	591
Gosforth 2018-1	**872**	**745**	1,107	887
	5,416	**4,135**	7,123	5,567
Less held by the Group		**(2,260)**		(3,181)
		1,875		2,386
Covered Bond Programmes				
Clydesdale Bank PLC	**-**	**-**	999	742
Clydesdale Bank PLC (formerly Virgin Money PLC)	**6,739**	**3,450**	3,960	1,100
	6,739	**3,450**	4,959	1,842

Bank	2022		2021	
	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
Clydesdale Bank PLC (formerly Virgin Money PLC)	**6,739**	**3,611**	3,960	1,113
	6,739	**3,611**	4,959	1,812

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 3.11.

During the year the Clydesdale Bank PLC Global Covered Bond Programme ceased activity and the Series 2012-2 Covered Bonds transferred 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.

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 and these mortgages are included in the securitised asset balances disclosed in the table above and are recognised on the Bank balance sheet.

The fair values of financial assets and associated liabilities relating to the securitisation programmes were £5,235m and £1,878m respectively (2021: £7,171m and £2,406m) where the counterparty to the liabilities has recourse only to the financial assets.

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	
	2022	2021
	£m	£m
Beneficial interest held	**1,239**	1,521
Subordinated loans	**42**	1
Junior notes held	**978**	1,206
	2,259	2,728

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

3.3 Securitisation and covered bond programmes (continued)

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 £3,127m (2021: £2,827m) in the Clydesdale Bank PLC (formerly Virgin Money PLC) programme. In the prior year there was also £541m over-collateralisation in the Clydesdale Bank PLC programme. From time to time the obligations of the Group to provide over-collateralisation may increase due to the formal requirements of the programme.

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

3.4 Cash and balances with central banks

Accounting policy

Cash and balances with central banks are measured at amortised cost, using the effective interest method 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 form part of the Group's treasury-related activities and are mostly short term in nature and repayable on demand or within a short timescale, generally three months.

	Group and Bank	
	2022	2021
	£m	£m
Cash assets	**1,206**	1,374
Balances with central banks (including EU payment systems)	**11,015**	8,337
	12,221	9,711
Less mandatory deposits with central banks[1]	**(266)**	(258)
Included in cash and cash equivalents (note 5.2)	**11,955**	9,453

(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 (sales ceased in 2012). Interest rate risk associated with these loans is managed using interest rate derivative contracts and the loans are recorded at fair value to avoid an accounting mismatch. The maximum credit exposure of the loans is £70m (2021: £133m) including accrued interest receivable of £Nil (2021: £Nil). The cumulative loss in the fair value of the loans attributable to changes in credit risk amounts to £1m (2021: £2m) and the change for the current year is a decrease of £1m (2021: decrease of £1m), of which £1m (2021: £1m) has been recognised in the income statement.

Other financial assets
Included in other financial assets are £2m (2021: £16m) of unlisted securities and £Nil (2021: £Nil) of debt instruments. Note 3.15 contains further information on the valuation methodology applied to financial assets held at FVTPL and their classification within the fair value hierarchy. Details of the credit quality of financial assets is provided in the Risk report.

3.6 Derivative financial instruments

Accounting policy

The Group uses derivative financial instruments to manage exposure to interest rate, contractually specified inflation 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. Contractually specified inflation risk arises from financial instruments whose cash flows are linked to an inflation index. 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).

Cash flow hedge

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

When a hedging instrument expires or is sold, or when a hedge is discontinued or 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

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	
	2022	2021	**2022**	2021
	£m	£m	**£m**	£m
Fair value of derivative financial assets				
Designated as hedging instruments	**277**	94	**245**	43
Designated as held for trading	**65**	46	**65**	44
	342	140	**310**	87
Fair value of derivative financial liabilities				
Designated as hedging instruments	**201**	143	**66**	97
Designated as held for trading	**126**	66	**126**	63
	327	209	**192**	160

Cash collateral totalling £241m (2021: £18m) has been pledged and £38m has been received (2021: £76m) in respect of derivatives with other banks. These amounts are included within due from and due to other banks respectively. Net collateral received from clearing houses, which did not meet offsetting criteria, totalled £149m (2021: collateral placed of £82m) 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.

3.6 Derivative financial instruments (continued)

Group Total derivative contracts	2022 Notional contract amount £m	2022 Fair value of assets £m	2022 Fair value of liabilities £m	2021 Notional contract amount £m	2021 Fair value of assets £m	2021 Fair value of liabilities £m
Derivatives designated as hedging instruments						
Cash flow hedges						
Interest rate swaps (gross)	**35,753**	**1,988**	**930**	24,886	71	90
Less: net settled interest rate swaps[1]	**(33,188)**	**(1,803)**	**(900)**	(21,500)	(64)	(79)
Interest rate swaps (net)[2]	**2,565**	**185**	**30**	3,386	7	11
Fair value hedges						
Interest rate swaps (gross)	**16,600**	**1,201**	**636**	30,707	295	447
Less: net settled interest rate swaps[1]	**(14,611)**	**(1,144)**	**(570)**	(25,260)	(209)	(390)
Interest rate swaps (net)[2]	**1,989**	**57**	**66**	5,447	86	57
Cross currency swaps[2]	**2,113**	**35**	**105**	1,880	1	75
	4,102	**92**	**171**	7,327	87	132
Total derivatives designated as hedging instruments	**6,667**	**277**	**201**	10,713	94	143
Derivatives designated as held for trading						
Foreign exchange rate related contracts						
Spot and forward foreign exchange[2]	**599**	**26**	**20**	805	13	12
Cross currency swaps[2]	**-**	**-**	**-**	490	-	3
Options[2]	**1**	**-**	**-**	1	-	-
	600	**26**	**20**	1,296	13	15
Interest rate related contracts						
Interest rate swaps (gross)	**1,411**	**52**	**66**	734	14	31
Less: net settled interest rate swaps[1]	**(665)**	**(50)**	**-**	-	-	-
Interest rate swaps (net)[2]	**746**	**2**	**66**	734	14	31
Swaptions[2]	**10**	**-**	**2**	10	-	1
Options[2]	**501**	**16**	**17**	495	1	2
	1,257	**18**	**85**	1,239	15	34
Commodity related contracts	**199**	**21**	**21**	97	17	17
Equity related contracts	**-**	**-**	**-**	1	1	-
Total derivatives designated as held for trading	**2,056**	**65**	**126**	2,633	46	66

(1) Presented within other assets and other liabilities.

(2) Presented within derivative financial instruments.

3.6 Derivative financial instruments (continued)

Bank Total derivative contracts	2022 Notional contract amount £m	2022 Fair value of assets £m	2022 Fair value of liabilities £m	2021 Notional contract amount £m	2021 Fair value of assets £m	2021 Fair value of liabilities £m
Derivatives designated as hedging instruments						
Cash flow hedges						
Interest rate swaps (gross)	**35,753**	**1,988**	**930**	24,886	71	90
Less: net settled interest rate swaps(1)	**(33,188)**	**(1,803)**	**(900)**	(21,500)	(64)	(79)
Interest rate swaps (net)(2)	**2,565**	**185**	**30**	3,386	7	11
Fair value hedges						
Interest rate swaps (gross)	**15,900**	**1,201**	**572**	30,007	244	447
Less: net settled interest rate swaps(1)	**(14,611)**	**(1,144)**	**(570)**	(25,260)	(209)	(390)
Interest rate swaps (net)(2)	**1,289**	**57**	**2**	4,747	35	57
Cross currency swaps(2)	**958**	**3**	**34**	958	1	29
Total derivatives designated as hedging instruments	**4,812**	**245**	**66**	9,091	43	97
Derivatives designated as held for trading						
Foreign exchange rate related contracts						
Spot and forward foreign exchange(2)	**599**	**26**	**20**	805	13	12
Cross currency swaps(2)	**-**	**-**	**-**	400	-	-
Options(2)	**1**	**-**	**-**	1	-	-
	600	**26**	**20**	1,206	13	12
Interest rate related contracts						
Interest rate swaps (gross)	**1,411**	**52**	**66**	734	13	31
Less: net settled interest rate swaps(1)	**(665)**	**(50)**	**-**	-	-	-
Interest rate swaps (net)(2)	**746**	**2**	**66**	734	13	31
Swaptions(2)	**10**	**-**	**2**	10	-	1
Options(2)	**501**	**16**	**17**	495	1	2
	1,257	**18**	**85**	1,239	14	34
Commodity related contracts	**199**	**21**	**21**	97	17	17
Total derivatives designated as held for trading	**2,056**	**65**	**126**	2,542	44	63

(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 or 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;
- inflation risk where it is a contractually specified component of a debt instrument; 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 a portion of 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 2020, 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, inflation or foreign currency denominated fixed rate assets held at FVOCI and GBP and foreign currency denominated fixed rate debt issuances by the Group. Where assets and liabilities are exposed to multiple risk components, for example interest rate and foreign currency risk, these components are simultaneously designated as hedged risks within the same hedge relationship.

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).

The Group has no remaining hedge relationships exposed to LIBOR and as no uncertainty remains regarding interest rate benchmark reform, the Group no longer applies the reliefs provided by 'Interest Rate Benchmark Reform - Phase 1 and Phase 2 amendments' to hedge accounting. Further detail on the Group's approach to managing the risk of LIBOR replacement, including derivatives designated as held for trading that have not yet transitioned, is provided on page 79.

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	2022				2021			
		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][3] £m
CASH FLOW HEDGES								
Interest rate risk								
Interest rate swaps[1]	**35,753**	**1,988**	**930**	**916**	24,886	71	90	127
Foreign exchange risk								
Cross currency swaps	**-**	**-**	**-**	**-**	-	-	-	(28)
Total derivatives designated as cash flow hedges	**35,753**	**1,988**	**930**	**916**	24,886	71	90	99
FAIR VALUE HEDGES								
Interest rate risk								
Interest rate swaps[1]	**16,150**	**1,059**	**361**	**1,052**	30,707	295	447	500
Inflation and interest rate risk								
Inflation linked interest rate swaps[1]	**450**	**142**	**275**	**96**	-	-	-	-
Foreign exchange and interest rate risk								
Cross currency swaps	**2,113**	**35**	**105**	**6**	1,880	1	75	(86)
Total derivatives designated as fair value hedges	**18,713**	**1,236**	**741**	**1,154**	32,587	296	522	414

Bank	2022				2021			
		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][3] £m
CASH FLOW HEDGES								
Interest rate risk								
Interest rate swaps[1]	**35,753**	**1,988**	**930**	**916**	24,886	71	90	127
Total derivatives designated as cash flow hedges	**35,753**	**1,988**	**930**	**916**	24,886	71	90	127
FAIR VALUE HEDGES								
Interest rate risk								
Interest rate swaps[1]	**15,450**	**1,059**	**297**	**1,168**	30,007	244	447	539
Inflation and interest rate risk								
Inflation linked interest rate swaps[1]	**450**	**142**	**275**	**96**				
Foreign exchange and interest rate risk								
Cross currency swaps	**958**	**3**	**34**	**(1)**	958	1	29	(27)
Total derivatives designated as fair value hedges	**16,858**	**1,204**	**606**	**1,263**	30,965	245	476	512

(1) As shown in the total derivatives contracts table on pages 144 - 145 , 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) The change in fair value of the hedging instrument used for ineffectiveness measurement has been restated in the comparative year in line with the current year presentation, as detailed in note 1.11.

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	2022			2021		
		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]	**(962)**	**979**	**(14)**	(127)	2	13
Foreign exchange risk						
Floating rate currency issuances[2]	**-**	**-**	**-**	29	-	-
Total	**(962)**	**979**	**(14)**	(98)	2	13

Group	2022				2021			
	Carrying amount of hedged items		Accumulated hedge adjustment on the hedged item	Change in fair value of hedged items in the year used for ineffectiveness measurement	Carrying amount of hedged items		Accumulated hedge adjustment on the hedged item[3]	Change in fair value of hedged items in the year used for ineffectiveness measurement[3]
	Assets £m	Liabilities £m	£m	£m	Assets £m	Liabilities £m	£m	£m
FAIR VALUE HEDGES								
Interest rate risk								
Fixed rate mortgages[4]	**9,520**	**-**	**(941)**	**(779)**	24,265	-	(179)	(420)
Fixed rate customer deposits[5]	**-**	**-**	**(2)**	**-**	-	-	(5)	-
Fixed rate FVOCI debt instruments[6]	**2,443**	**-**	**(613)**	**(629)**	3,010	-	(115)	(197)
Fixed rate issuances[2]	**-**	**(2,385)**	**358**	**385**	-	(2,768)	28	104
Inflation and interest rate risk								
Fixed rate FVOCI debt instruments[6]	**589**	**-**	**(105)**	**(96)**	-	-	-	-
Foreign exchange and interest rate risk								
Fixed rate currency FVOCI debt instruments[6]	**76**	**-**	**(3)**	**(3)**	78	-	-	(5)
Fixed rate currency issuances[2]	**-**	**(1,955)**	**83**	**11**	-	(1,730)	72	91
Total	**12,628**	**(4,340)**	**(1,223)**	**(1,111)**	27,353	(4,498)	(199)	(427)

(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 and related party transactions.

(3) The accumulated hedge adjustment on the hedged item and the change in fair value of the hedged items used for ineffectiveness measurement have been restated in the comparative year in line with the current year presentation, as detailed in note 1.11.

(4) Hedged item and the cumulative fair value changes, are recorded in loans and advances to customers.

(5) Hedge relationship was discontinued in 2020. The fair value adjustment taken will be amortised over the remaining life of the hedged items, and is recordec customer deposits.

(6) 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	2022			2021		
		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]	**(962)**	**979**	**(8)**	(127)	3	25
Total	**(962)**	**979**	**(8)**	(127)	3	25

Bank	2022				2021			
	Carrying amount of hedged items		Accumulated hedge adjustment on the hedged item	Change in fair value of hedged items in the year used for ineffectiveness measurement	Carrying amount of hedged items		Accumulated hedge adjustment on the hedged item[2]	Change in fair value of hedged items in the year used for ineffectiveness measurement[2]
	Assets £m	Liabilities £m	£m	£m	Assets £m	Liabilities £m	£m	£m
FAIR VALUE HEDGES								
Interest rate risk								
Fixed rate mortgages[4]	**9,520**	**-**	**(941)**	**(779)**	24,265	-	(179)	(420)
Fixed rate customer deposits[5]	**-**	**-**	**(2)**	**-**	-	-	(5)	-
Fixed rate FVOCI debt instruments[6]	**2,443**	**-**	**(613)**	**(629)**	3,010	-	(115)	(197)
Fixed rate issuances[3]	**-**	**(1,749)**	**284**	**268**	-	(2,015)	(15)	64
Inflation and interest rate risk								
Fixed rate FVOCI debt instruments[6]	**589**	**-**	**(105)**	**(96)**				
Foreign exchange and interest rate risk								
Fixed rate currency FVOCI debt instruments[6]	**76**	**-**	**(3)**	**(3)**	78	-	-	(5)
Fixed rate currency issuances[3]	**-**	**(849)**	**33**	**8**	-	(856)	26	32
Total	**12,628**	**(2,598)**	**(1,347)**	**(1,231)**	27,353	(2,871)	(288)	(526)

(1) Highly probable future cash flows arising from loans and advances to customers, due to customers and debt securities in issue.

(2) The accumulated hedge adjustment on the hedged item and the change in fair value of the hedged items used for ineffectiveness measurement have been restated in the comparative year in line with the current year presentation, as detailed in note 1.11.

(3) Hedged item is recorded in debt securities in issue and related party transactions.

(4) Hedged item and the cumulative fair value changes, are recorded in loans and advances to customers.

(5) 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.

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

3.6 Derivative financial instruments (continued)

Group	2022				2021			
			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	**(46)**	**962**	**17**	**(4)**	-	127	10	(5)
Foreign exchange risk								
Floating rate currency issuances	**-**	**-**	**-**	**-**	-	(28)	-	-
Total gains/(losses) on cash flow hedges	**(46)**	**962**	**17**	**(4)**	-	99	10	(5)

Group	Hedge ineffectiveness recognised in income	
	2022 £m	2021 £m
FAIR VALUE HEDGES		
Interest rate risk		
Fixed rate mortgages	**33**	(10)
Fixed rate FVOCI debt instruments	**(2)**	1
Fixed rate issuances	**(2)**	(4)
Inflation and interest rate risk		
Fixed rate FVOCI debt instruments	**-**	-
Foreign exchange and interest rate risk		
Fixed rate currency FVOCI debt instruments	**(1)**	-
Fixed rate currency issuances	**15**	-
Total losses on fair value hedges[(1)]	**43**	(13)

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

3.6 Derivative financial instruments (continued)

Bank	2022				2021			
		Effective portion recognised in other comprehensive income	Reclassified into Income statement as			Effective portion recognised in other comprehensive income	Reclassified into Income statement as	
	Hedge ineffectiveness recognised in income statement[1] £m	£m	Net interest income £m	Non-interest income £m	Hedge ineffectiveness recognised in income statement[1] £m	£m	Net interest income £m	Non-interest income £m
CASH FLOW HEDGES								
Interest rate risk								
Gross floating rate assets and gross floating rate liabilities	**(46)**	**962**	**19**	**-**	-	127	14	-
Total (losses)/gains on cash flow hedges	**(46)**	**962**	**19**	**-**	-	127	14	-

Bank	Hedge ineffectiveness recognised in income	
	2022 £m	2021 £m
FAIR VALUE HEDGES		
Interest rate risk		
Fixed rate mortgages	**33**	(10)
Fixed rate FVOCI debt instruments	**(2)**	1
Fixed rate issuances	**(3)**	(5)
Inflation and interest rate risk		
Fixed rate FVOCI debt instruments	**-**	-
Foreign exchange and interest rate risk		
Fixed rate currency FVOCI debt instruments	**(1)**	-
Fixed rate currency issuances	**5**	-
Total losses on fair value hedges[1]	**32**	(14)

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

3.7 Financial assets at fair value through other comprehensive income

Accounting policy

A financial asset is measured at FVOCI when: (i) the asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets; and (ii) the contractual terms give rise to cash flows on specified dates which are solely payments of principal and interest on the principal amount outstanding unless the financial asset is designated at FVTPL on initial recognition. An option for equity investments that are not held for trading can be taken to classify them at FVOCI where an irrevocable election is made at initial recognition. This option is available for each separate investment. The Group has not exercised this option for any equity investments.

Interest income and impairment gains and losses on FVOCI assets are measured in the same manner as for assets measured at amortised cost and are recognised in the income statement, with all other gains or losses recognised in other comprehensive income as a separate component of equity in the year in which they arise. Gains and losses arising from changes in fair value are included as a separate component of equity until sale when the cumulative gain or loss is transferred to the income statement. For all FVOCI assets, the gain or loss is calculated with reference to the gross carrying amount.

Debt instruments at FVOCI are subject to the same impairment criteria as amortised cost financial assets (note 3.2), with the ECL element recognised directly in the income statement. As the financial asset is 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.

A low credit risk option is available which allows entities not to assess whether there has been a significant increase in credit risk since initial recognition where the financial asset is deemed as being of low credit risk at the reporting date. The result of exercising the low credit risk exemption is that the financial assets are classed under Stage 1 with a 12-month ECL calculation applied.

The Group exercises the low credit risk option for debt instruments classified as FVOCI, recognising the high credit quality of the instruments. No material ECL provision is held for these financial assets.

Financial assets at FVOCI consists of £5,064m of listed securities (2021: £4,352m).

Note 3.15 contains further information on the valuation methodology applied to financial instruments at FVOCI at 30 September 2022 and their classification within the fair value hierarchy. Details of the credit quality of financial assets is provided in the Risk report.

3.8 Intangible assets and goodwill

Accounting policy

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

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

Goodwill arises on the acquisition of an entity and represents the excess of the fair value of the purchase consideration and direct costs of making the acquisition over the fair value of the Group's share of the net assets at the date of the acquisition. Goodwill is not subject to amortisation and is tested for impairment on an annual basis.

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

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

Group	Capitalised software	Goodwill	Core deposit intangible	Total
	£m	£m	£m	£m
Cost				
At 1 October 2020	1,028	11	6	1,045
Additions	80	-	-	80
Write-off	(65)	-	-	(65)
At 30 September 2021	1,043	11	6	1,060
Additions	**53**	**-**	**-**	**53**
Write-off	**(28)**	**-**	**-**	**(28)**
Disposal	**(8)**	**-**	**-**	**(8)**
At 30 September 2022	**1,060**	**11**	**6**	**1,077**
Accumulated amortisation and impairment				
At 1 October 2020	552	-	2	554
Charge for the year	123	-	1	124
Impairment	9	-	-	9
At 30 September 2021	684	-	3	687
Charge for the year	**81**	**-**	**3**	**84**
Impairment	**47**	**-**	**-**	**47**
Disposal	**(8)**	**-**	**-**	**(8)**
At 30 September 2022	**804**	**-**	**6**	**810**
Net book value				
At 30 September 2022	**256**	**11**	**-**	**267**
At 30 September 2021	359	11	3	373

3.8 Intangible assets and goodwill (continued)

Bank	Capitalised software	Goodwill	Core deposit intangible	Total
	£m	£m	£m	£m
Cost				
At 1 October 2020	1,099	11	6	1,116
Additions	80	-	-	80
Write-off	(65)	-	-	(65)
At 30 September 2021	1,114	11	6	1,131
Additions	**53**	**-**	**-**	**53**
Write-off	**(28)**	**-**	**-**	**(28)**
At 30 September 2022	**1,139**	**11**	**6**	**1,156**
Accumulated amortisation and impairment				
At 1 October 2020	623	-	2	625
Charge for the year	123	-	1	124
Impairment	9	-	-	9
At 30 September 2021	755	-	3	758
Charge for the year	**81**	**-**	**3**	**84**
Impairment	**47**	**-**	**-**	**47**
At 30 September 2021	**883**	**-**	**6**	**889**
Net book value				
At 30 September 2022	**256**	**11**	**-**	**267**
At 30 September 2021	359	11	3	373

All (2021: all) of the software additions in both Group and Bank form part of internally generated software projects.

A £62m charge (2021: £68m) (comprising write-offs of £17m (2021: £65m) and impairments of £45m (2021: £3m)) was recognised in the year following a reassessment of the Group's accounting practices on the capitalisation of internally generated software against the backdrop of the move to an Agile project delivery.

3.9 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 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	**2022**	2021
	£m	£m
Active members' defined benefit obligation	**(9)**	(16)
Deferred members' defined benefit obligation	**(987)**	(1,973)
Pensioner and dependant members' defined benefit obligations	**(1,220)**	(1,800)
Total defined benefit obligation	**(2,216)**	(3,789)
Fair value of Scheme assets	**3,216**	4,636
Net defined benefit pension asset	**1,000**	847
Post-retirement medical benefits obligations(1)	**(2)**	(2)

(1) Post-retirement medical benefits obligations are included within other liabilities (note 3.14).

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 2022 (2021: £2m) and is included within other liabilities in note 3.14.

3.9 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.

During 2020 the Trustee concluded the latest triennial valuation for the Scheme, which was conducted in accordance with Scheme data and market conditions as at 30 September 2019. The valuation resulted in an improvement in the Scheme's funding position, with a reported surplus of £144m (previously a deficit of £290m) and a technical provisions funding level of 103% (previously 94%). As the 2019 valuation outcome was a funding surplus, 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.

The next triennial valuation is due to be conducted in 2023 with Scheme data and market conditions as at 30 September 2022.

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

3.9 Retirement benefit obligations (continued)

IAS 19 position

The Scheme movements in the year are as follows:

Group and Bank

	2022				2021			
	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	**(3,789)**	**4,636**	**847**	**(248)**	(3,958)	4,681	723	(302)
Total expense								
Past service credit	**9**	**-**	**9**		3	-	3	
Interest (expense)/income	**(84)**	**104**	**20**		(61)	73	12	
Administrative costs	**-**	**(5)**	**(5)**		-	(6)	(6)	
Total (expense)/income recognised in the consolidated income statement	**(75)**	**99**	**24**		(58)	67	9	
Remeasurements								
Return on Scheme assets greater than discount rate	**-**	**(1,393)**	**(1,393)**	**(1,393)**	-	(19)	(19)	(19)
Actuarial:								
Loss - experience adjustments	**(16)**	**-**	**(16)**	**(16)**	(15)	-	(15)	(15)
Gain - demographic assumptions	**36**	**-**	**36**	**36**	2	-	2	2
Gain - financial assumptions	**1,495**	**-**	**1,495**	**1,495**	86	-	86	86
Remeasurement gains/(losses) recognised in other comprehensive income	**1,515**	**(1,393)**	**122**	**122**	73	(19)	54	54
Contributions and payments								
Employer contributions	**-**	**7**	**7**		-	61	61	
Benefit payments	**105**	**(105)**	**-**		99	(99)	-	
Transfer payments	**28**	**(28)**	**-**		55	(55)	-	
	133	**(126)**	**7**		154	(93)	61	
Balance sheet surplus at 30 September	**(2,216)**	**3,216**	**1,000**	**(126)**	(3,789)	4,636	847	(248)

In July 2021, the Trustees 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 three phases and is due to complete in calendar year 2023. A past service credit of £10m has been recognised in the year to 30 September 2022 (2021: £5m) in line with member acceptance of the PIE offer by the balance sheet date; the balance of the credit will be recognised next calendar year as the exercise concludes.

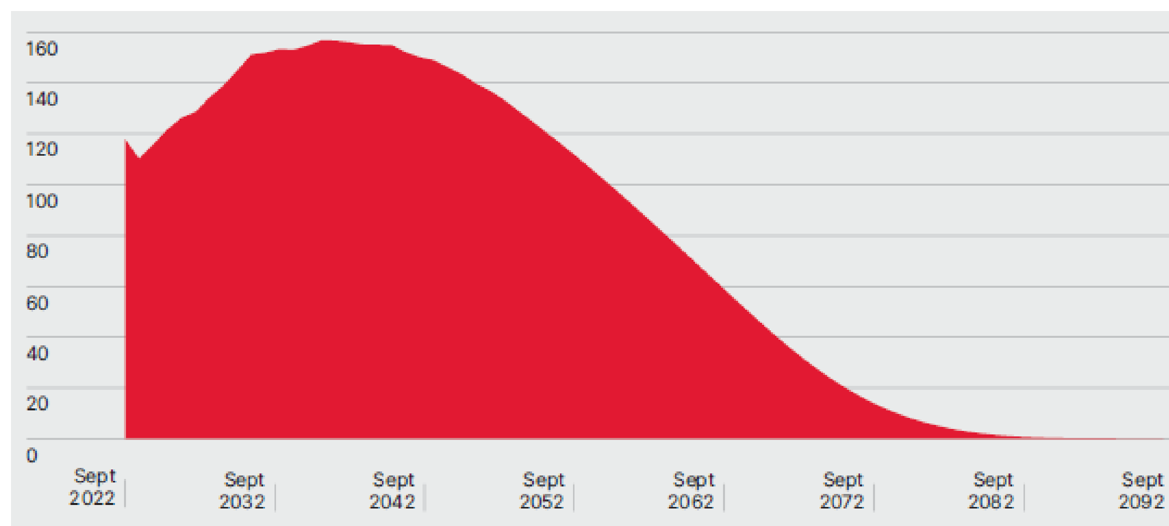
3.9 Retirement benefit obligations (continued)

The expected contributions and benefit payments for the year ending 30 September 2023 are £10m (2022: £7m) and £118m (2022: £115m) 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 2022 is 14 years (2021: 18.5 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 2022, the interest rate and inflation rate hedge ratios were 97% and 95% respectively (2021: 95% and 95%) 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.
- Return seeking assets – a range of investments designed to provide specific, planned and consistent returns.

3.9 Retirement benefit obligations (continued)

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

	2022				2021			
	Quoted £m	**Unquoted £m**	**Total £m**	**%**	Quoted £m	Unquoted £m	Total £m	%
Bonds								
Fixed government	**350**	**-**	**350**		894	-	894	
Index-linked government	**1,314**	**-**	**1,314**		1,815	-	1,815	
Global sovereign	**90**	**2**	**92**		117	4	121	
Corporate and other	**781**	**37**	**818**		1,011	47	1,058	
	2,535	**39**	**2,574**	**80%**	3,837	51	3,888	84%
Equities[1]								
Global equities	**-**	**137**	**137**		-	150	150	
Emerging market equities	**-**	**14**	**14**		-	16	16	
UK equities	**-**	**7**	**7**		-	8	8	
	-	**158**	**158**	**5%**	-	174	174	4%
Other								
Secured income alternatives	**-**	**229**	**229**		-	197	197	
Derivatives[2]	**-**	**(83)**	**(83)**		-	6	6	
Repurchase agreements	**-**	**(803)**	**(803)**		-	(719)	(719)	
Property	**-**	**59**	**59**		-	122	122	
Alternative credit	**-**	**645**	**645**		-	597	597	
Infrastructure	**-**	**194**	**194**		-	161	161	
Cash	**-**	**243**	**243**		-	209	209	
Equity options	**-**	**-**	**-**		1	-	1	
	-	**484**	**484**	**15%**	1	573	574	12%
Total Scheme assets	**2,535**	**681**	**3,216**	**100%**	3,838	798	4,636	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 2022, the Scheme had employer-related investments within the meaning of Section 40 (2) of the Pensions Act 1995 totalling £2m (2021: £2m)

3.9 Retirement benefit obligations (continued)

Actuarial assumptions

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

	2022	2021
	% p.a.	% p.a.
Financial assumptions		
Discount rate	**5.45**	2.08
Inflation (RPI)	**3.58**	3.40
Inflation (CPI)	**2.94**	2.77
Career average revalued earnings revaluations:		
Pre-31 March 2012 benefits (RPI)	**3.58**	3.40
Post-31 March 2012 benefits (CPI capped at 5% per annum)	**2.90**	2.73
Pension increases (capped at 2.5% per annum)	**2.21**	2.16
Pension increases (capped at 5% per annum)	**3.37**	3.23
Rate of increase for pensions in deferment	**2.91**	2.73

	2022	2021
	Years	Years
Demographic assumptions		
Post retirement mortality:		
Current pensioners at 60 - male	**27.0**	27.2
Current pensioners at 60 - female	**29.3**	29.4
Future pensioners at 60 - male	**28.0**	28.3
Future pensioners at 60 - female	**30.4**	30.5

3.9 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%	**(63)**	**(70)**	**(7)**
	- 0.25%	**64**	**74**	**6**
Inflation	+ 0.25%	**36**	**43**	**2**
	- 0.25%	**(34)**	**(43)**	**(2)**
Life expectancy	+1 year	**(67)**	**67**	**4**
	-1 year	**67**	**(67)**	**(4)**

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.

3.10 Customer deposits

	Group and Bank 2022 £m	2021 £m
Interest bearing demand deposits	**46,457**	46,839
Term deposits	**13,951**	15,097
Non-interest bearing demand deposits	**4,952**	4,936
	65,360	66,872
Accrued interest payable	**74**	99
	65,434	66,971

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

3.11 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.

Where relevant fair value hedge adjustments have been applied.

The breakdown of debt securities in issue is shown below:

2022

Group	**Securitisation £m**	**Covered bonds £m**	**Total £m**
Debt securities	**1,875**	**3,450**	**5,325**
Accrued interest payable	**5**	**17**	**22**
	1,880	**3,467**	**5,347**

2021

Group	Securitisation £m	Covered bonds £m	Total £m
Debt securities	2,386	1,842	4,228
Accrued interest payable	3	10	13
	2,389	1,852	4,241

2022

Bank	**Covered bonds £m**	**Total £m**
Total debt securities	**3,611**	**3,611**
Accrued interest payable	**17**	**17**
	3,628	**3,628**

2021

Bank	Covered bonds £m	Total £m
Debt securities	1,812	1,812
Accrued interest payable	10	10
	1,822	1,822

3.11 Debt securities in issue (continued)

Key movements in the year are shown in the tables below[1].

Group

	2022				2021			
	Issuances		**Redemptions**		Issuances		Redemptions	
	Denomination	**£m**	**Denomination**	**£m**	Denomination	£m	Denomination	£m
Securitisation	**GBP**	**700**	**USD, GBP**	**1,264**		-	USD, EUR, GBP	1,543
Covered bonds	**EUR, GBP**	**1,780**		**-**		-		-
		2,480		**1,264**		-		1,543

Bank

	2022				2021			
	Issuances		**Redemptions**		Issuances		Redemptions	
	Denomination	**£m**	**Denomination**	**£m**	Denomination	£m	Denomination	£m
Covered bonds	**EUR, GBP**	**1,780**		**-**		-		-
		1,780		**-**		-		-

(1) Other movements relate to foreign exchange, hedging adjustments and the capitalisation and amortisation of issuance costs.

Full details of all notes in issue can be found at https://www.virginmoneyukplc.com/investor-relations/debt-investors/.

3.12 Due to other banks

	Group and Bank	
	2022	2021
	£m	£m
Secured loans	**7,230**	5,896
Securities sold under agreements to repurchase[1]	**1,205**	-
Transaction balances with other banks	**1**	-
Deposits from other banks	**50**	22
	8,486	5,918

(1) The underlying securities sold under agreements to repurchase have a carrying value of £1,873m (2021: £Nil).

Secured loans comprise amounts drawn under the TFSME scheme (including accrued interest). In 2021, secured loans included both TFS and TFSME scheme drawings (including accrued interest).

3.13 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 and Bank	Employee related costs provision £m	Customer related provision £m	Property provision £m	Off-balance sheet ECL provisions[1] £m	Total £m
At 1 October 2020	16	130	26	-	172
Transfer of ECL from impairment provisions	-	-	-	7	7
Charge to the income statement	31	78	39	1	149
Utilised	(25)	(189)	(10)	-	(224)
At 30 September 2021	22	19	55	8	104
Charge/(credit) to the income statement	2	8	-	(5)	5
Utilised	(17)	(14)	(28)	-	(59)
At 30 September 2022	**7**	**13**	**27**	**3**	**50**

(1) The Group's ECL accounting policy can be found in (note 3.2).

During the year, the Group has refined its methodology for categorising provisions for liabilities and charges to align with current business operations. There has been no change to the total provisions in the prior year and comparatives have been amended to conform with the current year's presentation.

The change took the original provision categories and analysed this further to align with business operations. The revised prior year categories of PPI redress provision (£1m), customer redress and other provisions (£28m) and property closure and redundancy provision (£67m) is now allocated to employee related costs provision (£22m), customer related provision (£19m) and property provision (£55m). PPI redress provision of £1m has been reallocated to customer related provision, £10m of customer redress and other provisions has been reallocated in part £3m to employee related costs provision and £7m to property provision, and restructuring provisions of £19m which were previously included within property closure and redundancy provision has been reallocated to employee related costs provision.

Employee related costs provision

This includes provision for staff redundancies and for NIC on equity based compensation. During the year, provisions of £2m (2021: £31m) were raised relating to staff redundancy costs and NIC on equity based compensation.

Customer related provision

This relates to customer 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 provision

This includes costs for stores and office closures. During the year, provisions of £Nil (2021: £39m) were raised relating to store and office closures.

3.14 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**	
	2022	2021	**2022**	2021
	£m	£m	**£m**	£m
Notes in circulation	**1,822**	2,104	**1,822**	2,104
Accruals and deferred income	**70**	72	**67**	71
Deferred grant	**-**	20	**-**	20
Other	**496**	249	**497**	250
	2,388	2,445	**2,386**	2,445

In 2021, the Group received £9m from the Capability and Innovation Fund (as part of the RBS alternative remedies package), which has been utilised under the terms of the grant application during the year. As part of the grant the Group is subject to delivering a number of public commitments. These commitments can be found on the Banking Commission Remedies (BCR's) (the awarding body) website. As at 30 September 2022 the Group is currently on track with the delivery of these commitments.

The movement in the deferred grant is shown below:

	Group and Bank	
	2022	2021
	£m	£m
Opening balance	**20**	35
Grants received	**-**	9
Utilised against income statement spend in the year	**(20)**	(24)
Closing balance	**-**	20

3.15 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).
- 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.

3.15 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, as reported on the balance sheet, 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

	2022		2021	
	Carrying value	**Fair value**	Carrying value	Fair value
Financial assets	**£m**	**£m**	£m	£m
Loans and advances to customers[1]	**71,749**	**69,275**	71,874	72,227
Financial liabilities				
Customer deposits[2]	**65,434**	**65,069**	66,971	67,012
Debt securities in issue[2]	**5,347**	**5,359**	4,241	4,346
Due to other banks[2]	**8,486**	**8,469**	5,918	5,918
Due to related entities[2]	**3,210**	**3,292**	3,450	3,783

Bank	**2022**		2021	
	Carrying value	**Fair value**	Carrying value	Fair value
Financial assets	**£m**	**£m**	£m	£m
Loans and advances to customers[1]	**70,842**	**68,397**	70,922	71,267
Financial liabilities				
Customer deposits[2]	**65,434**	**65,069**	66,971	67,012
Debt securities in issue[2]	**3,628**	**3,481**	1,822	1,940
Due to other banks[2]	**8,486**	**8,469**	5,918	5,918
Due to related entities[2]	**4,941**	**5,023**	5,485	5,819

(1) Loans and advances to customers are categorised as Level 3 in the fair value hierarchy with the exception of £1,098m (2021: £1,057m) 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 at a weighted average cost of capital (appropriate to the portfolio) 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.

(d) *Due to other banks* – The fair value is determined from a discounted cash flow model using current market rates for instruments of similar terms and maturity.

(e) *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.

3.15 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 2022**				Fair value measurement 2021			
	Level 1 £m	**Level 2 £m**	**Level 3 £m**	**Total £m**	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets								
Financial assets at FVOCI	**5,064**	**-**	**-**	**5,064**	4,352	-	-	4,352
Loans and advances at FVTPL	**-**	**70**	**-**	**70**	-	133	-	133
Other financial assets at FVTPL	**-**	**-**	**2**	**2**	-	14	2	16
Derivative financial assets	**-**	**342**	**-**	**342**	-	139	1	140
Total financial assets at fair value	**5,064**	**412**	**2**	**5,478**	4,352	286	3	4,641
Financial liabilities								
Derivative financial liabilities	**-**	**327**	**-**	**327**	-	209	-	209
Total financial liabilities at fair value	**-**	**327**	**-**	**327**	-	209	-	209

Bank	**Fair value measurement 2022**				Fair value measurement 2021			
	Level 1 £m	**Level 2 £m**	**Level 3 £m**	**Total £m**	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets								
Financial assets at FVOCI	**5,064**	**-**	**-**	**5,064**	4,352	-	-	4,352
Loans and advances at FVTPL	**-**	**70**	**-**	**70**	-	133	-	133
Other financial assets at FVTPL	**-**	**-**	**1**	**1**	-	-	1	1
Derivative financial assets	**-**	**310**	**-**	**310**	-	87	-	87
Total financial assets at fair value	**5,064**	**380**	**1**	**5,445**	4,352	220	1	4,573
Financial liabilities								
Derivative financial liabilities	**-**	**192**	**-**	**192**	-	160	-	160
Total financial liabilities at fair value	**-**	**192**	**-**	**192**	-	160	-	160

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 £Nil of an unlisted equity investment that is valued based on an offer of purchase by an independent third party. The sale concluded in January 2022.

(d) *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.

(e) *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.

3.15 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:	2022		2021	
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	**2**	**1**	1	-
Fair value gains recognised[(1)]				
In profit or loss - unrealised	**-**	**(1)**	1	1
Purchases	**-**	**-**	-	-
Settlements	**-**	**-**	-	-
Balance at the end of the year	**2**	**-**	2	1

Level 3 movements analysis:	2022		2021	
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 £2m for Group and £1m for Bank which would be recognised directly in the income statement.

3.16 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**	
	2022	2021
	£m	£m
Interest expense and similar charges		
Interest expense	**(2)**	(3)
Other operating income		
Income from operating sub-leases where the Group is a lessor	**1**	1
Operating and administrative expenses		
Depreciation and impairment of right-of-use assets	**(26)**	(28)
Expense relating to short-term leases	**(1)**	(1)
Expense relating to leases of low-value assets that are not short-term leases	**(1)**	(1)
Total	**(29)**	(32)

The total leasing cash outflow in the year was £28m for Group and Bank (2021: £29m).

3.16 Lessee accounting (continued)

b) Amounts recognised on the balance sheet

Right-of-use assets

Group	2022 £m	2021 £m
As at 1 October	**135**	161
Additions	**4**	4
Remeasurements	**1**	1
Disposals	**(1)**	(2)
Depreciation and impairment	**(26)**	(29)
As at 30 September	**113**	135

Bank	2022 £m	2021 £m
As at 1 October	**134**	160
Additions	**5**	4
Remeasurements	**1**	1
Disposals	**(1)**	(2)
Depreciation and impairment	**(26)**	(29)
As at 30 September	**113**	134

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

The Group reviewed its existing surplus estate population 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. It was concluded that 19 properties (2021: 22) should be impaired following a reduction in value-in-use, resulting in an impairment charge of £4m (2021: £1m). In addition, an impairment of £5m was recognised in the current year in relation to right-of-use assets for office estate where no further economic benefit was expected following exit.

In the prior year the Group announced the closure of 30 stores leased by the Group and to relocate four stores to more prime locations in existing towns. The right-of-use assets were assessed following the above methodology resulting in an impairment charge of £5m.

3.16 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	
	2022	2021
	£m	£m
Operating leases	**1**	1
Finance leases	**3**	5
	4	6

Lease liabilities

	Group and Bank	
	2022	2021
	£m	£m
Lease liabilities[(1)]	**132**	154

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

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

	Group and Bank	
	2022	2021
Amounts falling due	**£m**	£m
Within 1 year	**22**	26
Between 1 and 5 years	**60**	73
Over 5 years	**66**	78
	148	177

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	
	2022	2021
Amounts falling due	**£m**	£m
Within 1 year	**4**	-
Between 1 and 5 years	**22**	21
Over 5 years	**99**	104
	125	125

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.

(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.

4.1.1 Share capital and share premium

	2022	2021
	£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	**2022 Number of shares**	2021 Number of shares	**2022 £m**	2021 £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 2022 rank equally with regard to the Bank's residual assets.

Interim dividends totalling 2.83p (2021: 0.16p) per ordinary share amounting to £353m (2021: £20m) were paid by the Bank in respect of the year ended 30 September 2022. A final dividend in respect of the year ended 30 September 2021 of 0.12p per ordinary share in the Bank, amounting to £14m, was paid in March 2022.

A final dividend in respect of the year ended 30 September 2022 of 0.85p per ordinary share in the Bank amounting to £106m to be paid in March 2023 is subject to the Virgin Money UK PLC shareholders approving the Virgin Money UK PLC dividend at the 2023 AGM. 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 comprises AT1 capital which consists 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 £73m and optional redemption on 8 December 2022. On 17 June 2022, securities totalling £377m (representing 83.86% of the original £450m principal amount) were redeemed. On 10 October 2022 it was announced that the remaining securities would be redeemed on the optional redemption date.
- 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.
- Perpetual securities (fixed 8.25% up to the first reset date) issued on 17 June 2022 with a nominal value of £350m and optional redemption on 17 June 2027.

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 £7m (2021: £3m). AT1 distributions of £60m were paid in the year (2021: £59m paid).

4.1.3 Other reserves

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.

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**	
	2022	2021	**2022**	2021
	£m	£m	**£m**	£m
At 1 October	**10**	(80)	**19**	(63)
Amounts recognised in other comprehensive income:				
Cash flow hedge – interest rate risk				
Effective portion of changes in fair value of interest rate swaps	**962**	127	**962**	127
Amounts transferred to the income statement	**(13)**	(5)	**(19)**	(14)
Taxation	**(260)**	(33)	**(259)**	(31)
Cash flow hedge – foreign exchange risk				
Effective portion of changes in fair value of cross currency swaps	**-**	(28)	**-**	-
Amounts transferred to the income statement	**-**	29	**-**	-
At 30 September	**699**	10	**703**	19

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 (2021: £5m).

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	2017, 2018, 2019, 2020 and 2021
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, 2019, 2020 and 2021
Share Incentive Plan (SIP)	All employees	Non-conditional share award	Continuing employment	2016, 2017 and 2019

(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 awards, 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.

Awards/rights made during the year:

Plan	Number outstanding at 1 October 2021	Number awarded	Number forfeited	Number released	**Number outstanding at 30 September 2022**	**Average fair value of awards at grant pence**
DEP						
2016 Commencement	2,620	-	-	(1,310)	**1,310**	266.03
2017 Bonus	49,909	-	-	(47,789)	**2,120**	313.20
2018 Bonus	170,649	-	-	(34,129)	**136,520**	192.35
2019 Bonus	85,544	-	-	(6,384)	**79,160**	174.50
2019 Commencement	19,843	-	-	(11,797)	**8,046**	174.50
2020 Commencement	19,570	-	-	(9,970)	**9,600**	135.40
2021 Bonus	-	590,513	(10,536)	(579,977)	**-**	172.65
2021 Commencement	-	107,747	-	-	**107,747**	142.70
LTIP						
2017 LTIP	380,924	-	-	(111,295)	**269,629**	313.20
2018 LTIP	4,751,736	-	(1,906,079)	(845,346)	**2,000,311**	190.47
2019 LTIP	7,680,636	-	(739,329)	-	**6,941,307**	174.50
2020 LTIP	10,379,519	-	(2,019,760)	-	**8,359,759**	135.40
2021 LTIP	-	6,761,290	(273,467)	-	**6,487,823**	172.65
SIP(1)						
2015 Demerger	629,169	-	-	(629,169)	**-**	194.67
2017 Free Share	564,118	-	-	(564,118)	**-**	313.20
2019 Free Share	1,684,854	-	(58,794)	(1,626,060)	**-**	202.53

(1) Shares awarded under the SIP do not have a release date but become available to award holders without restriction following the completion of relevant service conditions. The service conditions applicable to each of the awards in the table above has now been completed and, since no ongoing charge is taken in respect of these awards, the values in the table reflect that all awards have now fully vested and are available to award holders without restriction, with no awards still to vest as at 30 September 2022.

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 2021, based on the middle market share price on the day immediately preceding the grant (172.65p).

The Group has not issued awards under any plan with market performance conditions.

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, with the ECL allowance held as part of the provision for liabilities and charges balance (note 3.13).

Contingent liabilities
Contingent liabilities are possible obligations whose existence will be confirmed only by uncertain future events or present obligations where the transfer of economic benefit is uncertain or cannot be reliably measured. Contingent liabilities are not recognised on the balance sheet but are disclosed unless they are remote.

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

	Group		Bank	
	2022	2021	**2022**	2021
	£m	£m	**£m**	£m
Financial guarantees				
Guarantees and assets pledged as collateral security:				
Due in less than 3 months	**33**	20	**33**	20
Due between 3 months and 1 year	**23**	21	**23**	21
Due between 1 year and 3 years	**9**	13	**9**	13
Due between 3 years and 5 years	**3**	2	**3**	2
Due after 5 years	**44**	45	**44**	45
	112	101	**112**	101
Other credit commitments				
Undrawn formal standby facilities, credit lines and other commitments to lend at call	**19,247**	17,020	**19,204**	16,960

Capital commitments

The Group committed to providing additional funding of up to £5.5m over an eight-month period from June 2021 to enable the Group's JV, UTM, to support the business transformation and to meet its regulatory capital and liquidity requirements, of which £Nil was the remaining commitment as at 30 September 2022 (2021: £4m). 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 2022 of £0.4m (2021: £0.2m).

Other contingent liabilities

Conduct risk related matters

There continues to be uncertainty with judgement required in determining the quantum of conduct risk related liabilities, with note 3.13 reflecting the Group's current position where a provision can be reliably estimated. Until all matters are resolved 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	
	2022	2021	**2022**	2021
	£m	£m	**£m**	£m
Adjustments included in profit before tax				
Interest receivable	**(2,217)**	(1,910)	**(2,204)**	(1,897)
Interest payable	**641**	550	**652**	568
Depreciation, amortisation and impairment (note 2.4)	**179**	191	**179**	191
Derivative financial instruments fair value movements	**22**	9	**28**	21
Impairment losses/(credit) on credit exposures (note 3.2)	**52**	(131)	**52**	(129)
Equity based compensation (note 4.2)	**4**	5	**-**	-
Costs recharged to parent entity	**14**	3	**24**	(80)
Impairment of investment in subsidiaries	**-**	-	**6**	38
Gain on disposal of FVOCI assets (note 2.3)	**(4)**	-	**(4)**	-
Other non-cash movements	**3**	62	**(1)**	57
	(1,306)	(1,221)	**(1,268)**	(1,231)
Changes in operating assets				
Net (increase)/decrease in:				
Balances with supervisory central banks	**(3)**	(38)	**(3)**	(38)
Derivative financial instruments	**1,847**	257	**1,875**	175
Financial assets at FVTPL	**56**	29	**43**	44
Loans and advances to customers	**(713)**	491	**(758)**	450
Defined benefit pension assets	**(7)**	(61)	**(7)**	(61)
Other assets	**33**	141	**33**	140
	1,213	819	**1,183**	710
Changes in operating liabilities				
Net increase/(decrease) in:				
Due to other banks	**1,233**	(50)	**1,233**	(50)
Derivative financial instruments	**119**	(41)	**32**	(89)
Customer deposits	**(1,510)**	(644)	**(1,510)**	(644)
Provisions for liabilities and charges	**(50)**	(72)	**(52)**	(72)
Other liabilities	**(32)**	(219)	**(33)**	(220)
	(240)	(1,026)	**(330)**	(1,075)

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

	Group 2022 £m	Group 2021 £m	Bank 2022 £m	Bank 2021 £m
Cash and balances with central banks (less mandatory deposits)	**11,955**	9,453	**11,955**	9,453
Due from other banks	**656**	800	**268**	146
	12,611	10,253	**12,223**	9,599

5.3 Related party transactions

Amounts due from related entities	Group 2022 £m	Group 2021 £m	Bank 2022 £m	Bank 2021 £m
Loans and advances	**-**	-	**1,037**	999
Other receivables	**4**	4	**60**	100
Total amounts due from related entities	**4**	4	**1,097**	1,099
Interest income on the above amounts was as follows:				
Interest income	**-**	-	**13**	11
Total interest income from related entities	**-**	-	**13**	11

Amounts due to related entities	Group 2022 £m	Group 2021 £m	Bank 2022 £m	Bank 2021 £m
Deposits	**50**	19	**541**	449
Other payables	**5**	5	**1,245**	1,610
Subordinated debt[1]	**913**	1,015	**913**	1,015
Medium-term notes[2]	**2,242**	2,411	**2,242**	2,411
Total amounts due to related entities	**3,210**	3,450	**4,941**	5,485
Interest expense on the above amounts was as follows (note 2.2):				
Interest expense to related entities	**128**	122	**172**	155
Total interest expense	**128**	122	**172**	155

(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.

These are all classified at amortised cost and, for IFRS 9 purposes, held under Stage 1. The impact of the ECL requirements under IFRS 9 on these financial assets is immaterial.

5.3 Related party transactions (continued)

Other transactions with related entities	Group		Bank	
	2022	2021	**2022**	2021
	£m	£m	**£m**	£m
Other income				
Non-interest income received	**1**	-	**85**	49
Other expenses				
Other expenses	**18**	17	**17**	17
Equity				
Ordinary dividends paid	**367**	20	**367**	20
AT1 distributions	**60**	59	**60**	59
Total dividends to related entities	**427**	79	**427**	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 Group provides banking services to the Scheme, with customer deposits of £12m (2021: £40m). Pension contributions of £7m were made to the Scheme in the year (2021: £61m).

The Group and the Trustee to the Scheme (note 3.9) 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 (2021: £10m). The total share of loss for the year was £4m (2021: £5m). In addition, the Group had the following transactions with JV entities during the period:

- Salary Finance - the Group provides Salary Finance with a revolving credit facility funding line, of which the current gross lending balance was £318m (2021: £223m) and the undrawn facility was £32m (2021: £37m). The facility is now held under Stage 2 for credit risk purposes (2021: Stage 1), with an ECL allowance of £19m (2021: £Nil) held against the lending; further detail on the ECL allowance is provided in the credit risk section of the Risk report. Additionally, the Group received £10m (2021: £6m) of interest income from Salary Finance in the year. Board approval is in place for this facility up until March 2023 with £400m being the approved limit.
- UTM - the Group provides banking services to UTM which has resulted in amounts due of £4m (2021: £3m). Additionally, the Group received £7m of recharge income in the year (2021: £7m) from UTM in accordance with a Service Level Agreement in respect of resourcing, infrastructure and marketing. During the year, the Group provided £4m of additional funding to UTM (2021: £12m).

Other related party transactions with Virgin Group
The Group has related party transactions with other Virgin Group companies:

- The Group incurs credit card commissions and air mile charges with Virgin Atlantic Airways Limited (VAA) in respect of an agreement between the two parties. Amounts payable to VAA totalled £1m (2021: £2m) and expenses of £16m were incurred in the year (2021: £12m).
- The Group incurs charges and receives commissions concerning the cashback incentive scheme with Virgin Red Limited in relation to the credit card and personal current account portfolio. Amounts receivable from Virgin Red totalled £0.1m (2021: £Nil), amounts payable totalled £1m (2021: £Nil) and during the year this resulted in expenses of £3m (2021: £0.8m) along with income of £0.5m (2021: £Nil).
- The Group has an arrangement with Virgin Start Up Limited to host a series of events, podcasts and videos and other digital content. During the year this resulted in expenses of £0.5m (2021: £0.1m).

Charities
The Group provides banking services to the Virgin Money Foundation ('Foundation') which has resulted in customer deposits of £1m (2021: £1m). The Group has made donations of £1m in the year (2021: £1m) to the Foundation to enable it 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 (2021: £0.4m).

5.3 Related party transactions (continued)

Compensation of key management personnel (KMP)

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

	2022 £m	2021 £m
Salaries and short-term benefits	**9**	9
Equity based compensation[1]	**3**	3
	12	12

(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 2022 were £5m (2021: £3m).

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 2022 (2021: none).

None of the Directors hold share options and none were exercised during the year (2021: none).

Disclosures in respect of the highest paid Director

	2022 £m	2021 £m
Aggregate remuneration[1]	**2**	2

(1) Aggregate remuneration includes amounts paid for the 2022 year and amounts received during the year in relation to the 2018 LTIP award. LTIP figures in the single figure table for Executive Directors' 2022 remuneration in the Remuneration report relate to the 2019 LTIP award in respect of the 2020-2022 LTIP performance period cycle.

The highest paid Director does not hold any share options, nor were they a member of any pension plan during 2022, nor 2021.

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

	2022 £m	2021 £m
Loans and advances	**1**	3
Deposits	**1**	2

No provisions have been recognised in respect of loans provided to KMPs (2021: £Nil). There were no debts written off or forgiven during the year to 30 September 2022 (2021: £Nil). Included in the above are five (2021: six) loans totalling £0.3m (2021: £0.3m) made to Directors. In addition to the above, there are guarantees of £Nil (2021: £Nil) made to Directors and their related parties.

5.4 Pillar 3 disclosures

UK Capital Requirements Regulation

Pillar 3 disclosure requirements are set out within the Disclosure (CRR) part of the PRA rulebook. The disclosures required under the PRA framework are substantially equivalent to those required by Part Eight of the EU CRR. The consolidated disclosures of Virgin Money UK PLC, for the 2022 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/annual-reports/.

5.5 Post balance sheet events

There have been no significant events between 30 September 2022 and the date of approval of the Annual Report and Accounts which would require a change to or additional disclosure in the financial statements.

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	
	2022	2021
	£m	£m
At 30 September	**50**	50

The table below represents the wholly-owned subsidiary undertakings of the Group and Bank as at 30 September 2022:

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) Limited	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 Limited	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						
CGF No 9 Limited	Leasing	Ordinary	100%	Scotland	30 St Vincent Place, Glasgow, G1 2HL	30 September
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

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) Limited

An impairment test on the carrying value of the Bank's investment in Virgin Money Holdings (UK) Limited has been undertaken during the year, resulting in an impairment charge of £6m as at 30 September 2022 (2021: £12m). For the purposes of the impairment test, the carrying value of the Bank's investment is compared to the net asset value (as a proxy for fair value) of the companies in the Virgin Money Holdings (UK) Group. The recoverable amount of Virgin Money Holdings (UK) Limited is £22m as at 30 September 2022 (2021: £26m).

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 2022	Nature of business	Country of incorporation	Registered office	Financial year end
Clydesdale Covered Bonds No. 2 LLP (in liquidation)	Acquisition of mortgage loans	England	10 Fleet Place, London, EC4M 7RB	30 September
Eagle Place Covered Bonds LLP	Acquisition of mortgage loans	England	Jubilee House, Gosforth, Newcastle upon Tyne, NE3 4PL	30 September
Gosforth Funding 2016-1 PLC (in liquidation)	Issuer of securitised notes	England	10 Fleet Place, London, EC4M 7RB	30 September
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 2016-1 Limited (in liquidation)	Holding company	England	10 Fleet Place, London, EC4M 7RB	30 September
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 2016-1 Limited (in liquidation)	Trust	England	10 Fleet Place, London, EC4M 7RB	30 September
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	Suite 2, Seventh Floor, 50 Broadway, London, SW1H 0DB	30 September
Lanark Holdings Limited	Holding company	England	Suite 2, Seventh Floor, 50 Broadway, London, SW1H 0DB	30 September
Lanark Master Issuer PLC	Issuer of securitised notes	England	Suite 2, Seventh Floor, 50 Broadway, London, SW1H 0DB	30 September
Lanark Trustees Limited	Mortgages trustee	England	Suite 2, Seventh Floor, 50 Broadway, London, SW1H 0DB	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

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

6.2 Bank investments in controlled entities (continued)

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 and principal place of business (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 and Virgin Money Trustee Limited, both dormant companies registered at Jubilee House, Gosforth, Newcastle upon Tyne, NE3 4PL.

Investments in JVs are recognised in the consolidated financial statements within other assets. The undertakings above are incorporated in the UK.

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 188, 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 £5,288m (2021: £5,294m) plus senior unsecured securities issued by Clydesdale Bank PLC with greater than one year to maturity at the year end of £2,423m (2021: £2,408m) divided by RWAs at the period end of £24,128m (2021: £24,194m).
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

Management exclude certain items from the Group's statutory position to arrive at an underlying performance basis. Management's approach to underlying adjustments is aligned to the European Securities and Markets Authority (ESMA) guidelines on APMs and recommendations are subject to review and agreement by the Virgin Money Board Audit Committee. Additional detail on these items is provided below to help understand their exclusion from underlying performance.

Item	**2022 £m**	2021 £m	Reason for exclusion from the Group's current underlying performance
Restructuring charges	**(82)**	(146)	The current period costs relate to the Group's Digital-First strategy. The Group expects to incur c.£275m of restructuring charges across FY22-24. FY21 costs represented the Group's three year integration plan following the acquisition of Virgin Money Holidays (UK) PLC and comprised a number of one-off expenses that were required to realise the anticipated cost synergies.
Acquisition accounting unwinds	**(35)**	(88)	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. 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	**(8)**	(76)	These costs are historical in nature and are not indicative of the Group's current practices.
Other:			
SME transformation	**-**	(1)	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	**(9)**	(6)	These costs relate to UTM's transformation costs principally for the build of a new platform for administration and servicing.
Internally developed software adjustments	**(62)**	(68)	These costs relate to the write-off of WIP and intangible asset balances held on the balance sheet as a result of a reassessment of the Group's practices on capitalisation against the backdrop of the move to an Agile project delivery.
Total other	**(71)**	(75)	
Total underlying adjustments	**(196)**	(385)	

Main Glossary

Term	Definition
Additional Tier 1 **(AT1)**	Securities that are considered AT1 capital in the context of CRD IV.
Agile	Agile working is about bringing people, processes, connectivity and technology, time and place together to find the most appropriate and effective way of working.
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	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.
Coronavirus business interruption loan scheme	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	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 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.
CRR II	Capital Requirements Regulation (EU) 575/2013 and Directive (EU) 2013/36, revised by Regulation (EU) 2019/876 and Directive (EU) 2019/878, as implemented in the UK by PRA Policy Statement 22/21 and incorporated into the PRA Rulebook from 1 January 2022.

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 rate used to calculate interest income or expense under the effective interest method.
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.
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-absorbing capacity (LAC) requirement	The required level of MREL resources that the Group is required to hold to meet its MREL requirement and applicable capital buffers set by the BoE.
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.
Personal lending	Lending to individuals rather than institutions excluding mortgage lending which is reported separately.
probability of default **(PD)**	The probability that a customer will default over either the next 12 months or lifetime of the account.
Recovery loan scheme **(RLS)**	A scheme implemented by the UK Government to provide financial support to small and medium sized businesses across the UK to promote growth and investment following the disruption caused by COVID-19.
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 that 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	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.
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.

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
BCBS	Basel Committee on Banking Supervision
BCR	Banking Competition Remedies
BoE	Bank of England
bps	Basis points
BTL	Buy-to-let
CCyB	Countercyclical Capital Buffer
CET1	Common Equity Tier 1 Capital
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
FIRB	Foundation internal ratings based
FPC	Financial Policy Committee
FRC	Financial Reporting Council
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
JV	Joint Venture
KMP	Key management personnel
LAC	Loss-absorbing capacity
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
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
RLS	Recovery loan scheme
RMBS	Residential mortgage-backed securities
RMF	Risk Management Framework
RPI	Retail Price Index
RWA	Risk-weighted asset
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
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
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.

	2022
	UK
Average FTE employees (number)	**6,866**
Total operating income (£m)	**1,711**
Profit before tax (£m)	**590**
Corporation tax paid (£m)	**59**
Public subsidies received (£m)	**-**
Return on assets (%)	**0.58%**

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/annual-reports/.

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Forward-looking statements

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