28 February 2017

Pursuant to Listing Rule 9.6.1, the Annual Report and Accounts 2016 has been submitted to the UK Listing Authority and will shortly be available for inspection at the UK Listing Authority's Document Viewing Facility, via the National Storage Mechanism, which is located at: www.hemscott.com/nsm.do.

A copy of the Annual Report and Accounts 2016, Pillar III Disclosures 2016 and an investor presentation are available within the Investor Relations section of our website www.virginmoney.com.

This announcement also contains additional information for the purposes of compliance with the Disclosure and Transparency Rules, including principal risks and uncertainties, details of related party transactions and a responsibility statement.

Reference to pages and numbers refer to page numbers and notes to the financial statements in the Annual Report and Accounts 2016.

Virgin Money Holdings (UK) plc

Full year results

BASIS OF PRESENTATION

This report covers the results of Virgin Money Holdings (UK) plc together with its subsidiaries ("Virgin Money" or "the Group") for the year ended 31 December 2016.

Statutory basis

Statutory information is set out in the Financial Statements section of this announcement.

Underlying results

In order to present a more meaningful view of business performance, the results of the Group are presented on an underlying basis of reporting as described below. The following items have been excluded from underlying profits:

- IPO share based payments;
- Strategic items;
- Simplification costs;
- Fair value losses on financial instruments.

Unless otherwise stated, income statement commentaries throughout this document compare the year ended 31 December 2016 to the year ended 31 December 2015, and the balance sheet analysis compares the Group balance sheet as at 31 December 2016 to the Group balance sheet as at 31 December 2015.

Alternative performance measures

The Group uses a number of alternative performance measures, in the discussion of its business performance and financial position. Further information on these measures is set out on page 267 of the Annual Report and Accounts 2016.

Forward looking statements

This document contains certain forward looking statements with respect to the business, strategy and plans of Virgin Money and its current goals and expectations relating to its future financial condition and performance. Statements that are not historical facts, including statements about Virgin Money's or its directors' and/or management's beliefs and expectations, are forward looking statements. By their nature, forward looking statements involve risk and uncertainty because they relate to events and depend upon circumstances that will or may occur in the future. Factors that could cause actual business, strategy, plans and/or results (including but not limited to the payment of dividends) to differ materially from the plans, objectives, expectations, estimates and intentions expressed in such forward looking statements made by Virgin Money or on its behalf include, but are not limited to: general economic and business conditions in the UK and internationally; inflation, deflation, interest rates and policies of the Bank of England, the European Central Bank and other G8 central banks; fluctuations in interest rates (including low or negative rates), exchange rates, stock markets and currencies; the ability to access sufficient sources of capital, liquidity and funding when required; changes to Virgin Money's credit ratings; the ability to derive cost savings; changing demographic developments, including mortality, and changing customer behaviour, including consumer spending, saving and borrowing habits; changes in customer preferences; changes to borrower or counterparty credit quality; instability in the global financial markets, including Eurozone instability, the potential for one or more countries to exit the European Union (EU) (including the UK following its EU referendum vote to leave the EU) or the Eurozone, and the impact of any sovereign credit rating downgrade or other sovereign financial issues; technological changes and risks to cyber security; natural and other disasters, adverse weather and similar contingencies outside Virgin Money's control; inadequate or failed internal or external processes, people and systems; terrorist acts and other acts of war or hostility and responses to those acts; geopolitical, pandemic or other such events; changes in laws, regulations, taxation, accounting standards or practices, including as a result of the exit by the UK from the EU or a further possible referendum on Scottish independence; regulatory capital or liquidity requirements and similar contingencies outside Virgin Money's control; the policies and actions of governmental or regulatory authorities in the UK, the EU, the US or elsewhere including the implementation and interpretation of key legislation and regulation; the ability to attract and retain senior management and other employees; actions or omissions by Virgin Money's directors, management or employees , the extent of any future impairment charges or write-downs caused by, but not limited to, depressed asset valuations, market disruptions and illiquid markets; market relating trends and developments; exposure to regulatory scrutiny, legal proceedings, regulatory investigations or complaints; changes in competition and pricing environments; the inability to hedge certain risks economically; the adequacy of loss reserves; the actions of competitors, including non-bank financial services, lending companies and digital innovators and disruptive technologies; and the success of Virgin Money in managing the risks of the foregoing.

Any forward-looking statements made in this document speak only as of the date they are made and it should not be assumed that they have been revised or updated in the light of new information of future events. Except as required by the Prudential Regulation Authority, the Financial Conduct Authority, the London Stock Exchange plc or applicable law, Virgin Money expressly disclaims any obligation or undertaking to release publicly any updates of revisions to any forward-looking statements contained in this document to reflect any change in Virgin Money's expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based.

VIRGIN MONEY GROUP 2016 RESULTS

VIRGIN MONEY HOLDINGS (UK) PLC ANNOUNCES STRONG FINANCIAL PERFORMANCE SUPPORTED BY CONTINUED GROWTH IN HIGH-QUALITY LENDING

- **Underlying profit before tax increased by 33 per cent to £213.3 million, from £160.7 million in 2015**
- **Customer loan balances increased by 19 per cent against continued strict underwriting principles**
- **Customer base increased by 15 per cent to 3.3 million at rate of over 35,000 customers per month, driven predominantly through digital channels**
- **Overall Net Promoter Score (NPS) improved to +29 from +19, making Virgin Money one of the leading UK retail banks for customer advocacy**

Financial Highlights

- Underlying profit before tax increased by 33 per cent to £213.3 million, from £160.7 million in 2015.
- Underlying return on tangible equity increased to 12.4 per cent, from 10.9 per cent in 2015.
- Underlying cost:income ratio improved to 57.2 per cent, from 63.5 per cent in 2015.
- Statutory profit before tax increased to £194.4 million, compared to £138.0 million in 2015.
- Underlying basic earnings per share increased to 32.7 pence, compared to 26.8 pence in 2015.
- The Board recommends a final dividend of 3.5 pence per ordinary share. The total dividend for the year will be 5.1 pence per ordinary share, an increase of 13 per cent compared to 2015.
- Common Equity Tier 1 ratio of 15.2 per cent and a leverage ratio of 4.4 per cent as at 31 December 2016.

Jayne-Anne Gadhia, Chief Executive at Virgin Money, said:

"I am delighted to report another very successful year for Virgin Money in 2016. Our customer-focused strategy of growth, quality and returns continues to achieve and maintain outstanding customer approval ratings, excellent asset quality and strong financial performance. We recorded market-beating growth in our core mortgages, savings and credit card businesses to deliver a 33 per cent increase in underlying profit before tax to £213.3 million and strengthen our underlying return on tangible equity from 10.9 per cent to 12.4 per cent.

"We continue to target high quality lending growth and the combination of strong new mortgage lending and improved customer retention resulted in 17 per cent growth in mortgage balances to £29.7 billion, significantly outpacing the market. Our credit card business continues to flourish and 55 per cent growth in prime credit card balances to £2.4 billion means we remain well-placed to reach our target of £3 billion high-quality credit card balances at the end of 2017. The performance of our Essential Current Account was particularly strong and customer balances increased more than fivefold over the year. Our savings franchise continues to perform with 12 per cent growth in deposit balances to £28.1 billion and we are pleased with the increasing contribution and momentum in our Financial Services business.

"We increased our overall customer base by 15 per cent to 3.3 million, supported by growth in customer numbers across every product category. Our continued focus on delivering excellent customer service led to new highs in customer advocacy with our overall Net Promoter Score improving to +29, making us one of the best-rated retail banks in the UK.

"We are confident of sustaining strong asset growth and maintaining our excellent asset quality. We are excited about the strategic opportunities ahead of us including the build of our digital bank, which will be transformational for the business, and our partnership with Virgin Red, which will give our customers access to great deals from across the broader Virgin Group of companies. We will continue to put customers at the heart of everything we do and remain on track to sustain a solid double-digit return on equity in 2017."

Delivered strong growth in customer balances

- Mortgage balances increased by 17 per cent to £29.7 billion.
- Gross mortgage lending grew by 12 per cent to £8.4 billion, a market share of 3.4 per cent.
- Net mortgage lending grew by 20 per cent to £4.3 billion, a market share of 11 per cent.
- Retail deposit balances increased by 12 per cent to £28.1 billion.
- Credit card balances increased to £2.4 billion, up 55 per cent, a 3.5 per cent market share.

Maintained our high-quality balance sheet, underpinned by robust asset quality

- Strong capital position, with a Common Equity Tier 1 ratio of 15.2 per cent at 31 December 2016.
- Total capital ratio of 20.4 per cent and a leverage ratio of 4.4 per cent at 31 December 2016.
- Low overall cost of risk at 0.13 per cent reflects our excellent credit quality, driven by our conservative risk appetite and prudent underwriting.
- Mortgage arrears remained at low levels, with loans over three months in arrears of 0.15 per cent compared with the latest industry average of 1.00 per cent.
- Credit cards cost of risk improved to 1.70 per cent in 2016, from 2.00 per cent in 2015, reflecting the continued high quality of the book.

Continued to pursue our ambition of making 'everyone better off'

- *Customers:* total customer numbers increased to 3.3 million and overall NPS improved to +29 from +19 in 2015.

- *Communities:* helped charities raise £92 million in 2016 through Virgin Money Giving, Virgin Money's not-for-profit online donation service. The Virgin Money Foundation has now distributed grants worth almost £2 million in the North East of England since August 2015.
- *Corporate partners:* awarded the prestigious 'Best Lender Award' at the Legal & General Mortgage Club Awards for the second year running.
- *Colleagues:* maintained strong colleague engagement with an overall engagement score of 81 per cent, which benchmarks strongly against UK high performing companies.

Outlook

- Our strategy of growth, quality and returns is clear and unchanged. We will continue to target 3 to 3.5 per cent of high-quality gross mortgage lending, ahead of our market share of stock. We will maintain the application of strict underwriting standards to protect asset quality as we progress towards our target of £3 billion credit card balances by the end of 2017. As a result of the strength of the business, our operating leverage and our continued ability to manage our cost base, we remain well-placed to maintain a solid double-digit return on tangible equity (RoTE), somewhat ahead of the 12.4 per cent RoTE achieved in 2016.
- As a UK retail bank focused on serving domestic customers, the decision to exit the EU does not directly impact on our business. Whilst the UK economy proved resilient during the second half of the year, the eventual timing and nature of the UK's exit from the EU remains unclear and the longer-term impact on the economy is uncertain.
- We are sufficiently nimble to adjust to changes in the operating environment and will continue to target high-quality growth opportunities in value accretive market segments.
- Following the successful build of our credit card business, enhancing Virgin Money's digital capability is now a key focus having entered into a strategic partnership with 10x Future Technologies to build a scalable, integrated digital banking platform. Over 82 per cent of total sales were carried out digitally in 2016 and the enhancement of our online and mobile distribution will help us continue to serve our customers' emerging needs.
- Despite the current prolonged period of low interest rates we achieved a net interest margin (NIM) of 160 basis points in 2016. Although asset spreads will continue to put pressure on NIM, we expect to continue offsetting this pressure through strong income growth, a cost:income ratio of 50 per cent exiting 2017, impairments of up to 20 basis points and drawing from the Term Funding Scheme. We expect our NIM for 2017 to be up to 160 basis points.
- We are pleased with the increasing momentum in our Financial Services business and together with fee income from our lending products, other income should generate around 10 per cent of our total income.
- Our philosophy regarding acquisitions is unchanged. We will consider potential opportunities that are a good fit with the business, value accretive and within our prudent risk appetite.

CONSOLIDATED INCOME STATEMENT

	2016 £ million	2015 £ million[1]	***Change %***
Net interest income	**519.0**	456.1	**14**
Other income	**67.9**	67.4	**1**
Total income	**586.9**	523.5	**12**

Costs	**(336.0)**	(332.5)	**1**
Impairment	**(37.6)**	(30.3)	**24**
Underlying profit before tax	**213.3**	160.7	**33**

[1] Restated to show fair value gains and losses on financial instruments as a separate line item. In 2015, these were previously included in the costs line.

CONSOLIDATED BALANCE SHEET

	At 31 Dec 2016 £ million	At 31 Dec 2015 £ million	***Change*** *%*
Assets			
Cash and balances at central banks	**786.3**	888.6	**(12)**
Loans and receivables	**33,003.4**	27,724.6	**19**
Available-for-sale financial assets	**858.8**	1,296.9	**(34)**
Other	**407.1**	318.9	**28**
Total assets	**35,055.6**	30,229.0	**16**
Liabilities and equity			
Deposits from banks	**2,132.5**	1,298.7	**64**
Customer deposits	**28,106.3**	25,144.9	**12**
Debt securities in issue	**2,600.0**	2,039.4	**28**
Other	**537.8**	397.3	**35**
Provisions	**8.5**	8.4	**1**
Total liabilities	**33,385.1**	28,888.7	**16**
Total equity	**1,670.5**	1,340.3	**25**
Total liabilities and equity	**35,055.6**	30,229.0	**16**

KEY RATIOS

		2016	2015	***Change***
Net interest margin	%	**1.60**	1.65	**(5)bps**
Underlying cost:income ratio	%	**57.2**	63.5	**(6.3)pp**
Cost of risk[1]	%	**0.13**	0.12	**1bp**
Statutory basic earnings per share	p	**29.4**	22.9	**28%**
Tangible net asset value per share	£	**2.73**	2.54	**19p**
Common Equity Tier 1 ratio	%	**15.2**	17.5	**(2.3)pp**
Leverage ratio	%	**4.4**	4.0	**0.4pp**
Return on tangible equity	%	**12.4**	10.9	**1.5pp**

[1] Defined as impairment charges net of debt recoveries divided by average gross balances for the period.
Key ratios are presented on an underlying basis except where stated.

RECONCILIATION TO STATUTORY PROFIT

	2016 £ million	2015 £ million	***Change %***
Underlying profit before tax	**213.3**	160.7	**33**
IPO share payments	**(2.0)**	(10.5)	
Strategic items	**(2.4)**	(8.1)	
Simplification costs	**(5.6)**	(3.7)	

Fair value losses on financial instruments	**(8.9)**	(0.4)	
Statutory profit before tax	**194.4**	138.0	**41**

The Group uses a number of Alternative Performance Measures (APMs), in addition to underlying profit, in the analysis and discussion of its financial performance and financial position. APMs do not have standardised definitions and may not be directly comparable to measures defined within IFRS. A full list of APMs used by the Group, including their bases of calculation, are set out below.

CHIEF EXECUTIVE'S REVIEW

Results overview

DELIVERING GROWTH, QUALITY AND RETURNS

The strong performance of the business in uncertain and challenging conditions demonstrates the strength of the business and the benefits of our customer-focused strategy of growth, quality and returns, which continues to deliver excellent financial performance.

Against the backdrop of the UK's decision to leave the European Union and the resulting economic and political uncertainty, we continued to focus on providing outstanding service to our customers and intermediaries, growing our balance sheet carefully, protecting asset quality and delivering solid double digit shareholder returns. Our underlying profit before tax increased by 33 per cent to £213.3 million.

We protect our unique position as a low risk UK retail bank, unburdened by legacy conduct issues, with a far-sighted and data driven approach to risk management and asset quality. Our low cost of risk at 13 basis points was supported by our prudent risk appetite, consistent underwriting and rigorous use of credit data analytics as well as the benign economic environment.

Growth in mortgage and credit card lending was delivered without compromising asset quality, which remained within our risk appetite. Total customer loan balances grew by 19 per cent and our portfolios demonstrated stable or improving trends across a variety of credit metrics year-on-year.

Looking ahead, we believe our low-risk business model and strong balance sheet, combined with a continued focus on operational excellence, including strong cost and risk management, means we remain well positioned to continue to grow in a wide range of market conditions.

DELIVERING HIGH-QUALITY GROWTH

Mortgages

UK mortgage market activity remained strong in 2016, with gross lending of £245 billion, 11 per cent higher than in 2015.

While housing market activity slowed slightly following the EU referendum, demand returned strongly to the market in the second half of the year and there was an increase in remortgage activity following the reduction in Bank Base Rate in August.

Despite a highly competitive market, we were able to take a gross lending market share of 3.4 per cent, protect spreads and maintain our excellent asset quality.

We delivered gross mortgage lending of £8.4 billion, 12 per cent higher than 2015. This was driven by the strength of our intermediary relationships and our ongoing focus on developing and improving our mortgage proposition. We remained strong in the remortgage market and expanded our New Build purchase lending to 7 per cent of completions.

We improved our overall completion spread to 187 basis points, up from 186 basis points in 2015, despite competitive pressure on margins. This was achieved without venturing up the risk curve and all new mortgage business was written within our risk appetite.

Net mortgage lending increased to £4.3 billion, a market share of almost 11 per cent, as a result of strong gross lending and improved customer retention. Our improved retention performance was driven by a new retention platform for intermediaries, delivered by our innovative Mortgage Lab, as well as investment in our retention capability for our direct mortgage customers.

The combination of strong new lending and significantly improved retention allowed us to grow the mortgage book to £29.7 billion. Balance growth of 17 per cent significantly outpaced the market.

Intermediary partnerships remain a key part of our strategy.

This channel continues to deliver high credit quality mortgage customers with higher than average loan sizes. The quality of the service we provide to intermediaries was recognised by winning numerous awards, including receiving 'Five Stars' at the Financial Adviser Service Awards and the prestigious 'Best Lender for Partnership' award from the Legal & General Mortgage Club.

As a responsible lender we apply strict affordability criteria, combined with prudent and consistent underwriting, to deliver growth and returns without compromising the quality of our book.

We remain focused primarily on residential mortgages and the portfolio is comprised of 82 per cent residential and 18 per cent buy-to-let mortgages, in line with the market. Prudent underwriting and a focus on non-portfolio landlords continued to drive the quality of the buy-to-let portfolio.

The average loan-to-value (LTV) of the mortgage book was 55.4 per cent, flat year-on-year. The average LTV of new residential lending was 69.8 per cent and the LTV of new buy-to-let lending was 60.5 per cent.

As a result of the high-quality mortgage assets acquired from Northern Rock in 2012 and our subsequent focus on maintaining excellent asset quality, our arrears levels of 0.15 per cent are significantly below the CML industry average of 1.00 per cent.

The consistent application of our lending criteria and robust underwriting give us confidence that our mortgage book would be highly resilient in the event of a downturn.

Our mortgage expertise and dynamic commercial management give us confidence that we can continue to optimise our lending mix within our risk appetite to drive strong risk adjusted returns in a range of market conditions.

Credit cards

We continued to make significant progress with our credit card business in 2016, the first full year operating from our own platform. Our customer-focused approach and proposition resulted in card balances increasing to £2.4 billion, 55 per cent higher than 2015. This growth represented a 3.5 per cent share of the £68 billion market.

Robust underwriting principles and credit management, aligned to our overall strategy, improved the excellent asset quality of the portfolio.

Although the market remained competitive, we did not need to maintain best buy pricing during the year to deliver volume.

We continued to operate in the prime segment of the market, offering a mix of balance transfer and retail spending cards to high-quality applicants. We broadened our card proposition and launched our new Manchester United Football Club branded cards.

New lending during the year was strong and we opened 295,000 customer accounts in 2016, a 7 per cent share of new account sales with retail cards making up 30 per cent of our new accounts. Retail spend increased by just under 40 per cent during the year, supported by a fourfold increase in contactless usage. The potential for further growth, without compromising quality, is significant.

We have a prime customer base with no credit builder products in the portfolio. During the year, a downward trend in the standard of UK wide credit card lending was evident, with lower credit scores being accepted. We deliberately avoided this and maintained the application of strict underwriting standards to protect asset quality as we progressed towards our target of £3 billion balances by the end of 2017.

Our diligent approach means that we continue to target and lend to more low risk and less indebted customers and our unsecured debt-to-income ratio of 20.8 per cent compares favourably to the market average of 27.4 per cent.

To support our approach, we strengthened our underwriting standards further in the second half of 2016 and introduced a new eligibility checker for customers. This increased the credit quality of applicants and lifted our approval rate to 87 per cent resulting in over 86 per cent of new accounts in the highest credit score ranges.

The cost of risk improved to 1.70 per cent in 2016, from 2.00 per cent in 2015, reflecting the continued high quality of our credit card business.

We were delighted to win several awards including Best Overall Customer Service and Best Application Process from uSwitch and the Judges Award at the 2016 Card and Payment Industry Awards.

Deposits

Our lending growth was supported by a strong performance in retail deposits in 2016.

The UK savings market continued to grow and saw a significant uplift in activity driven by the EU referendum, as households held more savings to protect against future uncertainty.

We delivered 12 per cent growth in retail deposit balances to £28.1 billion, exceeding market growth of 3 per cent. This was achieved through £4.8 billion of new customer deposits and was supported by strong retention of maturing fixed rate bonds and ISAs, which improved to 89 per cent from 85 per cent in 2015.

As a result of the strength of our ISA proposition, we achieved a share of over 30 per cent of net market inflows and balances increased to £13.1 billion. We enjoy a stable retail funding base with ISA balances comprising 47 per cent and fixed rate deposits almost 45 per cent of our overall savings balances, further strengthening our liquidity positioning.

The number of customers increased by 5 per cent year-on-year to 1.45 million. This growth was supported by competitive pricing, where we are consistently top quartile but not price-leading, together with enhancements to the product range.

We delivered an improvement in average cost of retail funds through close management of pricing and the product mix, as well as passing on the reduction in Bank Base Rate to all variable rate customers. We aim to offer our customers both competitive and sustainable rates. In line with our EBO philosophy, we provide customers with exclusive fixed term products to ensure our interest rates remain good value in the context of the market. This approach continues to deliver fair margins and strong retention.

During the year, we continued to expand and enhance our product range, including a suite of new partnership products with Manchester United Football Club, which provides access to unique rewards programmes. We launched our own Virgin Money Regular Saver in September and exceeded expectations with more than 18,000 accounts opened by the end of 2016.

Almost 70 per cent of new accounts were opened online, with the remainder opened through our Store network, postal and telephone channels. Our online-led distribution model continues to be a key factor in growing our retail deposit business cost effectively, and the convenience of our online sales and servicing capability supported an 11 point increase in our NPS score to +16.

Essential Current Account

The performance of our Essential Current Account (ECA) was particularly strong in 2016. We almost trebled the total number of ECA accounts and customer balances increased more than fivefold during the year. The ECA attracts younger customers to our Stores and usage is strong with an average monthly credit of £1,300.

The ECA is a 'best in class' Basic Bank Account, which supports financial inclusion. It has the main features of a typical current account, including the ability to deposit and withdraw money through any UK Post Office, but has no overdraft facility or unpaid item fees. It is a free basic bank account, paying a fair rate of credit interest which is designed to help all our customers stay in control of their money.

Financial Services

We are pleased with the increasing momentum in our Financial Services business and we continue to explore the significant potential for further growth in this business area.

Our customers continue to appreciate the simplicity and transparency that our investment funds provide. Funds under management increased by 12 per cent to end at £3.4 billion. Equity ISA applications increased by 2 per cent, outperforming the decline seen in the market. At the Your Money Awards ceremony in July we won Best Direct Stocks and Shares ISA Provider.

The insurance business performed well during the year with an overall increase in new customers of 27 per cent. Travel insurance was particularly strong with 450,000 new travel insurance sales. To meet more customer needs, we extended the breadth of our travel coverage. This included the option to cover pre-existing medical conditions, a proposition which attracted over 100,000 new sales through the aggregator channel. In addition, we were proud to provide travel insurance to the UK Invictus Games Team when they competed in Orlando, Florida.

2016 was the first full year of our refreshed home insurance proposition which has proved to be popular with our existing mortgage and online customers.

Over 5,000 customers registered for our new International Money Transfer service in 2016 and with a strong ongoing flow of customers signing up for the service, we expect to see continued growth in 2017.

MAINTAINING A HIGH-QUALITY BALANCE SHEET

Our balance sheet reflects our straightforward business model and our lending is comprised primarily of residential mortgages and credit card advances, funded predominantly through retail deposits and an element of long term wholesale funding.

Our approach to responsible lending is driven by our conservative risk appetite and prudent underwriting. Our low cost of risk at 13 basis points in 2016 was supported by the resilience of the UK economy and our data driven approach to credit risk management to support asset quality.

During the year we strengthened our balance sheet further with the successful issuance of £230 million of Additional Tier 1 (AT1) capital. Our Common Equity Tier 1 (CET1) ratio and leverage ratio are key measures of our financial strength. At the end of the year, our CET1 ratio was 15.2 per cent, our total capital ratio was 20.4 per cent and our leverage ratio was 4.4 per cent, positioning us well for continued growth.

Our funding strategy is to access wholesale funding to supplement our core retail deposit base in order to extend tenor, ensure we have appropriate diversification in the funding base and optimise funding costs.

In 2016, we completed two issues of Residential Mortgage Backed Securities (RMBS) totalling £1.3 billion and accessed both the Funding for Lending scheme (FLS) and the Term Funding Scheme (TFS) to support lending growth.

Our loan-to-deposit ratio increased to 114.5 per cent at 31 December 2016 following our participation in the TFS.

Our liquidity position remains strong and our liquidity coverage ratio (LCR) was significantly above the regulatory minimum at 154 per cent. We hold substantial liquidity resources in the form of high-quality liquid assets.

Improving returns to shareholders

As a result of the successful delivery of our strategy for 2016, our underlying return on tangible equity strengthened from 10.9 per cent to 12.4 per cent.

Key contributors to this continued improvement were growing income across each of our business lines, maintaining credit and asset quality, the effective management of our funding base and further gains in operational efficiency.

We maintained the high quality of our mortgage and cards business, reflected in our low arrears and impairment levels, and total customer loan balances grew by 19 per cent compared to 2015.

Effective management of our funding base reduced our average weighted cost of funds to 130 basis points from 143 basis points in 2015. This partly offset pressure on mortgage asset spreads and resulted in a net interest margin of 160 basis points for 2016.

The financial contribution across each of our business lines increased and delivered 12 per cent growth in total underlying income to £586.9 million. Underlying cost growth was limited to 1 per cent, despite investment in the future of the business.

Within our flat cost base we opened a new Lounge in Sheffield, expanding our estate to seven customer Lounges and invested in our IT capability - to ensure the efficiency and resilience of our systems.

As a result of our operational leverage and continual improvements to operational efficiency, including re-engineering our mortgage and core back office processing systems, our cost:income ratio improved to 57.2 per cent, from 63.5 per cent in 2015. We increased our underlying profit before tax by 33 per cent to £213.3 million. Statutory profit before tax was £194.4 million, compared to £138.0 million in 2015.

Colleagues and culture

Our goal is to nurture a high performing, diverse and committed workforce. We aim to ensure that all colleagues can reach their full potential, feel valued and empowered to thrive in a truly inclusive business.

Our latest colleague survey results showed that we maintained our excellent staff engagement score at 81 per cent, which compares strongly against industry standards.

As part of the annual pay review cycle colleague pay was discussed with the union Unite. This resulted in an agreement which they could progress with their members. Average colleague pay increased by 4 per cent.

Our EBO culture sustains a virtuous circle based on a commitment to the communities in which we work and raises awareness of the Virgin Money brand and business as a force for good. We believe that our culture cannot be readily and credibly replicated in the UK banking sector and it provides the foundation for our strategy and differentiated approach to banking.

Management team

To support the continued development of the business, we strengthened the Executive further this year.

Hugh Chater joined the business as Chief Commercial Officer in June and Tim Arthur joined in September as Creative Director. Hugh has deep experience of retail banking, including at MBNA, where he became Managing Director of their UK Cards business. Tim was previously Global CEO of Time Out where he transformed an iconic brand into a global digital business.

Peter Bole joined the business in November and became Chief Financial Officer (CFO) in January 2017. Peter was the former Tesco Bank CFO and has extensive experience in UK retail banking. I would like to thank Dave Dyer, our former CFO, for his 20 years' service and I am delighted that following his retirement he will continue to support the business on a part-time basis in a strategy role.

Cyber resilience strategy

We have a well-developed Cyber Resilience Strategy to manage the increasing risk of cyber-crime. During the year we enhanced our Cyber Operations Centre monitors suspicious activity in real time and launched a new Security Zone on our intranet, providing detailed security advice to colleagues.

Business as a force for good

Our contribution to the communities in which we work is a fundamental part of Virgin Money's business model and strategy.

The success of Virgin Money Giving continued and our not-for-profit online donation service helped charities raise £92 million in 2016. Virgin Money Giving has helped to raise more than £500 million for charities since launch.

Colleagues selected the NSPCC as our corporate charity of the year for 2015/16 and raised over £2.1 million as the official charity of the 2016 Virgin Money London Marathon (VMLM). Runners in the 2016 VMLM raised a record £59.4 million for good causes.

The Virgin Money Foundation has distributed grants worth almost £2 million in the North East of England since August 2015. Grants awarded in 2016 focused on organisations working in the areas of housing and homelessness and youth employment. The Foundation will extend its reach nationally over time.

Outlook

As a UK retail bank focused on serving domestic customers, the decision to exit the European Union does not directly impact on our business. Whilst the UK economy has been resilient since the vote to leave the EU, the eventual timing and nature of the UK's exit from the EU remains unclear and the longer-term impact on the economy is uncertain.

Our strategy of growth, quality and returns is clear and unchanged. We will continue to focus on providing outstanding service to our customers, pursue disciplined growth of our balance sheet within our risk appetite, maintain our prudent underwriting to protect asset quality, and deliver strong and sustainable shareholder returns.

Our strategy, combined with our straightforward, low risk retail focused business model and strong balance sheet, means we remain well positioned to react to prevailing economic conditions.

We stand ready to take measures to protect asset quality further in the event of future economic headwinds.

We are sufficiently nimble to adjust to changes in the operating environment and will continue to target high-quality growth opportunities in value accretive market segments.

We will continue to grow assets at the right price and quality. We maintain a target market share of 3 to 3.5 per cent of gross mortgage lending and £3 billion high-quality credit card balances of at the end of 2017.

We will continue to access the Term Funding Scheme in 2017 and expect the overall loan-to-deposit ratio to go beyond 115 per cent for the period in which we use the scheme.

In 2016, we decided that it would be prudent to defer our SME plans and focus investment on enhancing our digital capability. Should the economic outlook support it in the future, SME remains a strategic option for the business.

We are delighted to be collaborating with 10x Future Technologies as part of our digital strategy. This is an exciting and complex programme which will ultimately create a fully integrated digital banking platform. Work has begun in earnest on this long-term project and we will provide an update on progress in the second half of 2017.

We have a proven track record on operational execution and we are well positioned to achieve a cost:income ratio of 50 per cent by the end of 2017.

The strength of our financial performance and capital position underpins our confidence in achieving our financial targets, notably continued progress in our return on tangible equity and a solid double-digit RoTE for 2017.

I would like to extend my thanks to our Virgin Money colleagues for their hard work and achievements over the year, and to all of our stakeholders who play such an important part in our success.

Jayne-Anne Gadhia, CBE

Chief Executive

CHIEF FINANCIAL OFFICER'S OVERVIEW OF PERFORMANCE

Summary of Group results

The financial results in 2016 further reinforced the strength of our business model with significant progression across the three pillars of our strategy – Growth, Quality and Returns:

- Growth – market share of new business continued to outstrip our share of stock resulting in significant growth in receivables with mortgages and card balances increasing by 16.8 per cent and 55.0 per cent respectively. This growth was funded predominantly by the continued strength of the retail deposit franchise with customer deposits growing 11.8 per cent;
- Quality – we maintained a disciplined approach to managing growth with consistently high underwriting standards leading to our low cost of risk. Balance sheet growth was carefully managed with lending growth supported by stable deposit funding and diversified long term wholesale funding. Capital resources grew both through retained earnings and the issue of £230 million of AT1 securities in the fourth quarter; and
- Returns – higher lending drove income growth which, combined with disciplined cost control, resulted in strong operational leverage. As a consequence our cost:income ratio fell by 6.3 percentage points to 57.2 per cent which, combined with our growth and low cost of risk, resulted in a 32.7 per cent increase in underlying profit before tax and underlying RoTE increasing to 12.4 per cent.

Gross mortgage lending of £8.4 billion was combined with strong retention performance to deliver mortgage stock balances of £29.7 billion at year end. That growth was carefully managed within our target range of 3 to 3.5 per cent of gross lending to support returns, with new-business mortgage spread 1 basis point higher than 2015 at 187 basis points. Card receivables increased by 55.0 per cent to £2.4 billion, continuing to demonstrate the strength of the franchise.

The scalability of the mortgage and card platforms continued to enhance Group operational leverage, with only a 1.1 per cent increase in underlying costs compared to income growth of 12.1 per cent – generating the 6.3 percentage point improvement in cost:income ratio to 57.2 per cent. This increase in cost efficiency, achieved across both operational areas and central functions, was achieved while continuing to invest in the business with investment spend maintained in line with income.

Growth did not come at the expense of quality. Cost of risk increased by only 1 basis point to 13 basis points, entirely as a consequence of higher card receivables. While this low cost of risk benefits, in part, from the benign economic environment in the UK, it undoubtedly reflects our continued disciplined approach to credit risk management across both our mortgage and cards portfolios. The growth has been achieved without any deterioration in the quality of new lending or the credit characteristics of the portfolios as a whole. Across all key credit metrics both portfolios exhibit either stable or improving trends and this is reflected in low arrears experience.

Leverage and total capital ratios were increased both by higher retained earnings and the successful issuance of £230 million Additional Tier 1 (AT1) capital. The Common Equity Tier 1 (CET1) ratio remained strong at 15.2 per cent, reflecting the quality of the capital base. The liquidity and funding profile benefitted from access to the Term Funding Scheme and we extended our term wholesale funding programme beyond Sterling and Euro to include US Dollars for the first time.

Our commercial agility allowed us to optimise asset and liability pricing during the course of the year resulting in a NIM of 160 basis points despite a 25 basis point reduction in Bank Base Rate. The combination of strong lending growth, stable NIM, improved operational leverage and our low cost of risk delivered an increase in underlying profit of 32.7 per cent, to £213.3 million.

As a consequence of this continued progression, measures of shareholder returns were materially improved. Unburdened by legacy issues, growth in underlying profit flowed to statutory profit before tax, which increased by 40.9 per cent to £194.4 million. Return on tangible equity increased to 12.4 per cent, underlying earnings per share rose by 22.0 per cent to 32.7 pence and our Board has recommended a final dividend that takes the total dividend relating to financial performance in 2016 to 5.1 pence per ordinary share.

Consolidated income statement

	2016 £m	2015 £m
Net interest income	**519.0**	456.1
Other income	**67.9**	67.4
Total income	**586.9**	523.5
Costs	**(336.0)**	(332.5)
Impairment	**(37.6)**	(30.3)
Underlying profit before tax	**213.3**	160.7
IPO share based payments	**(2.0)**	(10.5)
Strategic items	**(2.4)**	(8.1)
Simplification costs	**(5.6)**	(3.7)
Fair value losses on financial instruments	**(8.9)**	(0.4)
Statutory profit before tax	**194.4**	138.0
Taxation	**(54.3)**	(26.8)
Profit for the year – statutory	**140.1**	111.2
Basic earnings per share – statutory (pence)	**29.4**	22.9

Basis of preparation of financial results

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS). Aspects of the results are adjusted for certain items, which are listed below, to reflect how the Executive assesses the Group's underlying performance without distortions caused by items that are not reflective of the Group's ongoing business activities. Charges for such items were lower by 55.2 per cent in 2016, as the reduction in share based payments related to the IPO more than offset an increase in the cost of simplification and investment in strategic items. The following items have been excluded from underlying profits:

- IPO share based payments

These costs relate to share based payment charges triggered by our successful IPO in 2014, which we are recognising over their vesting period. By their nature, these payments are not reflective of ongoing trading performance and are not, therefore, considered part of the underlying results.

- Strategic items

We incurred strategic investment costs of £6.7 million in 2016, largely related to digital investment spend. These costs have been partly offset by fair value adjustments of £4.3 million arising from the Northern Rock acquisition which will not occur in future periods. Investments in building our digital capability are strategic investment items that are not considered part of the underlying results.

- Simplification costs

Now that our organisational structure is well established we have taken the opportunity to focus on simplification activity, including de-layering our organisation structure, the benefit of which is seen in our stable underlying cost base. This has led to one-off costs incurred in 2016 including those in relation to a number of senior leavers. These costs include accelerated share based payment charges. These are not considered part of the underlying results.

- Fair value losses on financial instruments

Fair value gains and losses on financial instruments reflect the results of hedge accounting and the fair value movements on derivatives in economic hedges to the extent that they either do not meet the criteria for hedge accounting or give rise to hedge ineffectiveness. Where these derivatives are held to maturity, fair value movements recorded in this heading represent timing differences that will reverse over their lives, but can result in volatility within and between specific reporting periods. Therefore, excluding these from underlying profit better represents the underlying performance of the Group.

Before 2016 fair value gains and losses on financial instruments were included within the underlying performance. These are now excluded from underlying results to remove this volatile item from the underlying business result. Prior periods presented have been adjusted to ensure consistency, however the change has no material impact on those periods.

Our effective tax rate in 2016 was 27.9%. The overall tax rate for UK banks increased by 8 percentage points in 2016 as a result of the bank tax surcharge, adding £12.5 million to the Group's tax charge. In 2016, the Group recognised a corporation tax charge of £54.3 million.

The reconciliations of the Group's statutory and underlying results are reported above and in note 2 to the consolidated financial statements.

The Group uses a number of Alternative Performance Measures (APMs), in addition to underlying profit, in the analysis and discussion of its financial performance and financial position. APMs do not have standardised definitions and may not be directly comparable to measures defined within IFRS. A full list of APMs used by the Group, including their bases of calculation, are set out on page 267.

Consolidated balance sheet

	2016 £m	2015 £m	Change %
Assets			
Cash and balances at central banks	**786.3**	888.6	(11.5)%
Loans and receivables	**33,003.4**	27,724.6	19.0%
Available-for-sale financial assets	**858.8**	1,296.9	(33.8)%
Other	**407.1**	318.9	27.7%
Total assets	**35,055.6**	30,229.0	16.0%
Liabilities and equity			
Deposits from banks	**2,132.5**	1,298.7	64.2%
Customer deposits	**28,106.3**	25,144.9	11.8%
Debt securities in issue	**2,600.0**	2,039.4	27.5%
Other	**537.8**	397.3	35.4%
Provisions	**8.5**	8.4	1.2%
Total liabilities	**33,385.1**	28,888.7	15.6%
Total equity	**1,670.5**	1,340.3	24.6%
Total liabilities and equity	**35,055.6**	30,229.0	16.0%

Key ratios

		2016	2015	Change
Net interest margin	%	**1.60**	1.65	(5)bps

Cost:income ratio	%	**57.2**	63.5	(6.3)pp
Cost of risk[1]	%	**0.13**	0.12	1bps
Statutory basic earnings per share	p	**29.4**	22.9	6.5 pence
Tangible net asset value per share	£	**2.73**	2.54	19 pence
Total Capital Ratio	%	**20.4**	20.2	0.2pp
Common Equity Tier 1 ratio	%	**15.2**	17.5	(2.3)pp
Leverage ratio	%	**4.4**	4.0	0.4pp
Return on tangible equity	%	**12.4**	10.9	1.5pp

1 Defined as impairment charges net of debt recoveries divided by average gross balances for the period. Key ratios are presented on an underlying basis except where stated.

Strong balance sheet growth

	At 31 Dec 2016 £m	At 31 Dec 2015 £m	Change
Loans and advances to customers	**32,367.1**	27,109.0	19.4%
Customer deposits	**28,106.3**	25,144.9	11.8%
Wholesale funding	**4,718.0**	3,314.3	42.4%
Wholesale funding <1 year maturity	**575.0**	1,274.9	(54.9)%
Loan-to-deposit ratio	**114.5%**	107.5%	7.0pp
High Quality Liquid Assets[1]	**4,222.6**	4,238.6	(0.4)%

1 These include Funding for Lending Scheme drawings which are held off balance sheet but are available for repo and hence count towards liquidity resources.

The continuing strength of our lending franchise led to 19.4 per cent growth in total loans and advances to customers in 2016. We achieved record gross mortgage lending of £8.4 billion during the year, up 11.9 per cent from 2015. There was particular focus on growing the mortgage portfolio, where we delivered an increase of £4.3 billion, or 16.8 per cent.

Growth in the credit card book reflected the strength of our brand, our scalable in-house platform and the continued development of our credit card offering. As a result, balances increased by 55.0 per cent from 2015, to reach £2.4 billion.

This significant asset growth was facilitated by the continued success of our retail and wholesale funding franchises. Customer deposits grew by 11.8 per cent or £3.0 billion, which was well in excess of market growth at 3.2 per cent. Our core retail deposit base is supplemented by wholesale funding. During the year, we completed two issues of Residential Mortgage Backed Securities (RMBS) totalling £1.3 billion through our established Gosforth programme, made up of Sterling, Euro and US Dollar tranches. Both offerings saw strong demand, reflecting the quality of our collateral and positive investor sentiment towards our low risk UK focused strategy.

In addition, we accessed the Government's Term Funding Scheme (TFS) with £1.3 billion drawn during the year to support lending growth.

The result of this funding approach was a lower cost of funds, a diversification of wholesale sources and an increase in the loan-to-deposit ratio to 114.5 per cent, from 107.5 per cent at the end of 2015. We expect the loan-to-deposit ratio to go beyond 115 per cent for the period during which we participate in TFS. This is within our Board approved risk appetite.

The Group's liquidity position remains strong, with high quality liquid assets of £4.2 billion at 31 December 2016 consistent with the prior year. Our liquidity coverage ratio (LCR) was significantly above the 90 per cent regulatory minimum from 1 January 2017 at 154 per cent. Our liquidity position resulted in high quality liquid assets representing more than 7 times our wholesale funding with a maturity of less than one year. This provides us with a substantial buffer in the event of market dislocation. In addition, in the short term, we have significant, immediately available, funding capacity from TFS if required.

Income benefited from growth in asset balances

	2016 £m	2015 £m	Change
Net interest income	**519.0**	456.1	13.8%
Other income	**67.9**	67.4	0.7%
Total income	**586.9**	523.5	12.1%
Net interest margin	**1.60%**	1.65%	(5)bps
Average interest earning assets	**32,521**	27,577	17.9%

During 2016 we increased net interest income by 13.8 per cent to £519.0 million. This was driven by strong balance growth across the mortgage and card books, reflecting the strength and potential of our lending franchise.

The continued strong growth in mortgage lending was a key driver of income growth in the year. Growth in the credit card portfolio and further optimisation of our funding base continued to support net interest margin (NIM). Ongoing active management of retail funding costs in the context of lower pricing in the market, and initial drawings from TFS, contributed to a reduction in the weighted average cost of funds from 143 basis points in 2015 to 130 basis points in 2016. This benefit was however tempered by the continued strength of growth in our mortgage portfolio, where new business was priced below back book spread, as well as by the one-off impact of the 25 basis point reduction in Bank base rate in August 2016, arising from the delay in repricing deposits compared to repricing assets.

Taken together, these factors moderated NIM to 160 basis points in 2016.

Other income increased by 0.7 per cent to £67.9 million reflecting an increase from our investment funds business.

Costs remained tightly controlled

	2016 £m	2015 £m	Change
Costs	**336.0**	332.5	1.1%
Cost:income ratio	**57.2%**	63.5%	(6.3)pp

Our operational leverage is derived from our scalable operating model, which combined with disciplined management of costs, continued to deliver enhancements to our operating profitability.

Set against lending and income growth of 19.4 per cent and 12.1 per cent respectively, cost growth (including the FSCS levy) in 2016 was constrained to just 1.1 per cent. This produced positive JAWS of 11.0 per cent and reduced the cost:income ratio by 6.3 percentage points to 57.2 per cent. Improvements were made across the business with the ongoing programme of operational efficiency initiatives and the ability to leverage our central functions being key drivers. As a consequence, the cost per customer in each product category reduced in the year. Excluding the cost of the FSCS levy, operating costs increased by 2.6 per cent year on year. Our strong cost performance did not come at the expense of investment into the business. In 2016 the level of investment spend was grown in line with income.

Impairments reflected rigorous credit risk management

	2016 £m	2015 £m	Change

Mortgages			
Impairment charge	**2.8**	3.0	(6.7)%
Cost of risk	**0.01%**	0.01%	–
Impaired loans as a % of loans and advances	**0.3%**	0.3%	–
Provisions as a % of impaired loans	**11.4%**	10.3%	1.1pp
Cards			
Impairment charge	**34.8**	27.3	27.5%
Cost of risk	**1.70%**	2.00%	(30)bps
Impaired loans as a % of loans and advances	**1.3%**	1.7%	(0.4)pp
Provisions as a % of impaired loans	**121.6%**	113.5%	8.1pp
Group			
Impairment charge	**37.6**	30.3	24.1%
Cost of risk	**0.13%**	0.12%	1bps
Impaired loans as a % of loans and advances	**0.4%**	0.4%	–
Provisions as a % of impaired loans	**40.0%**	35.6%	4.4pp

We maintained a low cost of risk in 2016 through our established risk appetite framework, ongoing focus on underwriting rigour and the origination of high credit quality customers and prime assets.

The cost of risk for mortgages was flat between 2015 and 2016 at 0.01 per cent and the underlying impairment charge fell in absolute terms. This stability reflected the continued high asset quality of the mortgage portfolio and our strategic approach to risk management, combined with the benign economic environment, leading to a further reduction in the low level of defaults.

Impaired loans as a percentage of mortgage loans and advances were unchanged from 2015 at 0.3 per cent. Against that stable level of impairments, the coverage ratio of provisions to impaired mortgage loans increased to 11.4 per cent in 2016 from 10.3 per cent in the prior year

In credit cards, set against growth of 55.0 per cent in balances, the impairment charge for the portfolio increased by only 27.5 per cent to £34.8 million. The resulting cost of risk for credit cards decreased by 30 basis points to 1.70 per cent in 2016, from 2.00 per cent in 2015. This underlines the continued high credit quality of new and existing cards and the low rate of default during the early stages of card lives. Performance of individual cohorts of cards remains strong with all cohorts showing a cost of risk in line with or better than expectations.

In the credit card book, impaired loans as a percentage of loans and advances decreased to 1.3 per cent in 2016 from 1.7 per cent in 2015. Similarly to the mortgage book, the coverage ratio of provisions to impaired credit card balances increased to reach 121.6 per cent in 2016 from 113.5 per cent in 2015. Impaired loans as a percentage of loans and advances for the Group was unchanged from 2015 at 0.4 per cent at 31 December 2016. Provisions as a percentage of impaired loans increased to 40.0 per cent at 31 December 2016, from 35.6 per cent at 31 December 2015. This rise reflects the increased proportion of card receivables, where provisions as a percentage of impaired loans are higher than for secured mortgage lending.

Continued strong progression in returns

		2016	2015	Change
Return on tangible equity	%	**12.4**	10.9	1.5pp
Return on assets[1]	%	**0.40**	0.37	3bps

1 Statutory basis.

The strength of income growth and improved operational leverage, combined with our rigorous approach to underwriting and asset quality, has driven material enhancement to returns achieved in 2016. This growth has been achieved despite the introduction of the bank tax surcharge for the first time in 2016.

Return on tangible equity increased to 12.4 per cent in 2016, higher than both our cost of capital and the 10.9 per cent generated in 2015. At the same time, the statutory return on assets grew by 3 basis points to 0.40 per cent in 2016, from 0.37 per cent in 2015.

Capital strength

		2016	2015	Change
Capital ratios and risk-weighted assets				
Common Equity Tier 1 capital (CET1)		**1,172.7**	1,070.0	9.6%
Risk-weighted assets (RWAs)		**7,694.8**	6,110.4	25.9%
Common Equity Tier 1 ratio		**15.2**	17.5	(2.3)pp
Tier 1 ratio		**20.2**	20.1	0.1pp
Total capital ratio		**20.4**	20.2	0.2pp
Leverage ratio		**4.4**	4.0	0.4pp

The evolution of capital ratios during 2016 continued to reflect our strategy of ensuring strong capital adequacy while optimising the capital structure as the business grows. Our objective is to enhance returns for shareholders while maintaining an overall quality and quantity of capital in line with our low risk profile. Consistent with that objective, we issued a further £230 million of AT1 capital in November 2016 to support future asset growth. This issuance was multiple times over-subscribed, reinforcing the market's confidence in our business strategy, asset quality and financial strength.

Our strong profitability resulted in CET1 capital resources increasing by 9.6 per cent. Loan book growth, increased card receivables and new mortgage lending were the drivers of the 25.9 per cent increase in risk-weighted assets. As a consequence of the growth in RWAs our CET1 ratio reduced to 15.2 per cent at the end of 2016 compared with 17.5 per cent at the end of 2015 but remained well in excess of our target minimum ratio of 12 per cent.

The combination of organic earnings performance plus the issuance of new AT1 capital meant that the Total capital ratio improved to 20.4 per cent despite our significant loan book growth.

The leverage ratio was 4.4 per cent at the end of 2016, compared with 4.0 per cent at the end of 2015. Growth in the asset base was more than offset by the impact of the issuance of the new AT1 capital and the strength of retained earnings growth. The AT1 issuance provides us with significant capacity for future high credit quality mortgage growth that is, relative to other lending types, leverage intensive.

Dividend

The strength of both our profitability and our capital base continues to give the Board confidence to recommend the payment of a dividend. In addition to the interim dividend for 2016 of 1.6 pence per ordinary share, paid to shareholders on 23 September 2016, the Board has recommended a final dividend of 3.5 pence per ordinary share in respect of 2016 which will be paid, subject to approval at our AGM, in May 2017. Our intention is to pay an interim and final dividend for 2017, subject to performance.

Conclusion

2016 represents a further year of significant financial progress for Virgin Money. The strong high quality lending growth combined with further operational leverage has driven improved returns for our shareholders. This has been achieved with no degradation of asset quality, further diversification of the funding base and with continued focus on the strength of the capital base and capital ratios.

As a consequence, we are well placed to continue growing our business, generating further operational leverage and continuing to generate attractive and sustainable returns for shareholders.

Peter Bole
Chief Financial Officer

Divisional results

	Mortgages & Savings £m	**Credit Cards £m**	**Financial Services £m**	**Central Functions £m**	**Group £m**
2016					
Net interest income	**383.0**	**136.0**	**–**	**–**	**519.0**
Other income	**2.0**	**17.7**	**37.5**	**10.7**	**67.9**
Total income	**385.0**	**153.7**	**37.5**	**10.7**	**586.9**
Total costs	**(97.4)**	**(37.8)**	**(15.6)**	**(185.2)**	**(336.0)**
Impairment charge	**(2.8)**	**(34.8)**	**–**	**–**	**(37.6)**
Underlying Contribution	**284.8**	**81.1**	**21.9**	**(174.5)**	**213.3**
Net interest margin	**1.38%**	**6.69%**	**–**	**–**	**1.60%**
Cost of risk	**0.01%**	**1.70%**	**–**	**–**	**0.13%**
Key balance sheet items at 31 December 2016					
Loans and advances to customers[1]	**29,740.8**	**2,447.1**	**–**	**–**	**32,187.9**
Customer deposits	**28,106.3**	**–**	**–**	**–**	**28,106.3**
Total customer balances	**57,847.1**	**2,447.1**	**–**	**–**	**60,294.2**
Risk-weighted assets	**5,204.5**	**2,012.3**	**50.4**	**427.6**	**7,694.8**

1 Excluding fair value of portfolio hedging.

	Mortgages & Savings £m	Credit Cards £m	Financial Services £m	Central Functions[1] £m	Group £m

2015					
Net interest income	358.5	97.6	–	–	456.1
Other income	2.5	18.0	36.6	10.3	67.4
Total income	361.0	115.6	36.6	10.3	523.5
Total costs	(92.7)	(37.1)	(16.7)	(186.0)	(332.5)
Impairment charge	(3.0)	(27.3)	–	–	(30.3)
Underlying contribution	265.3	51.2	19.9	(175.7)	160.7
Net interest margin	1.52%	8.22%	–	–	1.65%
Cost of risk	0.01%	2.00%	–	–	0.12%
Key balance sheet items at 31 December 2015					
Loans and advances to customers[2]	25,453.6	1,578.7	–	–	27,032.3
Customer deposits	25,144.9	–	–	–	25,144.9
Total customer balances	50,598.5	1,578.7	–	–	52,177.2
Risk-weighted assets	4,284.5	1,334.7	51.6	439.6	6,110.4

1 Restated to exclude fair value gains and losses on financial instruments from costs. 2 Excluding fair value of portfolio hedging.

MORTGAGES AND SAVINGS

We provide mortgages, savings and current accounts to more than 1.5 million customers. Mortgages are sold primarily through our intermediary partners and retail deposits are largely originated directly through our digital channel. Our Mortgage & Savings business (including Current Accounts) is an important profit driver for the Group, contributing 65.6 per cent of total income in 2016.

Mortgage Strategy

In what remains a very competitive market, our approach to mortgages is very straightforward. We offer a wide range of mortgage products to prime credit quality customers who are supported by excellent service, acquired primarily through our intermediary partners and supplemented by direct distribution.

Within our existing risk appetite we have continued to develop our residential mortgage proposition to broaden our presence across segments of the market where we are under-represented. We aim to maintain our stock share for buy-to-let mortgages in line with the overall market. We will continue to strengthen our intermediary proposition to enrich existing intermediary relationships, which have been a driver of value for us during 2016. Additionally, we will continue to invest in the retention of our existing customers.

Key developments – Mortgages

We were pleased to deliver strong growth in balances, driven by new lending of £8.4 billion in the year to 31 December 2016. This represented an increase of 11.9 per cent on 2015 and was equivalent to a 3.4 per cent market share of gross lending, in line with the 3.4 per cent share in 2015 and at the upper end of our target range of 3 to 3.5 per cent of gross lending.

Mortgage retention rates at product maturity have improved substantially with 70 per cent of customers with maturing fixed rate or tracker products successfully retained during 2016, an increase from 64 per cent in 2015.

The combined effect of new business and retention performance resulted in year-on-year net lending growth of 20.2 per cent in 2016, equating to net lending of £4.3 billion. This represented a 10.5 per cent market share of net lending, consistent with 10.0 per cent in 2015. This stable progression continues to bring our share of stock towards our target share of flow.

Mortgage balances increased by 16.8 per cent to £29.7 billion in 2016, materially outperforming growth in the market of 2.8 per cent over the same period. Prime residential balances grew by 15.3 per cent to £24.3 billion. Residential lending represented 82 per cent of the overall mortgage book and 81 per cent of new lending in 2016. Buy-to-let balances of £5.5 billion represented 18 per cent of the overall mortgage book at year end, which is consistent with our strategy to maintain stock share in line with the market.

Growth in mortgage balances was delivered while increasing the completion spread to an average of 187 basis points, compared to 186 basis points in 2015. This performance was supported by our dynamic approach to adjusting pricing in response to competitor movements and also by tangible benefits from improvements in intermediary relationships.

Geographically we lend broadly in line with the market, and we continue to remain strong in more affluent areas such as London and the South East. Arrears emergence is lower in London and the South East and our underwriting ensures a lower LTV of new business in these areas. This affords us protection should we see house prices fall in future.

We continue to deliver enhancements that make it increasingly straightforward for a mortgage broker to do business with Virgin Money. We have further strengthened the intermediary proposition with new retention capability at product maturity and commenced the rollout of a digital front end to allow intermediary partners to access Virgin Money using a device of their choice. Our partnerships with key national intermediaries continue to deliver over 90 per cent of our new business loans. Our share of the intermediary market increased to 4.6 per cent and we increased the volume of business with each of our top 5 intermediary partners as we continued to invest in our mortgage proposition.

We remain committed to helping customers achieve their home ownership aspirations and made a number of enhancements to our First Time Buyer and New Build propositions during the year. The response from customers was very positive, with the value of gross lending in 2016 to First Time Buyers increasing by 26 per cent year-on-year and the value of gross lending to New Build customers representing 7 per cent of new lending, reflecting our focus on building our capability in these key segments. All lending over 90 per cent LTV during the year was made under the Help to Buy guarantee scheme and represented just 3 per cent of our new business loans. Customer demographics were very stable and performance remained robust.

The quality of our mortgage franchise was recognised with several industry awards over the course of the year: Yourmoney Best Online Mortgage Provider; Moneyfacts Best Buy-To-Let Lender and Best Service From A Mortgage Provider; Best Remortgage Lender at the Your Mortgage awards; and we were reinstated as a 5* lender at the Financial Adviser Service awards for 2016.

Savings Strategy

Our savings products are simple and transparent, with no hidden catches. We have avoided 'teaser' products with bonus rates which subsequently fall to sub-market levels and provoke customer churn. Instead, we encourage customer retention with enduring, good value offers. We offer customers a range of competitively-priced instant access and fixed term savings products, both available as ISAs. Whilst customers predominantly choose to open their accounts through our digital channels, we also offer multi-channel distribution via postal, telephony and store propositions.

Key developments – Savings

We grew retail savings and current account balances by 11.8 per cent to £28.1 billion at 31 December 2016, up from £25.1 billion at 31 December 2015, opening more than 300,000 new savings accounts in the year. At the end of 2016 we had more than 1.2 million savings customers and balances continued to grow to new record levels. We continued to beat growth in the savings market, with balance growth of 11.8 per cent compared to market growth of 3.2 per cent over the course of 2016.

Net inflows equated to a 2.8 per cent market share, broadly in line with 3.0 per cent in 2015 growing our market share of savings stock from 1.5 per cent at 31 December 2015 to 1.6 per cent at 31 December 2016. Cash ISA performance was particularly strong in 2016, taking a 32.6 per cent share of net inflows in the market which reflected the strong appeal of our customer proposition. This performance resulted in our Cash ISA market share of 4.8 per cent at the end of December 2016, an improvement from 4.1 per cent at the end of 2015.

In July we introduced our first savings products in our "Red Devil" range as official UK financial services partner of Manchester United Football Club. In this range we launched three savings products, including The Champions Bond, which pays a higher rate of interest dependent on the team's performance, an Easy Access product and the 'Fred the Red' children's account. All of these accounts provide access to unique rewards programmes. We also won the Best Cash ISA Provider award in the "What Investment" readers' poll.

We launched a new Regular Saver product in H2 2016, available to all customers and providing unrestricted access and an attractive fixed rate of interest. We sold more than 18,000 Regular Savers in 2016, supporting those customers in developing a savings habit. Customers continue to save into our Help to Buy ISA. Since launch in December 2015, we have helped over 27,000 customers take their first steps towards owning a home.

Our Essential Current Account is a best in class basic bank account that demonstrates our commitment to making 'Everybody Better Off'. The product is available to all customers and is easy to apply for in any of our stores. During the year we developed partnerships with Scotcash (a Glasgow based financial inclusion charity) and other organisations in our local communities to provide wider distribution of the ECA proposition and raise visibility of the product amongst those in society it could help most. We are working to expand our community partnerships in 2017.

2016 financial highlights

- net interest income increased by 6.8 per cent to £383.0 million, driven by growth in mortgage balances more than offsetting the reduction in mortgage NIM. Combined with a £0.5m reduction in other income, total income in this segment rose by 6.6 per cent to £385.0 million;
- our scalable platform and diligent cost control resulted in positive JAWS of 1.5 per cent, with income rising by 6.6 per cent and cost growth constrained to 5.1 per cent in this segment;
- combined with ongoing high asset quality, these factors combined to increase contribution by 7.4 per cent in 2016;
- NIM for the full year 2016 was 1.38 per cent in the mortgage and savings business. The moderation of NIM relative to 2015 reflects the dilutive effect of strong new lending. This was partially mitigated by active management of pricing and mix in both mortgages and savings markets;
- the high quality of our mortgage business continues to be reflected in our low arrears levels, which reduced further in 2016. The percentage of loans over three months in arrears was 0.15 per cent at the end of 2016, compared to 0.22 per cent in 2015. Our impaired provision coverage increased to 11.4 per cent, compared to 10.3 per cent in 2015;
- at £2.8 million, the impairment charge in 2016 was lower than 2015, reflecting our strong credit management and resulting high-quality mortgage book, supported by benign economic conditions. Impaired loans as a percentage of mortgage loans and advances remained flat year on year at 0.3 per cent; and
- risk-weighted assets at the end of 2016 increased by 21.5 per cent to £5.2 billion, primarily reflecting increased lending and new business coming onto the book at risk weights higher than stock.

Performance summary – Mortgages and Savings

	2016 £m	2015[1] £m	Change
Net interest income	**383.0**	358.5	6.8%
Other income	**2.0**	2.5	(20.0)%
Total underlying income	**385.0**	361.0	6.6%
Total costs	**(97.4)**	(92.7)	5.1%
Impairment	**(2.8)**	(3.0)	(6.7)%
Contribution	**284.8**	265.3	7.4%
Mortgages and savings net interest margin	**1.38%**	1.52%	(14)bps
Cost of risk	**0.01%**	0.01%	–

	2016 £m	2015 £m	Change
Key balance sheet items at 31 December			
Loans and advances to customers	**29,740.8**	25,453.6	16.8%
– of which prime residential	**24,273.6**	21,052.7	15.3%

– of which buy-to-let	**5,467.2**	4,400.9	24.2%
Customer deposits[2]	**28,106.3**	25,144.9	11.8%
Total customer balances	**57,847.1**	50,598.5	14.3%
Risk-weighted assets	**5,204.5**	4,284.5	21.5%

1 2016 includes Current Accounts; in 2015 Current Accounts were reported under 'Current Accounts, Insurance and Investment' (renamed Financial Services).

2 2016 and 2015 include current accounts. In the 2015 Annual Report and Accounts Current Accounts were reported under 'Current Accounts, Insurance and Investment' (renamed 'Financial Services').

CREDIT CARDS

We provide credit card products, predominantly online, to over 800,000 customers. Our portfolio is a mix of balance transfer and retail credit cards, and the offering continues to develop. Our Credit Card business contributed 26.2 per cent of total income in 2016, an increase of over 4 percentage points from 22.1 per cent in 2015 due to growth in receivables.

Strategy

Our Credit Card business has continued to build on the foundations laid by the successful migration onto our own platform in early 2015 of the book purchased from MBNA in 2013. The functionality of our own credit card platform has allowed us to continue to grow the business through simple, transparent products offered to high credit quality applicants, supported by strong risk management and analytical capability.

The product portfolio has been expanded to cater for different customer needs in the balance transfer and retail card segments. We have achieved this with a range of products that focus on core customer needs: debt consolidation, borrowing and everyday spending. The strength of financial performance and asset quality in the cards business during 2016 means that £3 billion of receivables remains our target for the end of 2017.

Key developments

2016 marked the first full year of operating the cards business on our own platform and we continued to deliver growth, a stable customer profile and improving credit quality. Balances from customers originated on our new platform overtook those from the migrated book during 2016. This was supported by further enhancements to the customer journey, notably the introduction of Card Checker – a tool allowing consumers to check their eligibility for our Cards before submitting an application, without affecting their credit history. This enables customers to apply for a card with confidence.

Card balances increased to £2.4 billion representing a 3.5 per cent share of the £68 billion credit card market. This represented a 1.0 percentage point increase from our 2.5 per cent market share in 2015. As a result of our continued success, we ended the year with over 295,000 new customers. This represents an increase of 100,000 over the number of new customers acquired in 2015, representing 8 per cent market share of new cards and underlines our ability to attract customers in a competitive market. The number of new cards written is consistent with meeting our 2017 target of £3 billion of receivables.

Despite the increase in unsecured borrowing evident in the UK credit card market, our indebtedness scores remained significantly below the market average, driven by strong affordability criteria. Our ongoing analysis of customer spending, borrowing and repayment behaviour, demonstrated stable usage and a highly consistent pattern of activity. Early arrears continued to positively outperform the industry, as did portfolio arrears levels. The profile of newly acquired customers has remained broadly stable and the average credit score has increased slightly following proactive tightening of credit score cut-offs since the EU referendum. We continue to take our fair share of the strongest credit quality applicants and do not book customers outside our stable credit risk appetite.

Our new account proposition is strongly supported by the Virgin brand and does not have to be top of the price tables to attract excellent customer quality and volume. These features, together with improvements in customer service, have led to customer NPS improving to +42 points. The strength of the customer proposition and experience was recognised by winning the Judges Award at the 2016 Card and Payment Industry Awards.

2016 financial highlights

- the strength of our customer proposition increased credit card balances by 55.0 per cent to £2.4 billion at the end of 2016;

- net interest income grew by 39.3 per cent to £136.0 million reflecting this growth in balances;
- net interest margin decreased by 1.53 percentage points to 6.69 per cent as a result of the growth in the number of front book customers, where the yield is lower than the mature acquired portfolio;
- other income reduced by 1.7 per cent. This decrease was driven by the reduction in interchange income, earned as a commission on retail spend, reflecting the impact of the EU ruling effective December 2015 that capped the domestic interchange rate in the UK at 30 basis points;
- these factors combined to increase total income by 33.0 per cent;
- 2016 represented the first full year of our cards operating platform and, despite significant volume growth, stringent cost control constrained cost growth to just 1.9 per cent delivering JAWS of 31.1 per cent;
- the impairment charge for credit cards increased by 27.5 per cent to £34.8 million – comparing favourably to the 55.0 per cent growth in balances and demonstrating stable credit quality. This translated to a cost of risk for credit cards that decreased by 30 basis points to 1.70 per cent in 2016, from 2.00 per cent in 2015;
- taken together, these factors increased contribution in the segment by 58.4 per cent, to £81.1 million from £51.2 million in 2015; and
- risk-weighted assets in the segment increased by 50.8 per cent, driven by the growth of receivables.

Performance summary – Credit Cards

	2016 £m	2015 £m	Change
Net interest income	**136.0**	97.6	39.3%
Other income	**17.7**	18.0	(1.7)%
Total income	**153.7**	115.6	33.0%
Total costs	**(37.8)**	(37.1)	1.9%
Impairment charge	**(34.8)**	(27.3)	27.5%
Contribution	**81.1**	51.2	58.4%
Credit cards net interest margin	**6.69%**	8.22%	(153)bps
Cost of risk	**1.70%**	2.00%	(30)bps

	2016 £m	2015 £m	Change %
Key balance sheet items at 31 December			
Credit card balances	**2,447.1**	1,578.7	55.0%
Total customer balances	**2,447.1**	1,578.7	55.0%
Risk-weighted assets	**2,012.3**	1,334.7	50.8%

FINANCIAL SERVICES

The Financial Services business manages and develops our insurance and investment offerings. We work with a number of partners to deliver these products, which typically require limited capital and generate attractive returns.

This part of our business contributed 6.4 per cent of total income in 2016.

Strategy

Our Financial Services strategy is based on a partnership model. We seek partners who share our commitment to straightforward, transparent and good value customer propositions. We leverage their capabilities with our brand and marketing expertise to access profitable sectors and capital-light product lines, whilst limiting our exposure to financial risk.

Key developments

The insurance business performed well in 2016, delivering an increase in new customers of 27 per cent. Our successful travel insurance business continued to flourish, adding 450,000 new travel insurance sales, supported by the launch of underwriting for pre-existing medical conditions in March 2016. Following the launch of our home insurance product with Ageas in late 2015, we have focused on building customer engagement and optimising price.

Our newly launched travel money and international money transfer services gained momentum and awareness in 2016 as we helped customers to transfer £30 million overseas and access £1 million of holiday spending money.

Our customers continued to appreciate the transparency and choice our investment funds provide. Funds under management increased by 12 per cent to end at £3.4 billion. Equity ISA applications increased by 2 per cent, outperforming the decline seen in the market and we won Best Direct Stocks and Shares ISA Provider at the Your Money Awards in July.

2016 financial highlights

- the majority of income in the Financial Services segment continues to come from our successful investment funds business;
- funds under management stood at £3.4 billion at 31 December 2016. The Group currently mitigates the risk associated with stock market movements and their impact on earnings through the use of a FTSE hedge;
- our insurance and other income in 2016 grew 16.0 per cent, reflecting our expanded product range and the continued success of our more mature travel insurance line;
- stringent cost control in the business contributed to a 6.6 per cent reduction in costs; and
- taken together, these factors improved the contribution from the Financial Services business by 10.1 per cent on 2015.

Performance summary – Financial Services

	2016 £m	2015[1] £m	Change %
Investments and pensions	**31.7**	31.6	0.3%
Insurance and other	**5.8**	5.0	16.0%
Total income	**37.5**	36.6	2.5%
Total costs	**(15.6)**	(16.7)	(6.6)%
Contribution	**21.9**	19.9	10.1%

	2016 £m	2015 £m	Change %
Key balance sheet items at 31 December			
Loans and advances to customers	**–**	–	–
Customer deposits	**–**	–	–
Total customer balances	**–**	–	–
Risk-weighted assets	**50.4**	51.6	(2.3)%

1 2015 results include Current Accounts; in 2016 Current Accounts is reported under Mortgages and Savings.

CENTRAL FUNCTIONS

Our Central Functions provide shared support services to each of our business lines. These services include Information Technology and Property, together with functions such as Risk, Finance, Treasury, Human Resources and the Group's Executive. It is not our policy to allocate the cost of these shared functions to each business line.

Our segmental view of the business allocates directly attributable costs to the main income lines, with the remainder of overheads in central functions.

This part of our business contributed 1.8 per cent of total income in 2016.

Key developments

Management of central overhead is a key discipline for the business. Further simplification and efficiency activity across a number of central functions in the year more than offset the cost of increased investment in the development of the business through both the project portfolio and enhanced distribution activity.

The scope of simplification and efficiency improvements was broad. Fixed costs efficiencies were driven by holding people costs flat with targeted delayering especially at the senior levels and other operational efficiencies offsetting inflationary and volume driven increases. Property and IT costs were managed carefully through contract negotiations and the disposal of our ATMs. Operational cost efficiencies were driven by contact centre economies of scale. The benefits of these improvements can be seen not only in the reduction in cost:income ratio but also in the reduction of cost per customer across all product lines.

We have continued to optimise and prioritise our project delivery in 2016, using our £50 million investment budget effectively to deliver a wide range of initiatives that helped grow and protect our business, as well as meet key regulatory requirements. This includes the development of our mortgage proposition via our successful 'Mortgage Lab', further advancing our fraud, financial crime and anti-money laundering capability and improvements to our complaints management system, reducing the time it takes us to resolve complaints. We have integrated multiple third party solutions and developed our core systems this year, leaving us well positioned to offer an improved debit card proposition to new and existing customers in 2017 through a new partnership with MasterCard.

In July 2016 we opened our seventh Lounge, this time in Sheffield. This expands our established network of lounges and Sheffield has continued the successful trends of our other six lounges. The highly visible presence on a primary retail site has proved to be very popular with new and existing customers, as well as the local community, as demonstrated through very strong net promoter scores. We will continue to use the lessons that we learn to further optimise our store and lounge strategy.

2016 financial highlights

- interest income and expense incurred from Treasury funding and liquidity operations is allocated to the Mortgage and Savings and Cards businesses;
- other income is primarily driven by gains on the sale of investment securities from within the Treasury portfolio;
- a £1.4 million increase in depreciation and amortisation arose from capital expenditure in prior years, as we continued to invest in our future; and
- despite the cost of increased depreciation, amortisation and continued investment, the cost of running Central Functions reduced by 0.4 per cent – continuing to evidence the benefits of our stringent cost control and operational leverage.

Performance summary – Central Functions

	2016 £m	2015 £m	Change
Other income	**10.7**	10.3	3.9%
Total income	**10.7**	10.3	3.9%
Total costs	**(185.2)**	(186.0)	(0.4)%

Contribution	**(174.5)**	(175.7)	(0.7)%

	2016 £m	2015 £m	Change
Key balance sheet items at 31 December			
Risk-weighted assets	**427.6**	439.6	(2.7)%

RESPONSIBILITY STATEMENT OF THE DIRECTORS IN RESPECT OF THE ANNUAL FINANCIAL REPORT

The responsibility statement below has been prepared in connection with the Company's full annual report for the year ending 31 December 2016. Certain parts thereof are not included within this announcement.

We confirm to the best of our knowledge:

- The financial statements, prepared in accordance with the applicable set of accounting standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and the undertakings included in the consolidation taken as a whole; and
- the Strategic Report and Directors' Report include a fair review of the development and performance of the business and the position of the Company and Group together with a description of the principal risks and uncertainties that they face.

This responsibility statement was approved by the board of directors on 27 February 2017 and is signed on its behalf by:

Jayne–Anne Gadhia, Chief Executive

Glen Moreno, Chairman of the Board

PRINCIPAL RISKS AND UNCERTAINTIES

Effective risk management is a core part of our strategy.

The Board-approved risk appetite reflects our tolerance for risk in pursuit of our strategic objectives. It is designed to achieve an appropriate balance between risk and reward. Risk appetite is embedded in the business through delegation of authority from the Board to the Executive. Our risk management approach is fully aligned with Board risk appetite, regulatory requirements and industry good practice. Risks are identified, managed and mitigated using our risk management framework (see page 135 of the 2016 ARA).

We use a 'Three Lines of Defence' model which describes clear accountabilities, appropriate segregation of duties and effective independent assurance. The principal risks which could impact the delivery of our strategy are outlined on pages 48 to 51.

Risk culture

Our risk culture and values are aligned to our EBO philosophy and emphasise accountability. A strong and independent Risk function helps to ensure adherence to our risk management framework. Our risk culture is founded on a clear articulation of risk appetite, an effective governance structure, rapid escalation of threats and the sharing of information across the Group.

Risk as an enabler of growth, quality and returns

As a UK retail bank we are focused on serving domestic customers. We are subject to risks arising from macroeconomic conditions in the UK, geopolitical uncertainty and new structural and regulatory changes which will come into force over the next few years.

The way in which we manage risk through the economic cycle is a core part of our strategy and an enabler of growth, quality and returns. Our ongoing focus on maintaining a high-quality balance sheet is supported by our prudent risk appetite and our robust approach to risk management.

Achievements in 2016

The emphasis placed on protecting a high-quality balance sheet, with focus on credit quality, was maintained in 2016. The application of strict affordability requirements and prudent underwriting standards across our mortgage and credit card lending ensured that our lending continued to be high quality and within our asset quality guardrails.

Credit

The high quality of our mortgage business is reflected in our low arrears levels.

Secured 3+ arrears levels were 0.15 per cent at the end of 2016, compared to 0.22 per cent in 2015; substantially below the latest Council of Mortgage Lenders industry average of 1.00 per cent. Additionally, the proportion of secured assets classified as neither past due nor impaired improved by 0.1 per cent during 2016, to 99.1 per cent.

Our impairment provision coverage improved to 11.4 per cent during 2016, compared to 10.3 per cent in 2015.

The consistent application of our lending criteria and robust underwriting give us confidence that our mortgage book would be highly resilient in the event of a downturn. In H2 2016, we further strengthened our lending criteria in relation to buy-to-let lending.

The portfolio LTV remained broadly stable at 55.4 per cent at the end of 2016, compared to 55.0 per cent in 2015.

The quality of our credit card business was reinforced in 2016.

Following the EU referendum, we further strengthened our credit card underwriting standards in H2 2016. As a result, 86 per cent of new accounts during the year were in the high or very high credit score range, reflecting the strong credit quality of our cards portfolio.

Unsecured book quality continued to improve with a 0.4 per cent increase in the percentage of the book currently classified as neither past due nor impaired to 98.7 per cent. Unsecured 2+ arrears levels continued to fall, reducing by 18 bps compared to 2015.

Our low unsecured cost of risk of 1.7 per cent reflects a rigorous approach to underwriting, account management and credit decisioning, supported by the benign economic environment.

Capital and funding strength

Maintaining a well-capitalised business supports stable balance sheet growth, our credit rating and regulatory requirements. Our capital structure is managed to ensure that the business is well placed to react to current and forecast economic and regulatory conditions, as well as material downturns in the economy.

Our funding strategy is retail deposit led and we fund before we lend. We hold high quality liquid assets (HQLA) appropriate to our view of liquidity risks in the business and this level is approved by the Board.

- We strengthened our balance sheet further with the successful issuance of £230 million Additional Tier 1 (AT1) capital.
- We maintained our strong capital position and, as at 31 December 2016, our Common Equity Tier 1 (CET1) ratio was 15.2 per cent, our total capital ratio was 20.4 per cent and our leverage ratio was 4.4 per cent, positioning us well for continued growth.

We completed two issues of Residential Mortgage Backed Securities (RMBS), totalling £1.3 billion, which extended our reach in the wholesale markets beyond Sterling and Euro into US Dollars. Wholesale funding supplements our core retail deposit base, extends tenor, ensures we have appropriate diversification in the funding base and optimises funding costs.

During the final quarter of the year, we made three drawings from the Bank of England's (BoE) Term Funding Scheme (TFS) totalling £1.3 billion. This low-cost funding creates additional lending capacity and supports our overall funding plan.

Our strong funding position is reflected in a liquidity coverage ratio of 153.7 per cent as at 31 December 2016.

Regulatory change

The findings from the Financial Conduct Authority's (FCA) final Credit Card Market Study were published during 2016. We endorsed these and will implement the limited changes required for us to achieve full compliance with their recommendations.

We achieved compliance with the rules and guidance relating to the FCA's Cash Market Study, which came into force in December 2016.

The processes, controls and ongoing management training required for the Senior Managers and Certification Regime have been designed and implemented.

Full compliance with the Deposit Guarantee Scheme Directive was achieved and we received full regulatory permissions under the FCA Consumer Credit Sourcebook (CONC).

Cyber-crime

We have a well-developed Cyber Security Strategy to manage the increasing risk of cyber-crime. In addition to this, during 2016,

- We enhanced our Cyber Operations Centre, which monitors suspicious activity in real time, and launched a new Security Zone on our intranet, providing detailed security advice to colleagues.
- We became members of the Global Cyber Alliance; a broad international community of organisations working together to tackle cyber-crime.

Priorities in 2017

Macro-economic environment

The outcome of the EU referendum in June 2016 has created a period of economic uncertainty in the UK and Europe and this is likely to continue until the UK's exit strategy is clear. Whilst we continue to see strong customer demand and no evidence of material changes in customer behaviour, the potential risks around inflation, a slowing housing market and rising unemployment remain. We are subject to inherent risks arising from macro-economic conditions in the UK, including geopolitical uncertainty and the lower for longer interest rate environment.

The current low interest rate environment is unprecedented and as such further reductions to central bank rates or rapid rises from current levels both represent risk to future financial performance. We have an ongoing programme of stress testing to assess our vulnerability to changing macro-economic conditions. The results are used to inform the strategic planning process and ensure that adequate resources are available in the event of a downturn.

2017 is likely to bring further political uncertainty across Europe and we remain alert to the business impact that may have. We will continue to monitor key exposures and regularly review earnings in light of the prevailing economic outlook. We have implemented additional oversight activities, alongside contingency plans, which are designed to respond to and mitigate the impact of adverse macroeconomic conditions that may emerge.

Management of the credit card portfolio

During 2016, our credit card book grew substantially, increasing our market share to 3.5 per cent. We will continue to focus on strong credit management of these exposures, particularly in light of the current uncertain economic environment, where a rise in unemployment could result in pressure on disposable incomes leading to increased impairments. Although we are resilient to these risks as a result of our strong asset quality, we will monitor this closely in 2017, supported by our strong risk management and analytical capability.

Macro-structural changes

Our strategic planning fully addresses the new structural and regulatory changes which come into force over the next several years. We will continue to work with our regulators as requirements evolve. These changes include:

- Capital buffers: CRD IV introduced new capital limits and buffers for banks, and includes a requirement to hold CET1 capital to account for capital conservation and countercyclical buffers. A capital conservation buffer of 0.625 per cent was introduced on 1 January 2016. This will increase each year to a maximum of 2.5 per cent in 2019, in line with regulations. The countercyclical buffer applied to UK exposures is currently 0 per cent, however, this could grow to a maximum of 2.5 per cent by 2019. We understand our position and the strategic plan has been assessed against this.
- Minimum Requirements for Own Funds and Eligible Liabilities (MREL): will be fully phased in by 1 January 2022. The BoE provided our MREL guidance, including transitional arrangements, during 2016. Prior to 31 December 2019 MREL will be equal to our minimum regulatory capital requirements. From 1 January 2020 until 31 December 2021, MREL will be equal to 18 per cent of our risk-weighted assets. This guidance has been fully reflected in our strategic planning process.

- The Financial Services Banking Reform Act 2013: will result in the ring-fencing of retail and commercial banking operations to separate them from investment banking activities. We are in the process of agreeing our detailed ring-fence compliance plans with the Prudential Regulation Authority (PRA) and do not anticipate any material change to our structure or business model as a result.
- IFRS 9: will be implemented in 2018 and will result in new calculations of expected credit loss and additional disclosure requirements. We are in the process of developing new models and business practices to meet these requirements.
- EU legislation: the outcome of the EU referendum introduces uncertainty in relation to regulation derived from EU legislation. The material items of regulatory change deriving from EU legislation include the EU Market Abuse Directive, Payment Services Directive 2 (PSD2) and General Data Protection Regulation (GDPR).

Regulatory change programmes

The delivery of the following regulatory change programmes will be a core focus in 2017:

- FCA Asset Management Market Study: The FCA is consulting on a package of proposed remedies designed to improve the way asset management services and products could work better for both retail and institutional investors.
- General Data Protection Regulation: The General Data Protection Regulation (GDPR) provides an updated EU data protection framework to replace the existing 1995 Data Protection Directive (the Directive). We will implement the changes required to ensure compliance with the requirements of GDPR prior to its implementation date in May 2018.
- Fourth Money Laundering Directive: The EU's Fourth Money Laundering Directive (4MLD) requires European member states to update their money laundering laws and transpose the new requirements into local law by June 2017. We are working to ensure compliance with this directive prior to its implementation date.

Cyber-crime

Cyber-crime remains a material risk for all banks and we recognise the pace of change in the external threat environment. We will continue to monitor this changing external threat landscape and develop our capability to protect against cyber-crime through enhancement of our control environment.

Stable balance sheet growth

Our focus on asset quality and balance sheet stability will continue as the business grows. Credit policy and decision systems are regularly reviewed and tested to ensure they develop in response to changes in customer and competitor behaviours, maintaining the quality of the portfolios. This focus will continue throughout 2017.

Buy-to-let

During 2016, the Financial Policy Committee sought further powers of direction over buy-to-let mortgage lending. Buy-to-let lending accounts for 18 per cent of our mortgage portfolio, focusing on retail customers rather than portfolio landlords. Our affordability and rental cover requirements are prudent.

Third party administration

Outsourced relationships with parties which support the credit card, investment and insurance business lines, such as IFDS for Unit Trust Management and TSYS/TMS for our credit card business, are fundamental to the success of the business and remain a significant area of management focus. Reliance on key corporate partners and strategic suppliers involves the potential risk of disruption to service arising from the failure of a third party. Thorough risk assessment during the onboarding process, and robust ongoing oversight, are key to managing this risk.

Principal risks

Credit risk

We provide residential and buy-to-let mortgages and credit cards to customers across the UK. There is a risk that any adverse changes in the macro-economic environment and/ or the credit quality or behaviour of borrowers results in additional impairment losses, thereby reducing profitability.

Wholesale exposures arise through our liquid asset portfolio and the use of derivative instruments to manage interest rate risk.

Key mitigating actions

- credit risk is managed through risk appetite and risk limits reflected in approved credit policy;

- a robust credit risk framework helps ensure that the credit quality and composition of the portfolios remain within risk appetite limits. This is monitored and reported through governance committees regularly;
- stress and scenario testing allows us to confirm portfolio resilience;
- credit risk metrics are benchmarked against competitors and industry averages; and
- credit risk arising from derivatives and from securities financing transactions is mitigated by collateralising exposures on a daily basis.

Commentary

Impaired loans as a percentage of overall balances has remained stable in 2016. Wholesale credit quality remains strong with 97% of debt security counterparties rated AA or above.

Future focus

We will continue to deliver strong asset quality aligned to growth of the mortgage and credit card books. We will maintain our ‘no loss’ position for the wholesale credit portfolio.

Market risk

Market risk is the risk that unfavourable market movements lead to a reduction in earnings or value. We do not trade or make markets. Interest rate risk in the banking book is the only material category of market risk.

Key mitigating actions

- market risk is managed through Board-approved risk appetite limits and policies;
- exposures are mitigated through the use of natural offsets and derivatives; and
- stress and scenario testing focuses on the impacts of differing interest rate environments.

Commentary

Capital at Risk has remained stable in a positive rate shock scenario and has reduced as a proportion of our capital base. The interest rate risk exposure remains safely within limits.

Future focus

We will look to refine our interest rate risk management systems and approaches to reflect the evolving regulatory landscape.

Operational risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, including legal risk. The management of third party relationships, cyber-crime and information security remain a key focus for Virgin Money.

Key mitigating actions

- risk appetite is focused on maturing the control environment and therefore managing operational risk;
- a programme of investment in security infrastructure is in place to mitigate threats including cyberattack;
- we continue to invest in and develop risk management frameworks, systems and processes; and
- we monitor external events impacting other financial services companies to inform stress testing.

Commentary

As expected, the absolute amount of losses has increased, as the balance sheet has grown, but has remained low.

Future focus

We will continue to invest in cyber-crime defence, fraud and anti-money laundering infrastructure.

Conduct risk and compliance

Conduct and compliance risk is defined as the risk that our operating model, culture or actions result in unfair outcomes for customers. This could result in regulatory sanction, material financial loss or reputational damage if we fail to design and implement effective operational processes, systems and controls which maintain compliance with all applicable regulatory requirements.

Key mitigating actions

- compliance is maintained through an effective and timely response to changes in the regulatory environment;
- the customer is placed at the heart of decision-making by ensuring fair outcomes through comprehensive risk assessment and testing;

- we continue to invest in and develop risk management frameworks, systems and processes; and
- we focus on training to ensure colleague performance is aligned with the regulatory responsibilities and enable an awareness of good customer outcomes.

Commentary

Complaints per 1,000 accounts have remained stable, despite significant book growth.

Future focus

We will focus on our Complaints Transformation project to continue to improve the volume of complaints resolved at point of contact.

Strategic and financial risk

Strategic risk is the risk of significant loss or damage arising from business decisions that impact the long-term interests of stakeholders or from an inability to adapt to external developments.

Financial risk is focused primarily on concentration risk. Credit concentration risk is managed for retail and wholesale credit exposures at portfolio, product and counterparty levels.

Key mitigating actions

- Board focus is on ensuring alignment of business development and planning with risk appetite;
- we invest in processes, systems, recruitment and training to support new business developments;
- we use robust risk and project management disciplines to ensure that implementation is delivered safely;
- active focus is on asset origination and portfolio management to eliminate inappropriate concentration risk; and
- regular validation and review of models is performed.

Commentary

The average LTV in Greater London (49.3 per cent) and South East (53.8 per cent) is lower than the average portfolio LTV of 55.4 per cent.

Future focus

Focus will be on the development of our customer proposition and digital capability.

Funding and liquidity risk

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

Funding risk represents the inability to raise and maintain sufficient funding in quality and quantity to support the delivery of the business plan.

Key mitigating actions

- Board-approved risk appetite and funding and liquidity policies define a limit structure;
- liquid resources are maintained in adequate quantity and quality to meet stressed outflows;
- a prudent mix of funding sources is maintained with a maturity profile set in risk appetite and policy limits; and
- stress and scenario testing considers threats to funding plans and changes in consumer behaviour.

Commentary

Improved diversity of funding has been achieved through RMBS issuance and TFS drawings.

Future focus

We will continue to improve balance sheet efficiency and resilience through measured diversification of wholesale funding.

Capital risk

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

Key mitigating actions

- Board-approved risk appetite ensures we are holding sufficient capital within regulatory requirements;
- the capital management policy sets out minimum standards for the management of capital;
- capital procedures are subject to independent oversight; and

- stress and scenario testing assesses capital adequacy under a range of severe market wide stress scenarios and idiosyncratic stress events.

Commentary

Our total capital and leverage ratios have increased as a result of the AT1 capital raise in November 2016.

Future focus

We will continue to maintain a high-quality capital base with ratios in excess of regulatory requirements.

FINANCIAL STATEMENTS

Consolidated income statement

For the year ended 31 December

	Note	**2016 £ million**	2015 £ million
Interest and similar income		**948.1**	839.3
Interest and similar expense		**(425.7)**	(384.5)
Net interest income	3	**522.4**	454.8
Fee and commission income		**28.8**	27.4
Fee and commission expense		**(1.2)**	(1.2)
Net fee and commission income	4	**27.6**	26.2
Other operating income	5	**40.3**	41.3
Fair value losses on financial instruments	13	**(8.9)**	(0.4)
Other income		**59.0**	67.1
Total income		**581.4**	521.9
Operating expenses	6	**(349.4)**	(353.6)
Profit before tax from operating activities		**232.0**	168.3
Impairment	8	**(37.6)**	(30.3)
Profit before tax		**194.4**	138.0
Taxation	9	**(54.3)**	(26.8)
Profit for the year		**140.1**	111.2
Profit attributable to equity owners		**140.1**	111.2
Profit for the year		**140.1**	111.2
Basic earnings per share (pence)	10	**29.4**	22.9
Diluted earnings per share (pence)	10	**29.1**	22.7

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated statement of comprehensive income

For the year ended 31 December

	Note	**2016 £ million**	2015 £ million
Profit for the year		**140.1**	111.2
Other comprehensive income Items that may subsequently be reclassified to profit or loss:			
Movements in revaluation reserve in respect of available-for-sale financial assets:			
Change in fair value	30	**44.4**	25.1
Income statement transfers in respect of disposals	30	**(38.3)**	(33.6)
Taxation	30	**(1.7)**	1.2
		4.4	(7.3)
Movements in cash flow hedge reserve:			
Effective portion of changes in fair value taken to other comprehensive income	30	**(36.1)**	(13.2)
Net income statement transfers	30	**13.6**	5.1
Taxation	30	**6.3**	1.6
		(16.2)	(6.5)
Other comprehensive expense for the year, net of tax		**(11.8)**	(13.8)
Total comprehensive income for the year		**128.3**	97.4
Total comprehensive income attributable to equity owners		**128.3**	97.4

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated balance sheet

As at 31 December

	Note	**2016 £ million**		2015 £ million
Assets				
Cash and balances at central banks		**786.3**		888.6
Derivative financial instruments	13	**104.2**		82.3
Loans and receivables:				
– Loans and advances to banks	14	**635.6**		614.5
– Loans and advances to customers	15	**32,367.1**		27,109.0
– Debt securities		**0.7**		1.1
		33,003.4		27,724.6
Available-for-sale financial assets	16	**858.8**		1,296.9
Intangible assets	19	**80.6**		64.4
Tangible fixed assets	20	**77.4**		74.6
Deferred tax assets	21	**23.0**		38.0
Other assets	22	**121.9**		59.6
Total assets		**35,055.6**		30,229.0

Consolidated balance sheet

As at 31 December

Equity and liabilities	Note	2016 £ million	2015 £ million
Liabilities			
Deposits from banks	23	**2,132.5**	1,298.7
Customer deposits	24	**28,106.3**	25,144.9
Derivative financial instruments	13	**229.7**	156.0
Debt securities in issue	25	**2,600.0**	2,039.4
Provisions	26	**8.5**	8.4
Other liabilities	27	**291.4**	235.0
Current tax liabilities		**16.7**	6.3
Total liabilities		**33,385.1**	28,888.7
Equity			
Share capital and share premium	28	**654.6**	654.6
Other equity instruments	29	**384.1**	156.5
Other reserves	30	**(27.4)**	(15.6)
Retained earnings	31	**659.2**	544.8
Total equity		**1,670.5**	1,340.3
Total liabilities and equity		**35,055.6**	30,229.0

The accompanying notes are an integral part of these consolidated financial statements.

The financial statements were approved and authorised for issue by the Board and were signed on its behalf on 27 February 2017.

Glen Moreno
Chairman

Jayne-Anne Gadhia CBE
Chief Executive

Consolidated statement of changes in equity

For the year ended 31 December

Attributable to equity holders

	Share capital and share premium £ million	Other equity instruments £ million	Other reserves £ million	Retained earnings £ million	Total equity £ million
Balance at 1 January 2016	**654.6**	**156.5**	**(15.6)**	**544.8**	**1,340.3**
Comprehensive income					
Profit for the year	**–**	**–**	**–**	**140.1**	**140.1**
Other comprehensive income					
Net movement in revaluation reserve in respect of available-for-sale financial assets	**–**	**–**	**4.4**	**–**	**4.4**
Net movement in cash flow hedge reserve	**–**	**–**	**(16.2)**	**–**	**(16.2)**
Total other comprehensive expense	**–**	**–**	**(11.8)**	**–**	**(11.8)**
Total comprehensive (expense)/income for the year	**–**	**–**	**(11.8)**	**140.1**	**128.3**
Transactions with equity holders					
Dividends paid to ordinary shareholders	**–**	**–**	**–**	**(20.8)**	**(20.8)**
Distribution to Additional Tier 1 security holders	**–**	**–**	**–**	**(12.6)**	**(12.6)**
Tax attributable to Additional Tier 1 securities	**–**	**–**	**–**	**2.5**	**2.5**
Purchase of own shares	**–**	**–**	**–**	**(7.3)**	**(7.3)**
Issue of Additional Tier 1 securities	**–**	**227.6**	**–**	**–**	**227.6**
Share based payments – charge for the year				**12.8**	**12.8**
Deferred tax on share based payments	**–**	**–**	**–**	**(0.3)**	**(0.3)**
Total transactions with equity holders	**–**	**227.6**	**–**	**(25.7)**	**201.9**
Balance at 31 December 2016	**654.6**	**384.1**	**(27.4)**	**659.2**	**1,670.5**

The accompanying notes are an integral part of these consolidated financial statements.

Further details of movements in the Group's share capital and reserves are provided in notes 28 to 31.

Consolidated statement of changes in equity

For the year ended 31 December

Attributable to equity holders (continued)

	Share capital and share premium £ million	Other equity instruments £ million	Other reserves £ million	Retained earnings £ million	Total equity £ million
Balance at 1 January 2015	654.6	156.5	(1.8)	434.5	1,243.8
Comprehensive income					
Profit for the year	–	–	–	111.2	111.2
Other comprehensive income					
Net movement in revaluation reserve in respect of available-for-sale financial assets	–	–	(7.3)	–	(7.3)
Net movement in cash flow hedge reserve	–	–	(6.5)	–	(6.5)
Total other comprehensive expense	–	–	(13.8)	–	(13.8)
Total comprehensive (expense)/income for the year	–	–	(13.8)	111.2	97.4
Transactions with equity holders					
Dividends paid to ordinary shareholders	–	–	–	(6.2)	(6.2)
Distribution to Additional Tier 1 security holders	–	–	–	(12.6)	(12.6)
Tax attributable to Additional Tier 1 securities	–	–	–	2.6	2.6
Purchase of own shares	–	–	–	(5.0)	(5.0)
Share based payments – charge for the year	–	–	–	20.0	20.0
Deferred tax on share based payments	–	–	–	0.3	0.3
Total transactions with equity holders	–	–	–	(0.9)	(0.9)
Balance at 31 December 2015	654.6	156.5	(15.6)	544.8	1,340.3

The accompanying notes are an integral part of these consolidated financial statements.

Further details of movements in the Group's share capital and reserves are provided in notes 28 to 31.

Consolidated cash flow statement

For the year ended 31 December

	Note	**2016 £ million**	2015 £ million
Profit before taxation		**194.4**	138.0
Adjustments for:			
Changes in operating assets	35(a)	**(5,387.3)**	(4,037.3)
Changes in operating liabilities	35(b)	**3,957.3**	3,146.4
Non-cash and other items	35(c)	**(19.5)**	62.4
Tax paid		**(22.1)**	(5.0)
Net cash used in operating activities		**(1,277.2)**	(695.5)
Cash flows from investing activities			
Purchase of securities		**(670.0)**	(659.2)
Proceeds from sale and redemption of securities		**1,150.0**	900.5
Purchase and investment in intangible assets		**(31.6)**	(29.5)
Purchase of tangible fixed assets		**(8.6)**	(10.2)
Disposal of tangible fixed assets		**0.7**	–
Net cash provided by investing activities		**440.5**	201.6
Cash flows from financing activities			
Dividends paid to ordinary shareholders	11	**(20.8)**	(6.2)
Distributions to Additional Tier 1 security holders		**(12.6)**	(12.6)
Net proceeds from issue of debt securities		**1,278.9**	1,047.2
Repayments of debt securities in issue		**(718.3)**	(601.9)
Purchase of own shares		**(7.3)**	(5.0)
Issue of Additional Tier 1 securities (net of costs)		**227.6**	–
Net cash provided by financing activities		**747.5**	421.5
Change in cash and cash equivalents		**(89.2)**	(72.4)
Cash and cash equivalents at beginning of year		**1,461.4**	1,533.8
Cash and cash equivalents at end of year	35(d)	**1,372.2**	1,461.4

The accompanying notes are an integral part of these consolidated financial statements.

Notes to the consolidated financial statements

Note 1: Basis of preparation and accounting policies

1.1 Reporting entity

Virgin Money Holdings (UK) plc (the Company) is a public limited company incorporated and registered in England and Wales. The registered office is Jubilee House, Gosforth, Newcastle-Upon-Tyne, NE3 4PL.

The Company was incorporated on 4 August 1995 as a private limited company with registered number 03087587. On 24 July 2014 the Company was re-registered as a public limited company.

The Company is the parent entity and the ultimate controlling party of the Virgin Money Group (the Group), which consists of the Company and its subsidiaries.

1.2 Basis of preparation

The Group consolidated financial statements, which should be read in conjunction with the Directors' Report, have been prepared on a going concern basis in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU, including interpretations issued by the IFRS Interpretations Committee, and with those parts of the Companies Act 2006 applicable to companies reporting under IFRS.

The Directors have reviewed the strategic plan which shows the financial position, cash flow, liquidity and capital forecasts for the Group. The Directors are confident that the Group will have sufficient resources to meet its liabilities as they fall due and to continue to operate for a period of at least 12 months from the date of approval of the financial statements. Accordingly the Directors believe that it remains appropriate to prepare the financial statements on a going concern basis.

1.3 Changes in accounting policy

New standards, amendments to standards and interpretations adopted

In 2016, the Group adopted a number of minor interpretations and amendments to standards, which were endorsed for adoption by the EU, and mandatory for annual reporting periods beginning on or after 1 January 2016. These included amendments published through the Annual Improvements to IFRSs 2010-2012 and 2012-2014 cycles, in addition to a number of stand-alone amendments.

The adoption of these interpretations and amendments to standards or interpretations had an insignificant impact on the Group and did not result in any change in accounting policies.

New accounting standards issued by the IASB that are relevant to the Group and effective in future periods are presented in note 38.

1.4 Presentation of information

Presentation of risk and capital management disclosures

Disclosures under IFRS 7 'Financial Instruments: Disclosure' concerning the nature and extent of risks relating to financial instruments and under IAS 1 'Presentation of financial statements' concerning objectives, policies and processes for managing capital have been included within the audited sections of the Risk Management Report. Where marked as 'audited' these are covered by the Independent Auditors' Report.

1.5 Basis of consolidation

The Group consists of the Company and its subsidiaries. The subsidiaries are listed in note 2 of the parent company financial statements. The consolidated financial statements comprise the financial statements of the Group.

Entities are regarded as subsidiaries where the Group has the power over an investee, exposure or rights to variable returns from its involvement with the investee and the ability to affect those returns. Inter-company transactions and balances are eliminated upon consolidation. Subsidiaries are consolidated from the date on which control is transferred to the Group and are deconsolidated from the date that power over an investee, exposure or rights to variable returns and the ability to affect these returns ceases. Accounting policies are applied consistently across the Group.

The Virgin Money Foundation, launched in August 2015, is managed and controlled by a Board of independent Trustees, such that the Group has no power over the Foundation or, exposure or ability to affect variable returns. The Foundation is therefore not consolidated in the financial statements of the Group.

Special Purpose Vehicles (SPV) are entities created to accomplish a narrow and well defined objective. For the Group this is the securitisation of mortgage assets. An SPV is consolidated if the Group has control over the SPV, through its exposure to variable returns from its involvement in the SPV and the ability to affect those returns through its power over the entity.

1.6 Basis of measurement

The financial statements have been prepared under the historical cost convention as modified by the revaluation of derivative financial instruments, available-for-sale and other assets held at fair value through profit or loss. A summary of the material accounting policies of the Group are included within note 1.9. Policies which are relevant to the financial statements as a whole are set out below.

The accounting policies have been applied consistently to all periods presented in these financial statements.

1.7 Client money

The Group's unit trust management and investment intermediary subsidiaries administer money on behalf of some clients in accordance with the Client Money Rules of the Financial Conduct Authority. Client money is not recognised in the balance sheet or in the notes to the financial statements as the Group is not the beneficial owner.

1.8 Foreign currency translation

The Group's financial statements are presented in Sterling, which is the functional currency of the Company, all of its subsidiaries and the SPVs included within the consolidated financial statements.

Foreign currency transactions are translated into functional currency using the exchange rates prevailing at the dates of the transactions. Monetary items denominated in foreign currencies are translated at the rate prevailing at the balance sheet date. Foreign exchange gains and losses resulting from the restatement and settlement of such transactions are recognised in the income statement, except when recognised in other comprehensive income if relating to a qualifying cash flow hedge or available-for-sale assets. Non-monetary items (which are assets or liabilities which do not attach to a right to receive or an obligation to pay currency) measured at historical cost and denominated in foreign currencies are translated at the exchange rate at the date of the transaction. Non-monetary items measured at fair value are translated at the exchange rate at the date of valuation. Where these are held at fair value through the income statement, exchange differences are reported as part of the fair value gain or loss.

1.9 Accounting policies

The accounting policies of the Group are set out below.

(a) Operating segments

The Group determines operating segments according to similar economic characteristics and the nature of its products and services in accordance with IFRS 8 'Operating Segments'. Management reviews the Group's internal reporting based around these segments in order to assess performance and allocate resources.

Segment performance is evaluated based on underlying profit or loss and is measured consistently with underlying profit or loss in the consolidated financial statements (income tax is unallocated). Segment results are regularly reviewed and reported to the Board of Directors to allocate resources to segments and to assess their performance.

Operating segments are reported in a manner consistent with the internal reporting provided to the Board. The Group Executive Committee (Management) has been determined to be the chief operating decision maker for the Group.

(b) Interest income and expense

Interest income and expense are recognised in the income statement for all instruments measured at amortised cost using the effective interest rate method.

This method calculates the amortised cost of a financial asset or liability, and allocates the interest income or expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts or payments through the expected life of the financial instrument or, where appropriate, a shorter period to the net carrying amount of the financial asset or liability. The Group estimates cash flows considering all contractual terms of the financial instrument (for example prepayment options) but does not consider future credit losses. The calculation includes all amounts received or paid by the Group that are an integral part of the overall return, direct incremental transaction costs related to the acquisition or issue of a financial instrument and all other premiums and discounts.

Once a financial asset or group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

Interest receivable or payable on derivatives, whether in economic or accounting hedges, is recorded on an accruals basis in interest receivable or payable. Interest on available-for-sale (AFS) debt securities is recorded in interest receivable using the effective interest rate method.

(c) Fees and commissions

Where they are not included in the effective interest rate calculation, fees and commissions are recognised on an accruals basis when the service has been received or provided. Loan commitment fees for loans that are likely to be drawn down are deferred (together with related incremental direct costs) and recognised as an adjustment to the effective interest rate on the loan.

Fee income from general insurance and life insurance policies is recognised in full on the effective date of commencement or renewal of the related policies to reflect underlying contracts with product providers.

(d) Other operating income

Other operating income comprises the fair value for services, net of value added tax, rebates and discounts. Other operating income is attributable to the sale and management of stocks and shares ISAs, pensions, authorised unit trusts and other financial services products.

Other operating income from sales of units in managed funds is recognised daily based on the average volume of funds under management.

Fees charged to register with Virgin Money Giving Limited are recognised from the date on which recovery is reasonably certain. The commission charged on donations and event fees is recognised from the date donations and event fees are transacted on the website. Both of these income streams contribute towards costs incurred by Virgin Money Giving Limited.

Other income includes commission on donations and other sundry income.

(e) Total operating expenses

Operating expenses are recognised on an accruals basis as services are provided. Included within the employee benefits expense are employee share based payments. The accounting policy in relation to share based payments is set out in policy (f).

Staff costs

The Group accounts for components of employee costs on the following bases:

Short-term employee benefits

Short term employee benefits include salaries and social security costs and are recognised over the period in which the employees provide the services to which the payments relate.

Cash bonus awards are recognised to the extent that the Group has a present obligation to its employees that can be measured reliably and are recognised over the period of service that employees are required to work to qualify for the payment.

Other long-term employee benefits

Other long-term employee benefits include deferred cash bonus awards. Deferred cash bonus awards are recognised at the present value of the obligation at the reporting date. These costs are recognised over the period of service that employees are required to work to qualify for the payment.

Retirement benefit obligations

A defined contribution plan is a post-employment benefit plan into which the Group pays fixed contributions and has no legal or constructive obligation to pay further amounts. Contributions are recognised as staff expenses in profit or loss in the periods during which related employee services are fulfilled.

The Group operates defined contribution pension schemes for its Directors and employees. The assets of the schemes are held separately from those of the Group in independently administered funds.

Leases

If the lease agreement in which the Group is a lessee transfers the risks and rewards of the asset, the lease is recorded as a finance lease and the related asset is capitalised. At inception, the asset is recorded at the lower of the present value of the minimum lease payments or fair value and is depreciated over the estimated useful life. The lease obligations are recorded as borrowings.

If the lease does not transfer the risks and rewards of the asset, the lease is recorded as an operating lease.

Operating lease payments are charged to profit or loss on a straight line basis over the lease term unless a different systematic basis is more appropriate. Where an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor in compensation is charged to profit or loss in the period in which termination is made.

(f) Share based payments

The Group puts in place share schemes for employees to reward strong long-term business performance and to incentivise growth for the future.

The Group engages in equity settled share based payment transactions in respect of services received from certain of its employees.

For these transactions the grant date fair value of the award is recognised as an employee expense with a corresponding increase in equity over the period that the employees become unconditionally entitled to the awards.

The grant date fair value of the award is determined using valuation models which take into account the terms and conditions attached to the awards. Inputs into valuation models may include the exercise price, the risk-free interest rate, the expected volatility of the Company's share price and other various factors which relate to performance conditions attached to the awards.

The amount recognised as an expense is adjusted to reflect the actual number of awards for which the related service and non-market vesting conditions are expected to be met such that the amount ultimately recognised as an expense is based on the number of awards that do meet the related service and non-market performance conditions at the vesting date.

(g) Impairment losses

The Group assesses its financial assets or groups of financial assets for objective evidence of impairment at each balance sheet date. An impairment loss is recognised if a loss event (or events) has occurred after initial recognition, and on or before the balance sheet date, that has an impact on the estimated future cash flows of the financial assets or groups of financial assets that can be reliably measured. Losses incurred as a result of events occurring after the balance sheet date are not recognised in these financial statements.

Assets held at amortised cost

The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant.

Objective evidence that a financial asset is impaired includes observable data that comes to the attention of the Group about the following loss events:

- there is evidence of the customer or issuer experiencing financial difficulty;
- there is a breach of contract, such as a default or delinquency in repayments;
- the customer is granted a concession that would otherwise not be considered;
- the borrower will enter bankruptcy or other financial reorganisation;
- the disappearance of an active market for that financial asset because of financial difficulties; and
- observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the portfolio, including:
  - there are adverse changes in the payment status of borrowers in the portfolio; and
  - economic conditions that correlate with defaults on the assets in the portfolio.

If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. In assessing collective impairment the Group uses statistical modelling of historic trends to assess the probability of a group of financial assets going into default and the subsequent loss incurred. Regular model monitoring is performed to ensure model assumptions remain appropriate.

Assets that are individually assessed and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

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

When a loan or receivable is uncollectible, it is written off against the related provision for loan impairment. 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 are recognised directly in the income statement. If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the customer's credit rating), the previously recognised impairment loss is reversed by adjusting the impairment allowance. The amount of the reversal is recognised in profit or loss.

A provision is also made in the case of accounts, which may not currently be in arrears, where losses may have been incurred but not yet recognised. An increased level of provision is held for accounts where an impairment trigger event has occurred which includes accounts benefiting from forbearance and those in arrears. Refer to the Risk Management Report for details of the forbearance policy.

Available-for-sale financial assets

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset, or group of financial assets are impaired. The amount of the loss is measured as the difference between the asset's acquisition cost less principal repayments and amortisation and the current fair value. The amount of the impairment loss is recognised in profit or loss. This includes cumulative gains and losses previously recognised in other comprehensive income which are recycled from other comprehensive income to the income statement.

If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through profit or loss. Impairment losses recognised in profit or loss on equity instruments are not reversed through profit and loss.

(h) Taxation

Taxation comprises current tax and deferred tax. Current tax and deferred tax are recognised in profit or loss except to the extent that they relate to items recognised directly in equity or other comprehensive income. Current tax is based on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years. The Group has adopted the Code of Practice on Taxation for Banks issued by HM Revenue and Customs.

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

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

(i) Earnings per share

Basic earnings per share is calculated by dividing the profit attributable to ordinary shareholders of the parent company by the weighted-average number of ordinary shares outstanding during the period excluding own shares held in employee benefit trusts or held for trading.

The diluted earnings per share is calculated by adjusting the profit or loss that is attributable to ordinary shareholders and the weighted-average number of ordinary shares outstanding for the effects of all dilutive potential ordinary shares, which comprise share options granted to employees.

For the calculation of diluted earnings per share the weighted-average number of ordinary shares in issue is adjusted to assume conversion of all dilutive potential ordinary shares, if any, that arise in respect of share options and rewards granted to employees. The number of shares that could have been acquired at the average annual share price of the Company's shares based on the monetary value of the subscription rights attached to outstanding share options and awards is determined. This is deducted from the number of shares issuable under such options and awards to leave a residual bonus amount of shares which are added to the weighted-average number of ordinary shares in issue, but no adjustment is made to the profit attributable to equity shareholders.

(j) Financial instruments

Financial assets

Management determines the classification of its financial instruments at initial recognition.

Financial assets can be classified in the following categories:

- loans and receivables;

- available-for-sale;
- held to maturity; or
- financial assets at fair value through profit or loss.

Purchases and sales of financial assets at fair value through profit or loss, held to maturity and available-for-sale are recognised on the trade date, the date on which the Group commits to purchase or sell the asset.

Loans and receivables at amortised cost

The Group's loans and advances to banks and customers and asset backed securities for which there is no active market are classified as loans and receivables. Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, whose recoverability is based solely on the credit risk of the customer and where the Group has no intention of trading the loan or receivable. Loans and receivables are initially recognised at fair value including direct and incremental transaction costs. Subsequent recognition is at amortised cost using the effective interest rate method, less any provision for impairment.

Available-for-sale financial assets

Available-for-sale financial assets are non-derivative assets that are either designated as available-for-sale or are assets that do not meet the definition of loans and receivables and are not derivatives or assets held at fair value through profit or loss. These are principally, but not exclusively, investment securities intended to be held for an indefinite period of time which may be sold in response to a need for liquidity or changes in interest rates, exchange rates or equity prices. They are initially measured at fair value including direct and incremental transaction costs. Fair values are obtained from quoted market prices in active markets and, where these are not available, from valuation techniques including discounted cash flow models (refer to policy (m)). With the exception of certain unquoted equity instruments measured at cost less impairment because their fair value cannot be measured reliably, subsequent measurement is at fair value, with changes in fair value being recognised in other comprehensive income except for impairment losses and translation differences, which are recognised in profit or loss. Upon derecognition of the asset, or where there is objective evidence that the investment security is impaired, the cumulative gains and losses recognised in other comprehensive income are removed from other comprehensive income and recycled to profit or loss.

Held to maturity financial assets

Held to maturity financial assets are non-derivative financial assets with fixed or determinable payments that the Group has the ability and intention to hold to maturity. They are initially measured at fair value including direct and incremental transaction costs. Subsequent measurement is at amortised cost using the effective interest rate method. No financial assets were classified as held to maturity during either the current or prior year.

Financial assets at fair value through profit or loss

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

The fair values of quoted investments in active markets are based on current bid prices. If the market for a financial asset is not active (and for unlisted securities), the Group establishes fair value using valuation techniques. These include the use of recent arm's length transactions, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants.

Financial liabilities

The Group measures all of its financial liabilities at amortised cost, other than derivatives and those instruments which have been designated as part of a hedging relationship (refer policy (n)). Borrowings, including deposits and debt securities in issue are recognised initially at fair value, being the issue proceeds net of premiums, discounts and transaction costs incurred. All borrowings are subsequently measured at amortised cost using the effective interest rate method. Amortised cost is adjusted for the amortisation of any premiums, discounts and transaction costs. The amortisation is recognised in interest expense and similar charges using the effective interest rate method. The Group does not hold any financial liabilities classified as held for trading.

Offsetting financial instruments

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

Sale and repurchase agreements

Securities sold subject to repurchase agreements (repos) are reclassified in the financial statements as assets pledged when the transferee has the right by contract or custom to sell or repledge the collateral. The counterparty liability is included in deposits from banks or customer deposits, as appropriate. Securities purchased under agreements to resell (reverse repos) are recorded as loans and advances to banks or customers as appropriate. The difference between sale and repurchase price is treated as interest and accrued over the life of the agreements using the effective interest rate method. Securities lent to counterparties are also retained in the financial statements.

Derecognition of financial assets and liabilities

Derecognition is the point at which the Group removes an asset or liability from its balance sheet. The Group's policy is to derecognise financial assets only when the contractual right to the cash flows from the financial asset expires or when the Group transfers the financial assets to another party provided the transfer of the asset also transfers the right to receive the cash flows of the financial asset or where the Group has transferred substantially all the risks and rewards of ownership. Where the transfer does not result in the Group transferring the right to receive the cash flows of the financial assets, but it does result in the Group assuming a corresponding obligation to pay the cash flows to another recipient, the financial assets are also accordingly derecognised. The Group derecognises financial liabilities only when the obligation specified in the contract is discharged, converted to shares, cancelled or has expired or is transferred to a third party. There were no transactions in the year where the Group transferred financial assets that should have been derecognised in their entirety.

(k) Loans and advances to banks

The Group's loans and advances to banks are classified as loans and receivables.

(l) Loans and advances to customers

The Group's loans and advances to customers are classified as loans and receivables.

(m) Available-for-sale financial assets

The Group's debt securities and equity instruments are classified as available-for-sale assets. Debt securities are principally available-for-sale as they are intended to be held for an indefinite period of time but may be sold in response to a need for liquidity, changes in interest rates or exchange rates. Equity instruments are classified as available-for-sale because they do not meet the definition of loans and receivables, have no defined maturity dates and are not derivatives or assets held at fair value through profit or loss.

(n) Derivative financial instruments and hedge accounting

The Group is authorised to undertake the following types of derivative financial instrument transactions for non-trading purposes: cross currency swaps, interest rate swaps, equity swaps, interest rate caps, forward rate agreements, options, foreign exchange contracts and similar instruments.

The Group's derivative activities are entered into for the purpose of matching or eliminating risk from potential movements in interest rates, foreign exchange rates and equity exposures inherent in the Group's assets, liabilities and positions. All derivative transactions are for economic hedging purposes and it is decided at the outset which position the derivative will be hedging. Derivatives are reviewed regularly for their effectiveness as hedges and corrective action taken, if appropriate. Derivatives are measured initially at fair value and subsequently remeasured to fair value. Fair values are obtained from quoted market prices in active markets and, where these are not available, from valuation techniques including discounted cash flow models and option pricing models. Where derivatives are not designated as part of an accounting hedge relationship, changes in fair value are recorded in the income statement. Where derivatives are designated within accounting hedge relationships, the treatment of the changes in fair value depends on the nature of the hedging relationship as explained below.

Hedge accounting is used for derivatives designated in this way provided certain criteria are met. The Group documents at the inception of the accounting hedge relationship the link between the hedging instrument and the hedged item as well as its risk management objective and strategy for undertaking various hedge transactions. The Group also documents its assessment both at hedge inception and on an ongoing basis of whether the derivatives used in hedging transactions are highly effective in offsetting changes in the fair values or cash flows of hedged items. The Group designates certain derivatives as either:

Cash flow hedges

A cash flow hedge is used to hedge exposures to variability in cash flows, such as variable rate financial assets and liabilities. The effective portion of changes in the derivative fair value is recognised in other comprehensive income, and recycled to the income statement in the periods when the hedged item will affect profit and loss. Interest rate derivatives designated as cash flow hedges primarily hedge the exposure to cash flow vulnerability from forecast loans and advances to customers. The fair value gain or loss relating to the ineffective portion is recognised immediately in profit or loss.

Fair value hedges

A fair value hedge is used to hedge exposures to variability in the fair value of financial assets and liabilities, such as fixed rate loans. Changes in fair value of derivatives that are designated and qualify as fair value hedges are recorded in the income statement, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. If the hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of the hedged item is amortised to the income statement over the period to maturity.

The most frequently used fair value hedges are:

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

(o) Securitisation transactions

Certain Group companies have issued debt securities in order to finance specific loans and advances to customers. Both the debt securities in issue and the loans and advances to customers remain on the Group balance sheet within the appropriate balance sheet headings unless:

- a fully proportional share of all or of specifically identified cash flows have been transferred to the holders of the debt securities, in which case that proportion of the assets are derecognised;
- substantially all the risks and rewards associated with the assets have been transferred, in which case the assets are fully derecognised; and
- a significant proportion of the risks and rewards have been transferred, in which case the assets are recognised only to the extent of the Group's continuing involvement.

The Group has also entered into self-issuance of securitised debt which may be used as collateral for repurchase or similar transactions. Investments in self-issued debt and the equivalent deemed loan, together with the related income, expense and cash flows, are not recognised in the financial statements.

Debt securities in issue

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

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

Securitisation is a means used by the Group to fund an element of its mortgage portfolio. These securitised advances are subject to non-recourse finance arrangements. These advances have been transferred at their principal value to Special Purpose Vehicles (SPV) and have been funded through the issue of amortising mortgage backed securities to investors.

As discussed in note 1.5, the Group controls the securitisation SPVs and therefore consolidates the assets and liabilities of the securitisation SPVs, on a line by line basis.

(p) Funding for Lending Scheme

The Group participates in the Funding for Lending Scheme (FLS). The scheme allows the Group to receive Treasury bills in return for eligible collateral, including approved portfolios of loans and advances to customers.

Receipt of Treasury bills under the FLS does not involve the substantial transfer of the risks and rewards on the collateral, or the right to receive its related cash flows, hence the derecognition criteria outlined in policy (j) are not satisfied. Therefore the collateral assets will continue to be recognised in the financial statements and the Treasury bills are not separately recognised.

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

(q) Intangible assets and amortisation

Intangible assets purchased separately from a business combination are capitalised at their cost and amortised from the date from which they become available for use over their useful economic life which is generally 3 to 10 years. Intangible assets acquired as part of an acquisition are capitalised at their fair value where this can be measured reliably in accordance with IFRS 13 'Fair Value Measurement'.

Expenditure incurred in relation to scoping, planning and researching the build of an asset as part of a project is expensed as incurred.

Development expenditure incurred on a project is capitalised only if the following criteria are met:

- an asset is created that can be identified;
- it is probable that the asset created will generate future economic benefits; and
- the development cost of the asset can be measured reliably.

Following the initial recognition of development expenditure, the cost is amortised over the estimated useful lives of the assets created. Amortisation commences on the date that the asset is brought into use.

Internally generated intangible assets relate to computer software and core banking platforms.

Computer software

Costs incurred in acquiring and developing computer software for internal use are capitalised as intangible assets where the software leads to the creation of an identifiable non-monetary asset and it is probable that the expected future economic benefits that are attributable to the asset will flow to the Group from its use for a period of over one year. The software is classified as an intangible asset where it is not an integral part of the related hardware and amortised over its estimated useful life on a straight line basis which is generally 3 to 10 years.

Costs associated with maintaining software are expensed as they are incurred.

Core banking platforms

Core banking platforms primarily represent the construction of core operating platforms, which are internally generated. Core banking platforms are amortised on a straight line basis over 3 to 10 years.

Impairment of intangible assets

Intangible assets are assessed for indications of impairment at each balance sheet date, or more frequently where required by events or changes in circumstances. If indications of impairment are found, these assets are subject to an impairment review. The impairment review compares the carrying value of the assets with their recoverable amounts, which are defined as the higher of the fair value less costs to sell and their value in use. Fair value less costs to sell is the amount at which the asset could be sold in a binding agreement in an arm's length transaction. Value in use is calculated as the discounted cash flows generated as a result of the asset's continued use including those generated by its ultimate disposal, discounted at a market rate of interest on a pre-tax basis.

Where impairments are indicated, the carrying values of intangible assets are written down by the amount of the impairment and the charge is recognised in the income statement in the period in which it occurs. A previously recognised impairment charge on an asset may be reversed in full or in part through the income statement where a change in circumstances leads to a change in the estimates used to determine its recoverable amount. The carrying value will only be increased to the value at which it would have been held had the impairment not been recognised.

(r) Tangible fixed assets and depreciation

Tangible fixed assets are stated at cost less accumulated depreciation and provision for impairment, as appropriate. Cost includes the original purchase price of the asset and the costs attributable to bringing the asset to its working condition for its intended use. Additions and subsequent expenditure are included in the asset's carrying value or are recognised as a separate asset only when they improve the expected future economic benefits to be derived from the asset. All other repairs and maintenance are charged to the income statement in the period in which they are incurred.

Depreciation is provided using the straight line method to allocate costs less residual values over estimated useful lives, as follows:

Freehold property	50-100 years
Leasehold property	Unexpired period of the lease
Plant and leasehold improvements	5-30 years
Computer equipment	3-5 years
Office equipment	3-10 years
Motor vehicles	4 years

The residual values and useful lives of assets are reviewed, and adjusted if appropriate, at each balance sheet date. Where the cost of freehold land can be identified separately from buildings, the land is not depreciated.

Impairment of tangible fixed assets

Tangible fixed assets are assessed for indications of impairment at each balance sheet date, or more frequently where required by events or changes in circumstances. If indications of impairment are found, these assets are subject to an impairment review. The impairment review compares the carrying value of the assets with their recoverable amount, which are defined as the higher of the fair value less costs to sell and their value in use. Fair value less costs to sell is the amount at which the asset could be sold in a binding agreement in an arm's length transaction. Value in use is calculated as the discounted cash flows generated as a result of the asset's continued use including those generated by its ultimate disposal, discounted at a market rate of interest on a pre-tax basis.

Where impairments are indicated, the carrying values of fixed assets are written down by the amount of the impairment and the charge is recognised in the income statement in the period in which it occurs. A previously recognised impairment charge on an asset may be reversed in full or in part through the income statement where a change in circumstances leads to a change in the estimates used to determine its recoverable amount. The carrying value will only be increased to the value at which it would have been held had the impairment not been recognised.

(s) Other assets

Other assets include prepayments and other amounts the Group is due to receive from third parties in the normal course of business.

(t) Deposits from banks

Deposits by banks are initially measured at fair value, which is normally the proceeds received net of any directly attributable transaction costs incurred. Subsequent measurement is at amortised cost, using the effective interest rate method.

(u) Customer deposits

Customer deposits are initially measured at fair value, which is normally the proceeds received. Subsequent measurement is at amortised cost, using the effective interest rate method.

(v) Provisions

Provisions are recognised for present obligations arising from past events where it is more likely than not that an outflow of resources will be required to settle the obligations and they can be estimated reliably.

Provisions for levies are recognised when the conditions that trigger the payment of the levy are met.

(w) Other liabilities

Deferred income represents amounts received in advance of the Group providing services, and will be recognised as income in profit or loss when the services have been provided.

Other creditors represent amounts the Group is due to pay to third parties in the normal course of business. These include expense accruals, which have been incurred, but not yet billed.

Accrued expenses are amounts that the Group is due to pay to third parties in the normal course of business.

(x) Share capital and share premium

Share capital

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

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

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

Share issue costs

Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction, net of tax, from the proceeds.

Dividends and appropriations

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

Share premium

Share premium substantially represents the aggregate of all amounts that have ever been paid above par value to the Company when it has issued Ordinary and Deferred Shares. Certain expenses in relation to the issue of share capital can be offset against the share premium account. These expenses must be the incremental expenses arising on issue of the shares.

(y) Other equity instruments

Issued financial instruments are recognised as equity where there is no contractual obligation to deliver either cash or another financial asset. The proceeds are included in equity, net of transaction costs. Distributions and other returns to equity holders are treated as a deduction from equity.

(z) Other reserves

Revaluation reserve in respect of available-for-sale financial assets

The revaluation reserve in respect of available-for-sale financial assets represents the unrealised change in the fair value of available-for-sale investments since initial recognition.

Cash flow hedge reserve

For derivatives designated in a cash flow hedge, the effective portion of changes in fair value is recognised in the cash flow hedge reserve and recycled to profit or loss in the periods when the hedged item will affect profit or loss.

(aa) Contingent liabilities

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

(ab) Fair value of financial assets and liabilities

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 in the principal, or in its absence, the most advantageous market to which the Group has access at that date. The fair value of a liability reflects its non-performance risk (the risk the Group will not fulfil an obligation), including the Group's own credit risk.

For the majority of instruments, fair value is determined with reference to quoted prices in an active market. A market is regarded as active if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

Where quoted prices are not available, fair value is based upon cash flow models, which use wherever possible independently sourced observable market parameters such as interest rate yield curves, currency rates and option volatilities. The chosen valuation technique incorporates all the factors that market participants would take into account in pricing a transaction and is discounted at a risk free rate.

Refer to note 33 for a description of different levels within the fair value hierarchy. Levels are reviewed at each balance sheet date and this determines where transfers between levels are required.

The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price – i.e. the fair value of consideration given or received. The Group does not apply a credit valuation adjustment (CVA) or debit valuation adjustment (DVA) to reflect the credit risk of its derivative exposures as the Group's portfolio is fully collateralised.

If an asset or a liability measured at fair value has a bid price and an ask price, the Group measures assets and long positions at bid price and liabilities and short positions at an ask price.

1.10 Critical estimates and judgements

The preparation of financial statements in conformity with IFRS requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the reporting period. Although these estimates are based on management's best knowledge of the amount, actual results ultimately may differ from those estimates.

The areas involving a higher degree of judgement or complexity, or where assumptions and estimates are significant to the 2016 financial statements were as follows:

(a) Effective interest rates

IAS 39 requires interest earned from mortgages and credit cards to be measured under the effective interest rate method. The effective interest rate is the rate that exactly discounts estimated future cash flows through the expected life of the financial instrument to the net carrying value amount of the financial instrument. The accuracy of the effective interest rate can be affected when actual cash flows vary from the initial estimation of future cash flows. In that circumstance the carrying value of the financial instrument is adjusted to reflect the revisions to estimated cash flows with the adjustment made to profit and loss.

For secured lending management model future expected cash flows for each tranche of lending (by year of lending, product and LTV banding). In determining the future cash flows management must use judgement to estimate the average life of each tranche of lending. Management estimate expected repayment and redemption profiles of mortgage customers based on previous customer behaviour, this incorporates estimates of the proportion of borrowers expected to incur early redemption charges.

Management consider the estimated life to be the most significant estimate in the secured effective interest rate calculation. The accuracy of the estimated life would be affected by altered customer behaviour arising from unexpected market movements. For secured loans to the extent that the estimated life differs by +/- one month, the value of such loans on the balance sheet would be £4.5 million (2015: £3.6 million) higher or £4.6 million (2015: £3.7 million) lower respectively.

For unsecured lending management model future expected cash flows for each tranche of lending (by year of lending and product) over the customer life, up to a maximum of seven years from origination. In determining the future cash flows management must use judgement to estimate the life of the card relationship. Management estimate customer behaviour including card balance, transaction activity, repayment profiles and post-promotional retention rates based on previous customer experience.

Management consider the estimated life to be the most significant measure of performance in assessing the unsecured effective interest calculation. The accuracy of the effective interest rate would be affected by altered customer behaviour giving rise to actual cash flows that differ to expected cash flows. For unsecured loans to the extent that that estimated life differs by +/- one month, the value of such loans on the balance sheet would be £2.1 million (2015: £1.1 million) higher or £2.1 million (2015: £1.1 million) lower respectively.

(b) Impairment of loans and receivables

Individual impairment losses on secured loans and advances are calculated based on an individual valuation of the underlying asset. Collective impairment losses on loans and advances are calculated using a statistical model.

The key assumptions within the impairment models are monitored regularly to ensure the impairment allowance is entirely reflective of current portfolio experience. Key assumptions used within the models are based on various behavioural and arrears status segments, which vary by exposure type:

- The secured impairment model is based on measuring the probability of default; the probability of this default resulting in possession; and the subsequent loss incurred in the event of possession.
- The unsecured impairment model is based on measuring the probability of default; the probability of this default resulting in charge-off; and the subsequent loss incurred in the event of charge-off.

The accuracy of the impairment calculation would therefore be affected by unanticipated changes to the economic environment and assumptions which differ from actual outcomes. For mortgage loan receivables to the extent that:

- the loss given default differs by +/- 10%, for example if the loss given default is 10% then it is increased to 11%, the impairment allowance would be an estimated £0.3 million (2015: £0.3 million) higher or £0.3 million (2015: £0.3 million) lower respectively;
- the level of house prices differs by +/- 10%, for example a property value of £100,000 is increased to £110,000, the impairment allowance would be an estimated £1.3 million (2015: £1.3 million) lower or £2.6 million (2015: £3.0 million) higher respectively;
- the emergence period of 6 months differs by +/- 3 months, the impairment allowance would be an estimated £0.3 million (2015: £0.2 million) higher or £0.3 million (2015: £0.2 million) lower respectively.

For unsecured loans, to the extent that the loss given default differs by +/- 10%, the impairment allowance would be an estimated £3.9 million (2015: £2.9 million) higher or £3.9 million (2015: £2.9 million) lower respectively, and to the extent the emergence period of 6 months differs by +/-3 months, the impairment allowance would be an estimated £5.9 million (2015: £3.8 million) higher or £5.9 million (2015: £3.8 million) lower respectively.

(c) Capitalisation and impairment of intangibles

Intangibles are initially recognised when they are separable or arise from contractual or other legal rights, the cost can be measured reliably and, in the case of intangible assets not acquired in a business combination, where it is probable that future economic benefits attributable to the assets will flow from their use. Management review and monitor the capitalisation of significant project development costs on a regular basis to ensure that they meet the recognition criteria for capitalisation of an intangible asset and to ensure the costs are directly attributable to the individual projects where an asset is under construction. A review of capitalisation of intangibles has been undertaken to ensure these conditions have been met.

A review of intangible assets which are not yet in use for indications of impairment is undertaken at each reporting date. If there are indicators of impairment, an estimate of the recoverable amount is made. The recoverable amount of the asset is the higher of its fair value less costs to sell and its value in use. Value in use is calculated by discounting the future cash flows (both costs to complete and benefits post completion) generated from the continuing use of the asset. If the carrying value of the asset is less than the greater of the value in use and the fair value less costs to sell, an impairment charge is recognised.

Through their assessment of intangible assets and review for impairment indicators Management have not identified any assets that have an impairment, therefore a £nil impairment charge has been recognised (2015: £nil).

(d) Deferred tax

Taxation involves estimation techniques to assess the liability in terms of possible outcomes. The assessment of the recoverability or otherwise of deferred tax assets is based mainly on a determination of whether the relevant entity will generate sufficient profits within 5 years to realise the deferred tax assets.

This is reviewed at each reporting date by the Directors with a detailed exercise conducted to establish the validity of profit forecasts and other relevant information including timescales over which the profits are expected to arise and the deferred tax assets will reverse. Deferred tax is determined using tax rates that have been enacted or substantially enacted by the balance sheet date and which are expected to apply when the related deferred tax assets are realised or the deferred tax liabilities are settled.

The judgement required in the assessment of whether to recognise deferred tax assets is set out in policy (h). Based on their assessment of future profitability and interpretation of the timing and level of reversal of existing taxable temporary differences, in line with relevant accounting standards, the Directors conclude that a net deferred tax asset of £23.0 million (2015: £38.0 million) should be recognised at the balance sheet date.

(e) Fair value of financial assets and liabilities

Management must use judgement and estimates calculating fair value where not all necessary inputs are observable or where factors specific to the Group's holdings need to be considered. The accuracy of the fair value calculations would therefore be affected by unexpected market movements, inaccuracies within the models used compared to actual outcomes and incorrect assumptions. For example, to the extent the interest yield curve differs by +/- 10 bps, the net impact on fair values of derivative financial instruments would be an estimated increase of £33.1 million (2015: £23.5 million) or decrease of £33.3 million (2015: £23.7 million) respectively.

Note 2: Segmental analysis

For Management reporting purposes, the Group is organised into the following business segments:

- Mortgages and savings;
- Credit cards;
- Financial services; and
- Central functions.

These business groupings reflect how the Group Executive Committee, in its capacity as the chief operating decision maker for the Group, assesses performance and makes decisions regarding the allocation of resources to the business on the basis of product and customers. Internal and external sources of revenue are allocated to the appropriate business segment.

Mortgages and savings

Mortgage products include residential and buy-to-let mortgages. Savings products include ISAs, easy access, fixed term accounts and current accounts.

Following a change in Management reporting of the financial performance and position of current accounts in 2016, these are now reported within this business segment. Previously these were reported within 'Current accounts, insurance and investments' (renamed 'Financial services').

Credit cards

Credit card products include balance transfer and retail credit cards.

Financial services

Financial services include financial products offered beyond the core banking products and include investments, international money transfers, travel money, pensions, life insurance, travel insurance, home insurance, motor insurance and pet insurance.

Central functions

Central functions provide shared support services to each of the Group's business lines and Virgin Money Giving Limited (VMG). These services include information technology and property along with central services such as Risk, Finance, Human Resources and Management. It is not the policy of the Group to allocate the cost of these shared services to each business line. All depreciation and amortisation is allocated to the central functions business line.

The Group does not manage Treasury as a profit centre, and so the interest expense incurred from its Group funding and liquidity operations has been allocated to the other business lines. Treasury is not engaged in trading activities. Central functions segment assets and liabilities includes fixed assets and treasury assets and liabilities.

Due to the nature of the Group's operations there are no inter-segmental transactions

	Mortgages and savings[1] £m	Credit cards £m	Financial services £m	Central functions £m	Underlying basis total £m
Year ended 31 December 2016					
Net interest income	**383.0**	**136.0**	**–**	**–**	**519.0**
Other income	**2.0**	**17.7**	**37.5**	**10.7**	**67.9**
Total underlying income	**385.0**	**153.7**	**37.5**	**10.7**	**586.9**
Total costs	**(97.4)**	**(37.8)**	**(15.6)**	**(185.2)**	**(336.0)**
Impairment	**(2.8)**	**(34.8)**	**–**	**–**	**(37.6)**

Underlying profit/(loss) before tax	**284.8**	**81.1**	**21.9**	**(174.5)**	**213.3**
Segment assets	**29,743.9**	**2,453.0**	**3.2**	**2,855.5**	**35,055.6**
Segment liabilities	**28,214.9**	**3.9**	**2.6**	**5,163.7**	**33,385.1**

	Mortgages and savings £m	Credit cards £m	Financial services £m	Central functions £m	Underlying basis total £m
Year ended 31 December 2015					
Net interest income	358.5	97.6	–	–	456.1
Other income	2.5	18.0	36.6	10.3	67.4
Total underlying income	361.0	115.6	36.6	10.3	523.5
Total costs	(92.7)	(37.1)	(16.7)	(186.0)	(332.5)
Impairment	(3.0)	(27.3)	–	–	(30.3)
Underlying profit/(loss) before tax	265.3	51.2	19.9	(175.7)	160.7
Segment assets	25,457.5	1,585.2	2.6	3,183.7	30,229.0
Segment liabilities	25,286.2	4.0	4.5[2]	3,594.0	28,888.7

1 Current accounts are now included in the Mortgages and savings segment.

2 Current account balances of £230.3 million are now shown in the Mortgages and savings segment.

Reconciliation of statutory results to underlying basis

The underlying basis is the basis on which financial information is presented to the chief operating decision maker which excludes certain items included in the statutory results, of which further information is provided on pages 54 and 55. The table below reconciles the statutory results to the underlying basis.

		Adjusted for				
	Statutory results £m	**IPO Share based awards £m**	**Strategic items £m**	**Simplification costs £m**	**Fair value losses on financial instruments £m**	**Underlying basis £m**
Year ended 31 December 2016						
Net interest income	**522.4**	**–**	**(3.4)**	**–**	**–**	**519.0**
Other income	**59.0**	**–**	**–**	**–**	**8.9**	**67.9**
Total income	**581.4**	**–**	**(3.4)**	**–**	**8.9**	**586.9**
Total operating expenses	**(349.4)**	**2.0**	**5.8**	**5.6**	**–**	**(336.0)**
Profit before tax from operating activities	**232.0**	**2.0**	**2.4**	**5.6**	**8.9**	**250.9**

Impairment	**(37.6)**	**–**	**–**	**–**	**–**	**(37.6)**
Profit before tax	**194.4**	**2.0**	**2.4**	**5.6**	**8.9**	**213.3**

		Adjusted for				
	Statutory results £m	IPO Share based awards £m	Strategic items £m	Simplification costs £m	Fair value losses on financial instruments £m	Underlying basis £m
Year ended 31 December 2015						
Net interest income	454.8	–	1.3	–	–	456.1
Other income	67.1	–	(0.1)	–	0.4	67.4
Total income	521.9	–	1.2	–	0.4	523.5
Total operating expenses	(353.6)	10.5	6.9	3.7	–	(332.5)
Profit before tax from operating activities	168.3	10.5	8.1	3.7	0.4	191.0
Impairment	(30.3)	–	–	–	–	(30.3)
Profit before tax	138.0	10.5	8.1	3.7	0.4	160.7

Geographical areas

The Group's operating activities are exclusively in the UK.

Note 3: Net interest income

	2016 £m	2015 £m
Interest and similar income:		
Loans and advances to customers	**933.1**	822.4
Loans and advances to banks	**2.3**	2.4
Interest receivable on loans and receivables	**935.4**	824.8
Available-for-sale financial assets	**8.9**	10.5
Cash and balances at central banks	**3.8**	4.0
Total interest and similar income	**948.1**	839.3
Interest and similar expense:		
Deposits from banks	**(7.6)**	(6.8)
Customer deposits	**(370.7)**	(342.7)
Debt securities in issue	**(40.6)**	(29.0)
Other	**(6.8)**	(6.0)
Total interest and similar expense	**(425.7)**	(384.5)
Net interest income	**522.4**	454.8

Interest accrued on individually impaired assets was £5.8 million (2015: £6.8 million).

Note 4: Net fee and commission income

	2016 £m	2015 £m
Fee and commission income:		
On loans and advances to customers	**19.5**	21.0
Other fee and commission income	**9.3**	6.4
Total fee and commission income	**28.8**	27.4
Fee and commission expense:		
Other fee and commission expense	**(1.2)**	(1.2)
Net fee and commission income	**27.6**	26.2

Note 5: Other operating income

	2016 £m	2015 £m
Investment and protection income	**31.7**	31.5
Gains on sale of available-for-sale financial assets (refer note 16)	**6.8**	8.8
Other	**1.8**	1.0

Total other operating income	**40.3**	41.3

Note 6: Operating expenses

	2016 £m	2015 £m
Staff costs:		
Wages and salaries	**156.8**	138.9
Social security costs	**14.6**	16.2
Other pension costs	**10.7**	10.6
Employee share option schemes	**12.8**	20.0
	194.9	185.7
Premises and equipment:		
Hire of equipment	**4.6**	4.6
Rent and rates	**14.3**	14.0
	18.9	18.6
Other expenses:		
Marketing costs	**21.0**	22.3
FSCS levy	**7.8**	12.5
Professional fees	**13.7**	10.7
Other	**72.1**	84.2
	114.6	129.7
Depreciation and amortisation:		
Depreciation of tangible fixed assets	**5.6**	8.4
Amortisation of intangible assets	**15.4**	11.2
	21.0	19.6
Total operating expenses	**349.4**	353.6

Average headcount

The monthly average number of persons (including Directors) employed by the Group during the year was as follows:

	2016	2015
Full time	**2,394**	2,359
Part time	**746**	699
Total	**3,140**	3,058

Retirement benefit obligations

The Group operates defined contribution pension schemes for its Directors and employees. The assets of the schemes are held separately from those of the Group in independently administered funds.

The Group made contributions of £10.7 million (2015: £10.6 million) during the year. There were no contributions overdue at the year end (2015: £nil).

Fees payable to the auditors

During the year the Group obtained the following services from the Group's auditors as detailed below:

	2016 £m	2015 £m
Fees payable for the audit of the current year annual report and accounts	**0.2**	0.3
Fees payable for other services:		
Audit of the subsidiaries pursuant to legislation	**0.7**	0.6
Total audit fees	**0.9**	0.9
Audit-related assurance services	**0.2**	0.2
Total audit and audit-related fees	**1.1**	1.1
Other non-audit fees:		
Other assurance services	**0.1**	0.2
Total other non-audit fees	**0.1**	0.2
Total fees payable to the auditors by the Group	**1.2**	1.3

All amounts are shown exclusive of VAT.

The following types of services are included in the categories listed above:

Audit and audit-related fees

This category includes fees in respect of the audit of the Group's annual financial statements and other services in connection with regulatory filings and services for assurance and related services that are reasonably related to the performance of the audit or review of the financial statements.

Note 7: Share based payments

All share based payments charges relate to equity settled schemes.

The scheme details are summarised below.

	Award plan	Eligible employees	Nature of award	Vesting conditions[1]	Issue dates[2]
(A)	Long-term incentive plan	Selected senior employees	Conditional share award	Continuing employment or leavers in certain circumstances and achievement of performance conditions	2015 & 2016
(B)	Deferred bonus share plan	Selected senior employees	Deferred bonus – conditional share award	Continuing employment or leavers in certain circumstances	2014, 2015 & 2016
(C)	Phantom share award	Selected senior employees	Deferred bonus – conditional share award	Continuing employment or leavers in certain circumstances	2012 & 2013
(D)	IPO incentive scheme	Selected senior employees	Conditional share award	Continuing employment or leavers in certain circumstances	2013
(E)	Recruitment award	Two senior employees	Conditional share award	Continuing employment or leavers in certain circumstances	2013
(F)	IPO share award	All employees excluding the Group's Executive Committee	Conditional share award	Continuing employment or leavers in certain circumstances	2014

1 All awards have vesting conditions and therefore some may not vest.

2 Issue dates show the year in which issues have been made under the relevant scheme. There could be further issuances in future years under the scheme.

The terms of the equity settled schemes the Group operated during the year are as follows:

(A) Long-term incentive plan (LTIP)

The LTIP introduced in 2014 is aimed at delivering shareholder value by linking the receipt of shares to performance measures that are based on delivering the Group's strategic objectives over a 3 year period. Awards are made within limits set by the rules of the plan.

During 2016, selected senior employees of the Group were granted up to a maximum of 1,572,717 Ordinary Shares under the LTIP scheme. This number includes awards granted to senior employees who joined the Company in 2016 in recognition of outstanding awards over shares in their previous employing company that lapsed on accepting employment with the Group. Awards granted under the LTIP have performance and service conditions, with vesting dates prescribed for each participant.

The weighted-average fair value of awards granted during 2016 was £3.64 based on market prices at the date of grant.

(B) Deferred bonus share plan

The deferred bonus share plan is an equity settled scheme that is operated in conjunction with the short-term incentive plan for Executive Directors and other senior managers of the Group.

Share awards for the deferred element of 2016 bonuses will be granted under this scheme in 2017.

During 2016, selected senior employees of the Group were granted up to a maximum of 1,695,266 Ordinary Shares under the scheme. This number includes awards granted to senior employees who joined the Company in 2016 in recognition of outstanding awards over shares in their previous employing company that lapsed on accepting employment with the Group. Awards granted under the scheme have service conditions, with vesting dates prescribed for each participant.

The weighted-average fair value of awards granted during 2016 was £3.64 based on market prices at the date of grant.

(C) Phantom share award

In 2012 a notional (phantom) share award for senior individuals was established. During 2014 an approved change to existing awards under this scheme resulted in a change in accounting treatment from a cash settled to an equity settled share based payment.

The fair value of the converted award was recalculated and is being recognised over the remaining vesting period within the income statement through to 2018. No awards were granted in 2016 (2015: none) under this scheme.

(D) IPO incentive scheme

The IPO incentive scheme was introduced in December 2013 for selected senior employees. Participants were entitled to receive shares in the event of a listing. The award was a pre-determined percentage of the listing value, which was then converted to a number of Ordinary Shares based on the listing price.

The final tranche of share awards made under this scheme vested in December 2016. No awards were granted in 2016 (2015: none) under this scheme.

(E) Recruitment award

Under the scheme the participants received shares in 2014, 2015 and 2016. The final tranche of share awards made under this scheme vested in March 2016. No awards were granted in 2016 (2015: none) under this scheme.

(F) IPO share award

On listing, the Group granted all employees below Executive level a one-off share award. A small number of senior employees received an award over Ordinary Shares of either 10% or 20% of salary. All other employees received an award over Ordinary Shares with a value of £1,000. The majority of awards vested on the first anniversary of the listing. Certain awards granted to senior employees were subject to different vesting schedules, and holding periods, to comply with the PRA Remuneration Code. No awards were granted in 2016 (2015: none) under this scheme.

Movement in share options and conditional shares

	Ordinary Shares						
	Former Chairman's interest in share options[1]	**Long-term incentive plan**[2]	**Deferred bonus share plan**[2]	**Phantom share award**[2]	**IPO incentive scheme**[2]	**Recruitment award**[2]	**IPO share award**[2]
Shares in existence at 1 January 2016	**625,328**	**1,399,453**	**1,157,800**	**3,061,820**	**332,334**	**175,810**	**139,041**
Granted in year	**–**	**1,572,717**	**1,695,266**	**–**	**–**	**–**	**–**
Exercised or vested in year	**–**	**(98,349)**	**(754,417)**	**(950,550)**	**(305,676)**	**(175,810)**	**(68,885)**
Forfeited in year	**–**	**(222,483)**	**–**	**(66,790)**	**(26,658)**	**–**	**(1,236)**
Outstanding 31 December 2016	**625,328**	**2,651,338**	**2,098,649**	**2,044,480**	**–**	**–**	**68,920**
Of which exercisable	**625,328**	**–**	**–**	**–**	**–**	**–**	**–**

	Ordinary Shares						
	Former Chairman's interest in share options[1]	**Long-term incentive plan[2]**	**Deferred bonus share plan[2]**	**Phantom share award[2]**	**IPO incentive scheme[2]**	**Recruitment award[2]**	**IPO share award[2]**
Shares in existence at 1 January 2015	**625,328**	**–**	**14,918**	**3,120,900**	**664,658**	**327,760**	**1,773,880**
Granted in year	**–**	**1,727,770**	**2,032,683**	**–**	**–**	**–**	**–**
Exercised or vested in year	**–**	**(95,075)**	**(761,247)**	**–**	**(332,324)**	**(151,950)**	**(1,431,866)**
Forfeited in year	**–**	**(233,242)**	**(128,554)**	**(59,080)**	**–**	**–**	**(202,973)**
Outstanding 31 December 2015	**625,328**	**1,399,453**	**1,157,800**	**3,061,820**	**332,334**	**175,810**	**139,041**
Of which exercisable	**625,328**	**–**	**–**	**–**	**–**	**–**	**–**

1 This scheme was set up for the previous Chairman, Sir David Clementi. All share options granted under the scheme had vested prior to 1 January 2015. No share options have been exercised during 2016 or 2015. The weighted-average exercise price for options outstanding at 1 January 2016 and 31 December 2016 was £2.15. The options outstanding will expire 10 years from the date of listing if not exercised.

2 Awards have vesting conditions.

Note 8: Allowance for impairment losses on loans and receivables

	2016			2015		
	On secured loans £m	**On unsecured loans £m**	**Total £m**	On secured loans £m	On unsecured loans £m	Total £m
At 1 January	**8.7**	**31.2**	**39.9**	7.6	23.0	30.6
Advances written off	**(0.8)**	**(32.3)**	**(33.1)**	(1.9)	(26.0)	(27.9)
Gross charge to the income statement	**2.7**	**40.6**	**43.3**	3.0	34.2	37.2
As at 31 December	**10.6**	**39.5**	**50.1**	8.7	31.2	39.9

Of the total allowance in respect of loans and advances to customers, £49.4 million (2015: £38.8 million) was assessed on a collective basis.

During the year, sales of credit card receivables which had previously been written-off resulted in net recoveries of £5.7 million (2015: £6.9 million). The full amount of the proceeds have been recognised as a gain and the net charge to the income statement is summarised below.

	2016 £m	2015 £m
Gross charge to the income statement	**43.3**	37.2
Debt sale recoveries	**(5.7)**	(6.9)
Net charge to the income statement	**37.6**	30.3

Note 9: Taxation

(A) Analysis of the tax charge for the year

	2016 £m	2015 £m
UK corporation tax		
Current tax on profit for the year	**(40.3)**	(13.6)
Adjustments in respect of prior years	**0.4**	–
Current tax charge	**(39.9)**	(13.6)
Deferred tax (refer note 21)		
Origination and reversal of temporary differences	**(14.0)**	(15.0)
Adjustments in respect of prior years	**(0.2)**	(0.7)
Reduction in UK corporation tax rate	**(0.2)**	2.5
Deferred tax charge to the income statement	**(14.4)**	(13.2)
Tax charge	**(54.3)**	(26.8)

Analysis of tax charge recognised in Other Comprehensive Income:

	2016 £m	2015 £m
Current tax		
Available-for-sale financial assets	**–**	2.1
Cash flow hedge	**4.9**	–
Deferred tax		
Available-for-sale financial assets	**(1.7)**	(0.9)
Cash flow hedge	**1.4**	1.6
Total credit	**4.6**	2.8

(B) Factors affecting the tax charge for the year

A reconciliation of the charge that would result from applying the standard UK corporation tax rate to the profit before tax to the actual tax charge for the year is given below:

	2016 £m	2015 £m
Profit before tax	**194.4**	138.0
Tax charge at standard tax rate of 20% (2015: 20.25%)	**(38.9)**	(27.9)
Factors affecting charge:		
Disallowed items	**(1.8)**	(1.5)
Bank corporation tax surcharge	**(12.5)**	–

Non-taxable income	**–**	0.8
UK corporation tax rate change	**(0.2)**	2.5
Deferred tax charge in respect of share schemes	**(1.1)**	–
Adjustments in respect of prior years	**0.2**	(0.7)
Total tax charge	**(54.3)**	(26.8)

During the year the Group resolved an open HMRC enquiry relating to the tax treatment of certain funding transactions dating back to 2009. A payment of £2.1 million was made to HMRC in final and full settlement. This has resulted in a prior year credit of £0.2 million in the year to 31 December 2016.

The Finance (No. 2) Act 2015 was substantively enacted on 26 October 2015. This reduced the main rate of corporation tax to 19% with effect from 1 April 2017 and to 18% with effect from 1 April 2020. A further reduction in the main corporation tax rate to 17% from 1 April 2020 was announced in the 2016 Budget and substantively enacted in the Finance Act 2016.

The corporation tax surcharge for banks was introduced from 1 January 2016. The surcharge imposes an 8% charge on the banking profits of the Group (less a £25 million allowance against those profits).

Note 10: Earnings per share

	2016 £m	2015 £m
Profit attributable to equity shareholders – basic and diluted	**140.1**	111.2
Distributions to Additional Tier 1 security holders (net of tax)	**(10.1)**	(10.0)
Profit attributable to equity holders for the purposes of basic and diluted EPS	**130.0**	101.2

	2016 Number of shares (million)	2015 Number of shares (million)
Weighted-average number of ordinary shares in issue – basic	**442.8**	441.0
Adjustment for share options and awards	**4.7**	4.7
Weighted-average number of ordinary shares in issue – diluted	**447.5**	445.7
Basic earnings per share (pence)	**29.4**	22.9
Diluted earnings per share (pence)	**29.1**	22.7

Basic earnings per share has been calculated after deducting 1.7 million (2015: 1.8 million) ordinary shares representing the Group's holdings of own shares in respect of employee share schemes.

Of the total number of employee share options and share awards at 31 December 2016 none were anti-dilutive (2015: nil).

Note 11: Dividends

The 2016 interim dividend of 1.6p per ordinary share, amounting to £7.1 million, was paid in September 2016 and a final dividend in respect of the year ended 31 December 2015 of 3.1 pence per Ordinary Share amounting to £13.7 million, was paid in May 2016. These dividends were deducted from retained profits in the current year.

The Directors have recommended for approval at the 2017 AGM the payment of a final dividend in respect of the year ended 31 December 2016 of 3.5p per ordinary share, amounting to £15.5 million. If approved, this final dividend will be paid on 10 May 2017 to shareholders on the register at close of business on 6 April 2017. The financial statements for the year ended 31 December 2016 do not reflect this final dividend, which will be accounted for in shareholders' equity as an appropriation of retained profits in the year ending 31 December 2017.

An interim dividend for 2015 of 1.4 pence per Ordinary Share amounting to £6.2 million, was paid in October 2015.

Under the trust deed of the Employee Benefit Trust (EBT), a standing waiver is in force in respect of any dividends declared on shares held by the EBT.

Note 12: Analysis of financial assets and financial liabilities by measurement basis

	Held at amortised cost £m	Loans and receivables £m	Available-for-sale securities £m	Derivatives not designated as hedging instruments £m	Derivatives designated as hedging instruments		Total £m
					Fair value hedges £m	Cash flow hedges £m	
As at 31 December 2016							
Financial assets							
Cash and balances at central banks	–	786.3	–	–	–	–	786.3
Derivative financial instruments	–	–	–	18.5	21.0	64.7	104.2
Loans and receivables:							
– Loans and advances to banks	–	635.6	–	–	–	–	635.6
– Loans and advances to customers	–	32,367.1	–	–	–	–	32,367.1
– Debt securities	–	0.7	–	–	–	–	0.7
Available-for-sale financial assets	–	–	858.8	–	–	–	858.8
Other assets	–	68.8	–	–	–	–	68.8
Total financial assets	–	33,858.5	858.8	18.5	21.0	64.7	34,821.5
Non financial assets							234.1
Total assets							35,055.6
Financial liabilities							
Deposits from banks	2,132.5	–	–	–	–	–	2,132.5
Customer deposits	28,106.3	–	–	–	–	–	28,106.3
Derivative financial instruments	–	–	–	22.9	206.8	–	229.7
Debt securities in issue	2,600.0	–	–	–	–	–	2,600.0
Other liabilities	189.5	–	–	–	–	–	189.5
Total financial liabilities	33,028.3	–	–	22.9	206.8	–	33,258.0
Non financial liabilities							127.1
Total liabilities							33,385.1
Equity							1,670.5

Total liabilities and equity							35,055.6

Note 12: Analysis of financial assets and financial liabilities by measurement basis (continued)

	Held at amortised cost £m	Loans and receivables £m	Available - for-sale securities £m	Derivatives not designated as hedging instruments £m	Derivatives designated as hedging instruments		Total £m
					Fair value hedges £m	Cash flow hedges £m	
As at 31 December 2015							
Financial assets							
Cash and balances at central banks	–	888.6	–	–	–	–	888.6
Derivative financial instruments	–	–	–	18.3	63.5	0.5	82.3
Loans and receivables:							
– Loans and advances to banks	–	614.5	–	–	–	–	614.5
– Loans and advances to customers	–	27,109.0	–	–	–	–	27,109.0
– Debt securities	–	1.1	–	–	–	–	1.1
Available-for-sale financial assets	–	–	1,296.9	–	–	–	1,296.9
Other assets	–	14.6	–	–	–	–	14.6
Total financial assets	–	28,627.8	1,296.9	18.3	63.5	0.5	30,007.0
Non financial assets							222.0
Total assets							30,229.0
Financial liabilities							
Deposits from banks	1,298.7	–	–	–	–	–	1,298.7
Customer deposits	25,144.9	–	–	–	–	–	25,144.9
Derivative financial instruments	–	–	–	15.4	139.6	1.0	156.0
Debt securities in issue	2,039.4	–	–	–	–	–	2,039.4
Other liabilities	155.1	–	–	–	–	–	155.1
Total financial liabilities	28,638.1	–	–	15.4	139.6	1.0	28,794.1
Non financial liabilities							94.6
Total liabilities							28,888.7
Equity							1,340.3
Total liabilities and equity							30,229.0

Note 13: Derivative financial instruments

	As at 31 December 2016			As at 31 December 2015		
	Contract/ notional amount £m	**Asset fair value £m**	**Liability fair value £m**	Contract/ notional amount £m	Asset fair value £m	Liability fair value £m
Derivatives in accounting hedge relationships						
Derivatives designated as fair value hedges:						
Interest rate derivatives	**21,584.8**	**21.0**	**(206.8)**	23,421.6	63.5	(139.6)
	21,584.8	**21.0**	**(206.8)**	23,421.6	63.5	(139.6)
Derivatives designated as cash flow hedges:						
Interest rate derivatives	**1,287.0**	**–**	**–**	369.7	0.5	(1.0)
Currency derivatives	**520.3**	**64.7**	**–**	–	–	–
Total derivative assets/(liabilities) – in accounting hedge relationships	**23,392.1**	**85.7**	**(206.8)**	23,791.3	64.0	(140.6)
Derivatives in economic hedging relationships but not in accounting hedge relationships						
Interest rate derivatives	**7,549.6**	**13.2**	**(14.8)**	3,651.4	16.8	(15.4)
Currency derivatives	**56.0**	**3.4**	**(3.8)**	–	–	–
Equity and other options	**149.5**	**1.9**	**(4.3)**	58.2	1.5	–
Total derivative assets/(liabilities) – in economic hedging relationship but not in accounting hedge relationships	**7,755.1**	**18.5**	**(22.9)**	3,709.6	18.3	(15.4)
Total recognised derivative assets/(liabilities)	**31,147.2**	**104.2**	**(229.7)**	27,500.9	82.3	(156.0)

The principal amount of the contract does not represent the Group's real exposure to credit risk which is limited to the current cost of replacing contracts with a positive value to the Group should the counterparty default. To reduce credit risk the Group uses a variety of credit enhancement techniques such as netting and collateralisation, where security is provided against the exposure. Further details are provided in the Risk Management Report.

Hedged cash flows

For designated cash flow hedges the following table shows when the Group's hedged cash flows are expected to occur and when they will impact income:

	2016 £m	2015 £m
Within one year	**(9.2)**	(5.5)
In one to five years	**(22.3)**	(9.8)
Total	**(31.5)**	(15.3)

Gains/(losses) from derivatives and hedge accounting

	2016 £m	2015 £m
Gain from fair value hedge accounting[1]:		
Derivatives designated as fair value hedges	**(69.9)**	53.7
Fair value movement attributable to hedged risk	**81.8**	(50.7)
	11.9	3.0
Loss from cash flow hedges	**(13.6)**	(5.1)
Fair value (losses)/gains from other derivatives[2]	**(7.2)**	1.7
Loss from derivatives and hedge accounting	**(8.9)**	(0.4)

1 Gains or losses from fair value hedges can arise where there is an IAS 39 hedge accounting relationship in place and either:
– the fair value of the derivative was not exactly offset by the change in fair value attributable to the hedged risk; or
– the derivative was designated in or dedesignated from the IAS 39 hedge accounting relationship and in the following months leads to amortisation of existing balance sheet positions.

2 Other derivatives are those used for economic hedging but which are not in an IAS 39 hedge accounting relationship.

Note 14: Loans and advances to banks

	2016 £m	2015 £m
Balances within securitisation vehicles	**354.3**	384.3
Money market placements with banks	**33.0**	97.1
Other lending to banks	**248.3**	133.1
Total loans and advances to banks	**635.6**	614.5

Note 15: Loans and advances to customers

	2016 £m	2015 £m
Advances secured on residential property not subject to securitisation	**19,375.2**	17,389.9
Advances secured on residential property subject to securitisation	**4,907.8**	3,670.4
	24,283.0	21,060.3
Residential buy-to-let loans not subject to securitisation	**5,468.4**	4,401.9
Total loans and advances to customers secured on residential property	**29,751.4**	25,462.2
Unsecured receivables not subject to securitisation	**2,486.6**	1,610.0
Total loans and advances to customers before allowance for impairment losses	**32,238.0**	27,072.2
Allowance for impairment losses on loans and receivables (refer note 8)	**(50.1)**	(39.9)
Total loans and advances to customers excluding portfolio hedging	**32,187.9**	27,032.3
Fair value of portfolio hedging	**179.2**	76.7
Total loans and advances to customers	**32,367.1**	27,109.0

The fair value of portfolio hedging represents an accounting adjustment which offsets the fair value movement on derivatives designated in IAS 39 hedge accounting relationships with the mortgage portfolio. Such relationships are established to protect the Group from interest rate risk on fixed rate products. See the Risk Management Report for further details.

For collateral held in respect of the values included in the table above, refer to the Risk Management Report.

Note 16: Available-for-sale financial assets

	2016 £m	2015 £m
At 1 January	**1,296.9**	1,539.6
Additions	**670.0**	659.2
Disposals (sales and redemptions)	**(1,111.1)**	(858.5)
Reclassification of equity investments[1]	**–**	1.3
Exchange differences	**0.1**	(0.7)
Changes due to amortisation and accrued interest	**(11.6)**	(9.6)
Net gains/(losses) on changes in fair value	**14.5**	(34.4)
At 31 December	**858.8**	1,296.9

1 Represents investments in unquoted equity securities relating to the Group's participation in banking and credit card operations, previously recognised within other assets.

Gains on sale of available-for-sale securities amounted to £6.8 million (2015: £8.8 million).

Analysis of the composition of debt securities categorised as available-for-sale financial assets is set out in the Risk Management Report on page 162. All assets have been individually assessed for impairment and following this assessment no write down of assets was required.

Note 17: Collateral pledged and received

The Group receives and accepts collateral in the form of cash and marketable securities in respect of the following transactions:

- derivatives;
- sale and repurchase and reverse sale and repurchase agreements; and
- secured loans.

Collateral in respect of derivatives is subject to the standard industry terms of ISDA Credit Support Annex. This means that securities received or given as collateral can be pledged or sold during the term of the transaction but must be returned on maturity of the transaction. The terms also give each counterparty the right to terminate the related transactions upon the counterparty's failure to post collateral.

At 31 December 2016 cash collateral of £235.0 million had been pledged by the Group, comprising £181.1 million recognised within loans and advances to banks and £53.9 million within Other assets (2015: £94.6 million, comprising £94.3 million recognised within loans and advances to banks and £0.3 million within Other assets) and £14.0 million (2015: £23.8 million) has been received as cash collateral by the Group and recognised within deposits from banks.

At 31 December 2016 available-for-sale financial assets of £10.6 million (2015: £nil) are pledged as collateral in respect of derivative transactions.

At 31 December 2016 loans and advances of £2,302.3 million (2015: £755.0 million) are pledged as collateral in respect of secured loans and sale and repurchase agreements under terms that are usual and customary for such activities.

Note 18: Securitisation

Assets and liabilities of the SPVs included in these consolidated financial statements comprise:

	2016 £m	2015 £m
Assets		
Derivative financial instruments	**64.5**	–
Loans and advances to customers	**4,907.8**	3,670.4
Loans and advances to banks	**354.3**	384.3
Other assets	**0.1**	0.3
Total assets	**5,326.7**	4,055.0
Liabilities		
Debt securities in issue	**2,294.2**	1,741.9
Deposits by banks	**0.4**	13.2
Derivative financial instruments	**0.1**	–
Other liabilities	**3.4**	3.1
Total liabilities	**2,298.1**	1,758.2

The following table sets out the carrying amount of financial assets that did not qualify for derecognition and their associated liabilities. Where relevant, the table also sets out the net position of the fair value of financial assets where the counterparty to the associated liabilities has recourse only to the financial assets.

	2016	2015

	£m	£m
Carrying amount of transferred assets	**4,907.8**	3,670.4
Fair value of transferred assets	**4,982.7**	3,728.4
Carrying amount of associated liabilities	**2,294.2**	1,741.9
Fair value of associated liabilities	**2,300.1**	1,740.0

There were no transactions in the year where the Group transferred financial assets that should have been derecognised in their entirety.

Note 19: Intangible assets

	Core deposit intangible £m	**Software £m**	**Core banking platform £m**	**Total £m**
Cost:				
At 1 January 2015	4.8	82.0	19.9	106.7
Additions	–	27.9	1.6	29.5
Disposals	–	(24.8)	–	(24.8)
At 31 December 2015	4.8	85.1	21.5	111.4
Additions	**–**	**31.6**	**–**	**31.6**
Disposals	**–**	**(2.1)**	**–**	**(2.1)**
At 31 December 2016	**4.8**	**114.6**	**21.5**	**140.9**
Accumulated amortisation:				
At 1 January 2015	3.7	56.9	–	60.6
Charge for the year	(0.3)	8.6	2.9	11.2
Disposals	–	(24.8)	–	(24.8)
At 31 December 2015	3.4	40.7	2.9	47.0
Charge for the year	**1.4**	**10.4**	**3.6**	**15.4**
Disposals	**–**	**(2.1)**	**–**	**(2.1)**
At 31 December 2016	**4.8**	**49.0**	**6.5**	**60.3**
Balance sheet amount at 31 December 2016	**–**	**65.6**	**15.0**	**80.6**
Balance sheet amount at 31 December 2015	1.4	44.4	18.6	64.4

Note 20: Tangible fixed assets

	Land and buildings £m	Plant, equipment fixtures, fittings and vehicles £m	Total £m
Cost:			
At 1 January 2015	61.2	41.6	102.8
Additions	2.1	8.1	10.2
Disposals	–	(10.2)	(10.2)
At 31 December 2015	63.3	39.5	102.8
Additions	**1.8**	**6.8**	**8.6**
Disposals	**(0.6)**	**(3.0)**	**(3.6)**
At 31 December 2016	**64.5**	**43.3**	**107.8**
Accumulated depreciation and impairment:			
At 1 January 2015	7.3	22.6	29.9
Depreciation charge for the year	2.2	6.2	8.4
Disposals	–	(10.1)	(10.1)
At 31 December 2015	9.5	18.7	28.2
Depreciation charge for the year	**0.1**	**5.5**	**5.6**
Disposals	**(0.5)**	**(2.9)**	**(3.4)**
At 31 December 2016	**9.1**	**21.3**	**30.4**
Balance sheet amount at 31 December 2016	**55.4**	**22.0**	**77.4**
Balance sheet amount at 31 December 2015	53.8	20.8	74.6

Note 21: Deferred tax

	2016 £m	2015 £m
Deferred tax assets/(liabilities):		
Accelerated capital allowances	**12.9**	15.1
Revaluation reserve in respect of available-for-sale financial assets	**(2.6)**	–
Cash flow hedge reserve	**5.2**	3.8
Change in accounting basis on adoption of IFRS	**(4.0)**	(4.8)
Tax losses carried forward	**7.3**	18.0
Other temporary differences	**4.2**	4.3
Fair value adjustments on acquisition of Northern Rock	**–**	1.6
Total deferred tax assets	**23.0**	38.0

The Group has not recognised deferred tax assets in respect of gross unused tax losses of £31.2 million (2015: £31.2 million).

The movement in the net deferred tax balance is as follows:

	2016 £m	2015 £m
At 1 January	**38.0**	50.2
Income statement (charge)/credit (refer note 9):		
Accelerated capital allowances	**(2.2)**	8.0
Tax losses carried forward	**(10.7)**	(20.1)
Other temporary differences	**(1.5)**	(1.1)
	(14.4)	(13.2)
Amounts (charged)/credited to equity:		
Available-for-sale financial assets	**(1.7)**	(0.9)
Cash flow hedges	**1.4**	1.6
Adjustments relating to share based payments	**(0.3)**	0.3
	(0.6)	1.0
At 31 December	**23.0**	38.0

Note 22: Other assets

	2016 £m	2015 £m
Trade debtors	**17.7**	9.7
Prepayments and accrued income	**27.9**	22.4
Other	**76.3**	27.5
Total other assets	**121.9**	59.6

Included within 'Other' assets are amounts receivable from clearing houses on centrally cleared derivative financial instruments of £50.7 million (2015: £0.2 million) recorded on a net basis.

Note 23: Deposits from banks

	2016 £m	2015 £m
Liabilities in respect of securities sold under repurchase agreements	**850.0**	1,274.9
Secured loans	**1,268.0**	–
Other deposits from banks	**14.5**	23.8
Total deposits from banks	**2,132.5**	1,298.7

Note 24: Customer deposits

	2016 £m	2015 £m
Savings and investment accounts	**27,762.7**	24,914.6
Personal current accounts	**343.6**	230.3
Total customer deposits	**28,106.3**	25,144.9

Note 25: Debt securities in issue

	Secured £m	Unsecured £m	Total £m
At 1 January 2015	1,594.1	–	1,594.1
Repayments	(601.9)	–	(601.9)
Issues	750.0	298.9	1,048.9
Other movements	(0.3)	(1.4)	(1.7)
At 31 December 2015	1,741.9	297.5	2,039.4
Repayments	**(798.1)**	**–**	**(798.1)**
Issues	**1,278.9**	**–**	**1,278.9**
Revaluations	**73.0**	**–**	**73.0**
Other movements	**(1.5)**	**8.3**	**6.8**
At 31 December 2016	**2,294.2**	**305.8**	**2,600.0**

Other movements comprise unamortised issue costs and hedge accounting adjustments.

On 16 April 2015, the Group issued 5 year Medium Term Notes with a nominal value of £300 million at a coupon of 2.25% per annum. The notes were issued as part of the Group's £3 billion Global Medium Term Note programme. On 8 June 2015, the Group raised £750 million from institutional investors through the issuance of Residential Mortgage Backed Securities in the Gosforth Funding 2015-1 transaction in Sterling.

On 25 January 2016, the Group raised £803 million from institutional investors through the issuance of Residential Mortgage Backed Securities in the Gosforth Funding 2016-1 transaction in Euro, US Dollars and Sterling. On 9 May 2016, the Group raised £474 million from institutional investors through the issuance of Residential Mortgage Backed Securities (RMBS) in the Gosforth Funding 2016-2 transaction in Euro and Sterling. For all RMBS funding raised in currencies other than Sterling, the Group enters into cross-currency derivatives which swap the foreign currency liabilities into Sterling.

Note 26: Provisions

	FSCS £m	Other £m	Total £m
At 1 January 2016	**6.6**	**1.8**	**8.4**
Provisions applied	**(6.7)**	**(1.1)**	**(7.8)**
Charge for the year	**7.8**	**0.1**	**7.9**
At 31 December 2016	**7.7**	**0.8**	**8.5**

The Financial Services Compensation Scheme (FSCS) is the UK's statutory compensation fund of last resort for customers of authorised financial services firms and pays compensation if a firm is unable to pay claims against it. The FSCS is funded by levies on the authorised financial services industry. Each deposit-taking institution contributes towards the FSCS levies in proportion to their share of total protected deposits on 31 December of the year preceding the scheme year, which runs from 1 April to 31 March. The FSCS can only raise a levy within its scheme year (which commences 1 April) and under IFRIC 21 'Levies' the Group recognises its FSCS provision in the scheme year itself.

Following the default of a number of deposit takers in 2008, the FSCS borrowed funds from HM Treasury to meet the compensation costs for customers of those firms. At 31 March 2016, the end of the latest FSCS scheme year for which it has published accounts, the principal balance outstanding on these loans was £15,655 million (31 March 2015: £15,798 million). Although it is anticipated that the substantial majority of this loan will be repaid from funds the FSCS receives from asset sales, surplus cash flow or other recoveries in relation to the assets of the firms that defaulted, any shortfall will be funded by deposit-taking participants of the FSCS. The amount of future levies payable by the Group depends on a number of factors including the amounts recovered by the FSCS from asset sales, the Group's participation in the deposit-taking market at 31 December, the level of protected deposits and the population of deposit taking participants.

Note 27: Other liabilities

	2016 £m	2015 £m
Trade creditors and accruals	**59.0**	55.5
Deferred income	**3.0**	5.0
Accrued interest	**127.2**	131.1
Other liabilities	**102.2**	43.4
Total other liabilities	**291.4**	235.0

Deferred income represents income advanced from partners that will be recognised in future periods.

Accrued interest primarily represents interest which has accrued on savings and investment accounts.

Note 28: Share capital and share premium

	2016 £m	2015 £m
Share capital	**0.1**	0.1
Share premium	**654.5**	654.5
Total share capital and share premium	**654.6**	654.6

Issued and fully paid share capital

	2016 Number of shares	**2016 £**	2015 Number of shares	2015 £
Ordinary Shares of £0.0001 each				
At 1 January	**443,711,458**	**44,371**	441,933,180	44,193
Issued during year	**1,230,550**	**123**	1,778,278	178
At 31 December	**444,942,008**	**44,494**	443,711,458	44,371
Deferred Shares of £0.001 each				
At 1 January and at 31 December	**10,052,161**	**10,052**	10,052,161	10,052

The following describes the rights attaching to each share class at 31 December 2016:

Ordinary Shares

The holders of Ordinary Shares are entitled to one vote per share at meetings of the Group. All Ordinary Shares in issue in the Company rank equally and carry the same voting rights and the same rights to receive dividends and other distributions declared or paid by the Company.

Deferred Shares

As set out in the Articles of Association adopted on listing (and pursuant to the provisions of the Companies Act in respect of shares held in own shares), the Deferred Shares have no voting or dividend rights and, on a return of capital on a winding up, have no valuable economic rights. No application has been made or is currently intended to be made for the Deferred Shares to be admitted to the Official List or to trade on the London Stock Exchange or any other investment exchange.

The Deferred Shares are held in treasury. This is to ensure that the aggregate nominal value of the Company's share capital will be not less than £50,000, which is the minimum level of nominal share capital required by the Companies Act for a company to be established as a public limited company.

Note 29: Other equity instruments

	2016 £m	2015 £m
At 1 January	**156.5**	156.5
Additional Tier 1 securities issued in the year (net of issue costs)	**227.6**	–
At 31 December	**384.1**	156.5

The Company issued Fixed Rate Resettable Additional Tier 1 (AT1) securities on the Luxembourg Stock Exchange of £230.0 million on 10 November 2016 and £160.0 million on 31 July 2014. 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 £5.9 million (2015: £3.5 million). Dividends and other returns to equity holders are treated as a deduction from equity.

The principal terms of the AT1 securities in issue are described below:

- the securities constitute direct, unsecured and subordinated obligations of the Company and rank pari passu with holders of other Tier 1 instruments and the holders of that class or classes of preference shares but rank junior to the claims of senior creditors;
- the securities bear a fixed rate of interest from the issue date of 8.750% and 7.875% from their issue dates up to their first reset dates on 10 November 2021 and 31 July 2019 respectively;
- interest on the securities will be due and payable only at the sole discretion of the Company, and the Company has sole and absolute discretion at all times and for any reason to cancel (in whole or in part) any interest payment that would otherwise be payable on any interest payment date;
- the securities are perpetual with no fixed redemption date and are repayable, at the option of the Company, all (but not part) on the first reset date or any reset date thereafter. In addition, the AT1 securities are redeemable, at the option of the Company, in whole for certain regulatory or tax reasons. Any optional redemption requires the prior consent of the PRA; and
- all AT1 securities will be converted into Ordinary Shares of the Company, at a pre-determined price, should the Common Equity Tier 1 ratio of the Group fall below 7.0% as specified in the terms.

Note 30: Other reserves

Other reserves comprise:

	2016 £m	2015 £m
Revaluation reserve in respect of available-for-sale financial assets		
At 1 January	**(0.3)**	7.0
Net gains/(losses) from changes in fair value	**52.8**	(0.8)
Net gains on disposal transferred to net income	**(38.3)**	(33.6)
Amounts transferred to net income due to hedge accounting	**(8.4)**	25.9
Taxation	**(1.7)**	1.2
At 31 December	**4.1**	(0.3)

	2016 £m	2015 £m
Cash flow hedge reserve		
At 1 January	**(15.3)**	(8.8)
Amounts recognised in equity	**(36.1)**	(13.2)
Amounts transferred to income statement	**13.6**	5.1
Taxation	**6.3**	1.6
At 31 December	**(31.5)**	(15.3)

Note 31: Retained earnings

	2016 £m	2015 £m
At 1 January	**544.8**	434.5
Profit for the year	**140.1**	111.2
Dividends paid to ordinary shareholders	**(20.8)**	(6.2)
Distributions to Additional Tier 1 security holders (net of tax)	**(10.1)**	(10.0)
Purchase of own shares	**(7.3)**	(5.0)
Share based payments (including deferred tax)	**12.5**	20.3
As at 31 December	**659.2**	544.8

Employee Benefit Trust (EBT)

Retained earnings are stated after deducting £6.9 million (2015: £2.9 million) representing 2,922,220 (2015: 1,815,387) own shares held in an EBT.

The Company established an EBT in 2011 in connection with the operation of the Company's share plans. The Company funded the EBT by means of a cash loan and is therefore considered to be the sponsoring entity. The

EBT purchased shares in the Company using the cash loan which is accounted for as a purchase of own shares by the Company. The investment in own shares at 31 December 2016 is £6.9 million (2015: £2.9 million). The market value of the shares held in the EBT at 31 December 2016 was £8.8 million.

Note 32: Contingent liabilities and commitments

Contingent liabilities

The Board was not aware of any significant contingent liabilities as at 31 December 2016 (31 December 2015: none).

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

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

Loan commitments

Contractual amounts to which the Group is committed for extension of credit to customers.

	2016 £m	2015 £m
Not later than 1 year	**4,854.3**	3,980.7
Later than 1 year and not later than 5 years	**88.2**	102.5
Later than 5 years	**346.6**	396.6
Total loan commitments	**5,289.1**	4,479.8

Operating lease commitments – land and buildings

Minimum future lease payments under non-cancellable operating leases:

	2016 £m	2015 £m
Not later than 1 year	**7.1**	7.2
Later than 1 year and not later than 5 years	**25.0**	25.2
Later than 5 years	**20.0**	24.1
Total operating lease commitments – land and buildings	**52.1**	56.5

Operating lease commitments – other operating leases

Minimum future lease payments under non-cancellable operating leases:

	2016 £m	2015 £m
Not later than 1 year	**4.6**	4.6
Later than 1 year and not later than 5 years	**4.6**	9.2
Later than 5 years	**–**	–
Total operating lease commitments – other operating leases	**9.2**	13.8

Capital commitments

Capital commitments for the acquisition of buildings and equipment:

	2016 £m	2015 £m
Not later than 1 year	**1.0**	2.9
Later than 1 year and not later than 5 years	**–**	–
Later than 5 years	**–**	–
Total capital commitments	**1.0**	2.9

Note 33: Fair value of financial assets and financial liabilities

Fair value of financial assets and liabilities recognised at cost

The following table summarises the fair values of those financial assets and liabilities not presented on the Group's balance sheet at their fair value, by the level in the fair value hierarchy into which each fair value measurement is categorised. The accounting policy in note 1.9 (j) sets out the key principles for estimating the fair values of financial instruments.

	Level 1 £m	**Level 2 £m**	**Level 3 £m**	**Total fair value £m**	**Total carrying value £m**
At 31 December 2016					
Cash and balances at central banks	**–**	**786.3**	**–**	**786.3**	**786.3**
Loans and advances to banks	**–**	**635.6**	**–**	**635.6**	**635.6**
Loans and advances to customers	**–**	**–**	**32,514.0**	**32,514.0**	**32,367.1**
Debt securities classified as loans and receivables	**0.7**	**–**	**–**	**0.7**	**0.7**
Available-for-sale financial assets	**–**	**–**	**0.3**	**0.3**	**0.3**
Other assets	**–**	**68.8**	**–**	**68.8**	**68.8**
Total financial assets at fair value	**0.7**	**1,490.7**	**32,514.3**	**34,005.7**	**33,858.8**
Deposits from banks	**–**	**2,132.5**	**–**	**2,132.5**	**2,132.5**
Customer deposits	**–**	**28,222.7**	**–**	**28,222.7**	**28,106.3**
Debt securities in issue	**2,610.8**	**–**	**–**	**2,610.8**	**2,600.0**
Other liabilities	**–**	**189.5**	**–**	**189.5**	**189.5**
Total financial liabilities at fair value	**2,610.8**	**30,544.7**	**–**	**33,155.5**	**33,028.3**

	Level 1 £m	Level 2 £m	Level 3 £m	Total fair value £m	Total carrying value £m
At 31 December 2015					
Cash and balances at central banks	–	888.6	–	888.6	888.6
Loans and advances to banks	–	614.5	–	614.5	614.5
Loans and advances to customers	–	–	27,243.2	27,243.2	27,109.0
Debt securities classified as loans and receivables	1.2	–	–	1.2	1.1
Available-for-sale financial assets	–	–	1.3	1.3	1.3
Other assets	–	14.6	–	14.6	14.6
Total financial assets at fair value	1.2	1,517.7	27,244.5	28,763.4	28,629.1
Deposits from banks	–	1,298.7	–	1,298.7	1,298.7
Customer deposits	–	25,162.5	–	25,162.5	25,144.9
Debt securities in issue	2,032.1	–	–	2,032.1	2,039.4
Other liabilities	–	155.1	–	155.1	155.1
Total financial liabilities at fair value	2,032.1	26,616.3	–	28,648.4	28,638.1

Fair value hierarchy

The table above summarises the carrying value and fair value of assets and liabilities held on the balance sheet. There are three levels to the hierarchy as follows:

Level 1 – Quoted prices (unadjusted) in active markets for identical assets and liabilities.

Level 2 – Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, whether directly (i.e. as prices) or indirectly (i.e. derived from prices).

Level 3 – Inputs for the asset or liability that are not based on observable market data (unobservable inputs).

Valuation methods for calculations of fair values of financial assets and liabilities recognised at cost are set out below:

Cash and balances at central banks

Fair value approximates to carrying value because cash and balances at central banks have minimal credit losses and are either short-term in nature or reprice frequently.

Loans and advances to banks

Fair value was estimated by using discounted cash flows applying either market rates where practicable or rates offered by other financial institutions for loans with similar characteristics. The fair value of floating rate placements, fixed rate placements with less than six months to maturity and overnight deposits is considered to approximate to their carrying amount.

Loans and advances to customers

The Group provides loans of varying rates and maturities to customers. The fair value of loans with variable interest rates is considered to approximate to carrying value as the interest rate can be moved in line with market conditions. For loans with fixed interest rates, fair value was estimated by discounting cash flows using market rates or rates normally offered by the Group. The change in interest rates since the majority of these loans were originated means that their fair value can vary significantly from their carrying value. However, as the Group's policy is to hedge fixed rate loans in respect of interest rate risk, this does not indicate that the Group has an exposure to this difference in value.

Loans and advances to customers are categorised as level 3 as unobservable pre-payment rates are applied.

Debt securities classified as loans and receivables

Fair values are based on quoted prices, where available, or by discounting cash flows using market rates.

Available-for-sale financial assets

These are unquoted equity securities held by the Group and relating to participation in banking and credit card operations (refer note 16). They are categorised as level 3 as the fair value of these securities cannot be reliably measured, due to the lack of equivalent instruments with observable prices.

Other assets and liabilities – trade debtors/creditors, accrued income and accrued interest

Fair value is deemed to approximate the carrying value.

Deposits from banks and customer deposits

Fair values of deposit liabilities repayable on demand or with variable interest rates are considered to approximate to carrying value. The fair value of fixed interest deposits with less than six months to maturity is their carrying amount. The fair value of all other deposit liabilities was estimated by discounting cash flows, using market rates or rates currently offered by the Group for deposits of similar remaining maturities.

Debt securities in issue

Fair values are based on quoted prices where available or by discounting cash flows using market rates.

Fair value of financial assets and liabilities recognised at fair value

The following table summarises the fair values of those financial assets and liabilities recognised at fair value, by the level in the fair value hierarchy into which each fair value measurement is categorised. The accounting policy in note 1.9(j) sets out the key principles for estimating the fair values of financial instruments.

2016	**Level 1 £m**	**Level 2 £m**	**Level 3 £m**	**Total £m**
Financial assets				
Derivative financial instruments	**–**	**104.2**	**–**	**104.2**
Available-for-sale financial assets	**850.9**	**–**	**7.6**	**858.5**
Financial liabilities				
Derivative financial instruments	**–**	**229.7**	**–**	**229.7**
2015	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets				
Derivative financial instruments	–	82.3	–	82.3
Available-for-sale financial assets	1,233.3	59.0	3.3	1,295.6
Financial liabilities				
Derivative financial instruments	–	156.0	–	156.0

Level 1 Valuations

The fair value of debt securities categorised as available-for-sale financial assets is derived from unadjusted quoted prices in an active market.

Level 2 Valuations

The fair values of derivative instruments are calculated by discounted cash flow models using yield curves that are based on observable market data or are based on valuations obtained from counterparties.

The fair value of level 2 available-for-sale securities were calculated using valuation techniques, including discounted cash flow models.

Level 3 Valuations

Level 3 available-for-sale financial assets represent the Group's best estimates of the value of certain equity investments in unlisted companies and of Visa Inc. preferred stock.

The level 3 valuation of £3.3 million at 31 December 2015 represented the Group's best estimate at that time of the value of its equity investment in Visa Europe Limited, with reference to the consideration expected to be received from the proposed acquisition of that company by Visa Inc.

The acquisition by Visa Inc. completed on 21 June 2016, resulting in disposal of the investment and receipt of Visa Inc. preferred stock and cash consideration and recognition of a gain on disposal of £5.3 million, included within Other Operating Income.

The Visa Inc. preferred stock value was determined by reference to the Visa Inc. common stock price at 31 December 2016, less a discount to reflect restrictions on transferability and the risk of future reduction in conversion to Visa Inc. common stock. The discount applied is the most significant unobservable input to the valuation.

The Company has determined of the fair value of the investments in the relevant unlisted entities by reference to third party valuations, taking into account pertinent information received on the individual investments to adjust those valuations, where considered appropriate.

Note 34: Offsetting of financial assets and financial liabilities

	Gross amounts of assets and liabilities £m	Amounts offset in the balance sheet[1] £m	Net amounts presented in the balance sheet £m	Related amounts where set off in the balance sheet not permitted[2]		Potential net amounts if offset of related amounts permitted £m
				Subject to master netting agreements £m	Collateral received/ pledged £m	
As at 31 December 2016						
Financial assets						
Derivative financial instruments	**123.9**	**(19.7)**	**104.2**	**(25.4)**	**(78.8)**	**–**
Loans and advances to banks	**635.6**	**–**	**635.6**	**–**	**(168.1)**	**467.5**
Other assets	**72.0**	**(3.2)**	**68.8**	**–**	**–**	**68.8**
Financial liabilities						
Deposits from banks	**2,132.5**	**–**	**2,132.5**	**–**	**(10.7)**	**2,121.8**
Derivative financial instruments	**254.1**	**(24.4)**	**229.7**	**(25.4)**	**(168.1)**	**36.2**
Other liabilities	**188.0**	**1.5**	**189.5**	**–**	**–**	**189.5**

	Gross amounts of assets and liabilities £m	Amounts offset in the balance sheet[1] £m	Net amounts presented in the balance sheet £m	Related amounts where set off in the balance sheet not permitted[2] Subject to master netting agreements £m	Collateral received/pledged £m	Potential net amounts if offset of related amounts permitted £m
As at 31 December 2015						
Financial assets						
Derivative financial instruments	82.6	(0.3)	82.3	(70.4)	(10.6)	1.3
Loans and advances to banks	614.5	–	614.5	–	(72.5)	542.0
Other assets	14.7	(0.1)	14.6	–	–	14.6
Financial liabilities						
Deposits from banks	1,298.7	–	1,298.7	–	(10.6)	1,288.1
Derivative financial instruments	156.4	(0.4)	156.0	(70.4)	(72.5)	13.1
Other liabilities	155.1	–	155.1	–	–	155.1

1 The amounts set off in the balance sheet as shown above represent derivatives and variation margin cash collateral with central clearing houses which meet the criteria for offsetting under IAS 32.

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

The effects of over collateralisation have not been taken into account in the above table.

Note 35: Cash flow statements

(a) Change in operating assets

	2016 £m	2015 £m
Change in loans and advances to customers	**(5,295.7)**	(4,046.2)
Change in derivative financial assets	**(21.9)**	18.9
Change in other operating assets	**(69.7)**	(10.0)
Change in operating assets	**(5,387.3)**	(4,037.3)

(b) Change in operating liabilities

	2016 £m	2015 £m
Change in customer deposits	**2,961.4**	2,779.2
Change in derivative financial liabilities	**73.7**	(72.2)

Change in other operating liabilities	**922.2**	439.4
Change in operating liabilities	**3,957.3**	3,146.4

(c) Non-cash and other items

	2016 £m	2015 £m
Depreciation and amortisation	**21.0**	19.6
Other non-cash items	**(40.5)**	42.8
Total non-cash and other items	**(19.5)**	62.4

(d) Analysis of cash and cash equivalents as shown in the balance sheet

	2016 £m	2015 £m
Cash and balances at central banks	**786.3**	888.6
Less: mandatory reserve deposits[1]	**(49.1)**	(41.7)
	737.2	846.9
Loans and advances to banks	**635.6**	614.5
Deposits from banks	**(2,132.5)**	(1,298.7)
Less: amounts not repayable on demand	**2,131.9**	1,298.7
	(0.6)	–
Total cash and cash equivalents	**1,372.2**	1,461.4

1 Mandatory reserves with central banks are not available for use in day-to-day operations.

Note 36: Related party transactions

Key Management Personnel

Key Management Personnel refer to the Executive Team of the Group, Non-Executive Directors and Directors of subsidiary companies.

	2016 £m	2015 £m
Compensation		
Salaries and other short-term benefits	**7.4**	8.2
Share based payments (Refer note 7)	**7.6**	12.3
Post-employment benefits	**0.8**	0.9
Total compensation	**15.8**	21.4

Aggregate contributions in respect of Key Management Personnel to defined contribution pension schemes £0.8 million (2015: £0.9 million).

	2016 £m	2015 £m
Deposits		
At 1 January	**2.2**	1.1
Placed	**1.5**	1.8
Withdrawn	**(2.3)**	(0.7)
Deposits outstanding at 31 December	**1.4**	2.2

Deposits placed by Key Management Personnel attracted interest rates of up to 3.0% (2015: 2.8 %). At 31 December 2016, the Group did not provide any guarantees in respect of Key Management Personnel (2015: none).

At 31 December 2016, transactions, arrangements and agreements entered into by the Group's banking subsidiaries with Key Management Personnel included amounts outstanding in respect of loans and credit card transactions of £0.9 million with 7 Key Management Personnel (2015: £0.3 million with 5 Key Management Personnel).

Subsidiaries

Transactions and balances with subsidiaries have been eliminated on consolidation. A full list of the company's subsidiaries and SPVs included within the consolidation is provided in note 2 to the parent company financial statements.

The Virgin Money Foundation, launched in August 2015, is managed and controlled by a Board of independent Trustees, such that the Group has no power over the Foundation or, exposure or ability to affect variable returns. The Foundation is therefore not consolidated in the financial statements of the Group.

Other transactions

Transaction value at year end:	**2016 £m**	2015 £m
Trademark licence fees to Virgin Enterprises Limited	**5.9**	5.1
Virgin Atlantic Airways Limited	**0.2**	–
Dividend payment to Virgin Group Holdings Limited	**7.3**	2.2
Other costs to Virgin Management Group Companies	**1.2**	0.4

Balance outstanding at year end:	**2016 £m**	2015 £m
Trademark licence fees to Virgin Enterprises Limited	**–**	(0.4)
Other costs to Virgin Management Group Companies	**(0.1)**	(0.1)

Trademark licence fees to Virgin Enterprises Limited

Licence fees are payable to Virgin Enterprises Limited for the use of the Virgin Money brand trademark.

Virgin Atlantic Airways Limited

The Group incurs credit card commissions and air mile charges to Virgin Atlantic Airways Limited (VAA) in respect of an agreement between the two parties.

Dividend payment to Virgin Group Holdings Limited

The Group made dividend payments totalling £7.3 million to Virgin Group Holdings Limited in the year, comprising a £4.8 million payment in May 2016 and a £2.5 million payment in September 2016, which represented that company's proportionate share of the total final 2015 dividend and the total interim 2016 dividend respectively. In the prior year, a dividend payment of £2.2 million was made to Virgin Group Holdings Limited in October 2015 which represented that Company's proportionate share of the total interim 2015 dividend. Refer to note 11.

Other costs to Virgin Management Group Companies

These costs include transactions with other companies in the Virgin Group.

Note 37: Events after balance sheet date

There have been no significant events between 31 December 2016 and the date of approval of the financial statements which would require a change or additional disclosure in the financial statements.

Note 38: Future accounting developments

A number of new accounting standards and amendments to accounting standards have been issued by the IASB, however are not yet effective and have not been early adopted by the Group. Those which may be relevant to the Group are set out below.

Pronouncement	Nature of change	IASB effective date
IFRS 9 'Financial Instruments'	IFRS 9 'Financial Instruments' replaces IAS 39 'Financial Instruments: Recognition and Measurement'. IFRS 9 is split over 3 core areas of change. **Classification and Measurement** IFRS 9 requires financial assets to be classified into one of three measurement categories, fair value through profit or loss, fair value through other comprehensive income and amortised cost. Classification is based on the objectives of the entity's business model for managing its financial assets and the contractual cash flow characteristics of the instruments, while it retains most of the existing requirements for financial liabilities. The Group has undertaken an assessment to determine the potential impact of changes in classification and measurement of financial assets and liabilities. The adoption of IFRS 9 is unlikely to result in a significant change to the current asset and liability measurement bases, however, the final impact will be dependent on the facts and circumstances that exist on 1 January 2018. **Impairment** IFRS 9 replaces the existing 'incurred loss' impairment approach with an expected credit loss approach, resulting in earlier recognition of credit losses. The IFRS 9 impairment model has three stages. Entities are required to recognise a 12 month expected loss allowance on initial recognition (stage 1) and a lifetime expected loss allowance when there has been a significant increase in credit risk (stage 2). Stage 3 requires objective evidence that an asset is credit-impaired, which is similar to the guidance on incurred losses in IAS 39. Loan commitments and financial guarantees not measured at fair value through profit or loss are also in scope for impairment. The assessment of whether a significant increase in credit risk has occurred is a key aspect of the IFRS 9 methodology. It involves quantitative and qualitative measures and therefore requires considerable management judgement. In addition IFRS 9 also requires the use of more forward-looking information including reasonable and supportable forecasts of future economic conditions. The need to consider multiple economic scenarios and how they could impact the loss allowance is a subjective feature of the IFRS 9 impairment model. The Group's final methodology for significant increase in credit risk and multiple economic scenarios are still under development. These changes may result in a material increase in the Group's balance sheet provisions for credit losses and may therefore negatively impact the Group's regulatory capital position, although the regulatory capital transitional	1 January 2018 (EU endorsed on 22 November 2016)

Pronouncement	Nature of change	IASB effective date
	arrangements are still in consultation and the impact may be spread over a period of time. The extent of any increase in provisions will depend upon, amongst other things, the composition of the Group's lending portfolios and forecast economic conditions at the date of implementation. The requirement to transfer assets between stages and to incorporate forward-looking data into the expected credit loss calculation, including multiple economic scenarios, is likely to result in impairment charges being more volatile when compared to the current IAS 39 impairment model. **Hedge Accounting** The hedge accounting requirements of IFRS 9 are more closely aligned with risk management practices and follow a more principle-based approach than IAS 39. However, there is an option to maintain the existing IAS 39 hedge accounting rules until the IASB completes its project on macro hedging. The Group currently expects to continue applying IAS 39 hedge accounting in accordance with this accounting policy choice. **Accounting Transition** IFRS 9 is effective for annual periods beginning on or after 1 January 2018 with no requirement to restate prior periods. If comparative periods are not restated, at the date of initial application, any difference between the carrying amount of financial assets and the change in loss allowance shall be recognised in opening retained earnings. **IFRS 9 implementation programme** The Group has an established IFRS 9 programme to ensure a high quality implementation in compliance with the standard and regulatory guidance. The programme involves multiple functions from across the Group with steering committees providing oversight. The key responsibilities of the programme include defining IFRS 9 methodology and accounting policy, development of expected loss models, identifying data and system requirements and establishing an appropriate operating model and governance framework. The Group is building new expected credit loss models using three key input parameters for the computation of expected loss: probability of default, loss given default and exposure at default. The initial build phase of the programme is complete and the Group is currently testing and refining the models in line with the Group's delivery plans. The Group will continue to refine the expected credit loss approach under IFRS 9 and provide an update on the progress made at each reporting period until implementation.	
IFRS 15 'Revenue from Contracts with Customers'	IFRS 15 replaces IAS 18 'Revenue' and IAS 11 'Construction contracts' as a comprehensive standard to address current inconsistencies in accounting practice for revenue recognition. Financial instruments and other contractual rights or obligations within the scope of IFRS 9 are excluded from the scope of this standard. The Group has reviewed the requirements of the new standard and it is not expected to have a significant impact, as a substantial proportion of the Group's income is generated from financial instruments.	1 January 2018 (EU endorsed on 22 September 2016)
IFRS 16 'Leases'	This standard replaces IAS 17 'Leases' and will result in most leases for lessees being brought on to the Balance Sheet under a single lease model, removing the distinction between finance and operating leases. It requires a lessee to recognise a 'right-of-use' asset and a lease liability. Lessor accounting remains largely unchanged. The Group is currently assessing the impact of the new standard.	1 January 2019 (has not been EU endorsed)

Note 39: Country by country reporting

The Capital Requirements (Country by Country Reporting) Regulations came into effect on 1 January 2014 and place certain reporting obligations on financial institutions within CRD IV.

The activities of the Group are described in the Strategic Report.

All companies consolidated within the Group's financial statements are UK registered entities.

	UK
Number of employees (average FTE)	2,893
Turnover (total income)	£581.4m
Pre-tax profit	£194.4m
Corporation tax paid	£22.1m
Public subsidies received	£0.0m

The Group received no public subsidies during the year.

Alternative Performance Measures

The Group analyses its performance on an underlying basis, as described in the basis of preparation of the financial results on pages 54 and 55, and reconciled to the statutory results in note 2 to the financial statements. These are consistent with the Board and the Executive's view of the Group's underlying performance without the distortions of items and timing differences which are not reflective of the Group's ongoing business activities.

The Group also calculates a number of metrics that are commonly used and reported throughout the banking industry on an underlying basis, as these provide the Board and the Executive with a consistent view of these measures from period to period and provide relevant information to investors and other external stakeholders.

Descriptions of alternative performance measures used throughout this Report, including their basis of calculation, are set out below.

Cost of risk	Impairment charges net of debt recoveries divided by simple average gross loans for the period.
Cost:income ratio	Operating expenses divided by total income, calculated on an underlying basis.
JAWS	The difference between the period on period percentage change in total income less the period on period change in operating expenses calculated on an underlying basis. e.g. an increase in underlying total income of 5% and an increase in underlying total operating expenses of 2% corresponds to JAWS of 3%.
Loan-to-deposit ratio	The ratio of loans and advances to customers, net of allowances for impairment, divided by customer deposits (each excluding adjustments for fair value of portfolio hedging).
Net interest margin (NIM)	Net interest income, calculated on an underlying basis, as a percentage of average interest-earning assets.
Return on assets	Profit attributable to equity owners divided by closing total assets.
Return on tangible equity (RoTE)	Underlying profit after tax, adjusted to evenly spread all distributions to Additional Tier 1 securities holders, divided by average tangible equity (equity that excludes Additional Tier 1 securities and intangible assets).
Tangible net asset value per share	Net assets excluding intangible assets and Additional Tier 1 securities divided by the closing number of Ordinary Shares (excluding own shares held).
Underlying basic earnings per share	Underlying profit after tax adjusted to evenly spread all distributions to Additional Tier 1 securities holders, divided by the weighted-average number of Ordinary Shares outstanding during the period excluding own shares held in employee benefit trusts or held for trading.
Underlying net interest income	Statutory net interest income adjusted for a subset of certain items as detailed on pages 54 and 55 and note 2 to the financial statements.
Underlying profit/(loss) before tax	Statutory profit/(loss) before tax adjusted for certain items as detailed on page 54 and note 2 to the financial statements.

Underlying total income	Statutory total income adjusted for a subset of certain items as detailed on page 54 and 55 and note 2 to the financial statements.

The Group also discloses a number of capital and liquidity metrics relevant to its financial position for which calculation is required under prudential rules issued by the PRA and FCA, in line with requirements of UK/EU legislation and Basel III. The bases of calculation of those metrics is defined within the relevant legislation (for example CRD IV) and are disclosed in the Glossary.

Glossary

Advanced Internal Ratings Based (AIRB) Approach	A CRD IV approach for measuring exposure to credit risks. The method of calculating credit risk capital requirements uses internal probability of default (PD), loss given default (LGD) and exposure at default (EAD) models. AIRB approaches may only be used with Prudential Regulation Authority (PRA) permission.
Basel III	Global regulatory standard on Bank Capital Adequacy, Stress Testing and Market and Liquidity proposed by the Basel Committee on Banking Supervision in 2010. See also CRD IV.
Basis Point (bps)	One hundredth of a per cent (0.01%). 100 basis points is 1%. Used when quoting movements in interest rates or yields.
Capital at Risk (CaR)	Approach set out for the quantification of interest rate risk expressed as the impact to the present value of the Group's capital under interest rate sensitivity analysis.
CASS	Client Assets Sourcebook – included in the FCA Handbook and sets out the requirements with which firms must comply when holding or controlling client assets.
Certificates of Deposit	A certificate issued by a bank to a person depositing money for a specified length of time at a specified rate of interest.
Charge-Off	Charge off occurs on outstanding credit card balances which are deemed irrecoverable. This involves the removal of the balance and associated provision from the balance sheet with any remaining outstanding balance recognised as a loss.
Common Equity Tier 1 Capital (CET1)	The highest quality form of capital under CRD IV that comprises common shares issued and related share premium, retained earnings and other reserves excluding the cash flow hedging reserve, less specified regulatory adjustments.
CRD IV	In June 2013, the European Commission published legislation for a Capital Requirements Directive (CRD) and Capital Requirements Regulation (CRR) which form the CRD IV package. The package implements the Basel III proposals in addition to the inclusion of new proposals on sanctions for non-compliance with prudential rules, corporate governance and remuneration. The rules are implemented in the UK via the PRA policy statement PS7/13 and came into force from 1 January 2014, with certain sections subject to transitional phase in.
Credit Enhancements	Techniques that improve the credit standing of financial obligations; generally those issued by a structured entity in a securitisation.
Credit Valuation Adjustments (CVA)	These are adjustments to the fair values of derivative assets to reflect the creditworthiness of the counterparty.
Cross-Currency Swaps	An arrangement in which two parties exchange specific principal amounts in different currencies at inception and subsequent interest payments on the principal amounts.
Debt Securities	Debt securities are assets held by the Group representing certificates of indebtedness of credit institutions, public bodies or other undertakings, excluding those issued by Central Banks.
Earnings at Risk (EaR)	Approach set out for the quantification of interest rate risk expressed as the impact to forecast net interest income under interest rate sensitivity analysis.

Expected Loss (regulatory)	Regulatory expected loss represents the anticipated loss, in the event of a default, on a credit risk exposure modelled under the Advanced Internal Ratings Based approach. Expected loss is determined by multiplying the associated PD, LGD and EAD.
Exposure at Default (EAD)	An estimate of the amount expected to be owed by a customer at the time of a customer's default.
Forbearance	Forbearance takes place when a concession is made on the contractual terms of a loan in response to borrowers' financial difficulties; or for where the contractual terms have been cancelled for credit cards. Forbearance options are determined by assessing the customer's personal circumstances.
Full Time Equivalent (FTE)	A full time employee is one that works a standard five day week. The hours worked by part time employees are measured against this standard and accumulated along with the number of full time employees and counted as full time equivalents.
Funding for Lending Scheme (FLS)	The Bank of England launched the Funding for Lending scheme in 2012 to allow banks and building societies to borrow from the Bank of England at cheaper than market rates for up to four years. This was designed to increase lending to businesses by lowering interest rates and increasing access to credit.
Funding Risk	The inability to raise and maintain sufficient funding in quality and quantity to support the delivery of the business plan.
Impaired Assets	Loans that are in arrears or where there is objective evidence of impairment, and where the carrying amount of the loan exceeds the expected recoverable amount.
Impairment Allowance	Impairment allowances are a provision held on the balance sheet as a result of the raising of a charge against profit for the incurred loss inherent in the lending book. An impairment allowance may either be individual or collective.
Impairment Losses	An impairment loss is the reduction in value that arises following an impairment review of an asset that determined that the asset's value is lower than its carrying value. For impaired financial assets measured at amortised cost, impairment losses are the difference between the carrying value and the present value of estimated future cash flows, discounted at the asset's original effective interest rate.
Interest Rate Risk	The risk of a reduction in the present value of the current balance sheet or earnings as a result of adverse movement in interest rates.
Interest Rate Risk in the Banking Book (IRRBB)	The risk of a reduction in the present value of the current balance sheet or earnings as a result of an adverse movement in interest rates arising as a consequence of carrying out and supporting core business activities.
Internal Capital Adequacy Assessment Process (ICAAP)	The part of the Pillar 2 assessment to be undertaken by a bank. The ICAAP allows financial institutions to assess the level of capital that adequately supports all relevant current and future risks in their business. In undertaking an ICAAP, a financial institution should be able to ensure that it has appropriate processes in place to ensure compliance with CRD IV.
Leverage Ratio	Total Tier 1 Capital expressed as a percentage of Total assets (adjusted in accordance with CRD IV).
Liquidity Coverage Ratio (LCR)	Stock of high quality liquid assets as a percentage of expected net cash outflows over the following 30 days according to CRD IV requirements.
Liquidity Risk	The inability to accommodate liability maturities and withdrawals, fund asset growth, and otherwise meet the Group's contractual obligations to make payments as they fall due.
Loan-to-Value Ratio	The amount of a secured loan as a percentage of the appraised value of the security e.g. the outstanding amount of mortgage loan as a percentage of the property's value.
Loss Emergence Period	Under IAS 39, losses are recognised on an incurred basis. The loss emergence period allows for the recognition of impairment in respect of losses that have been incurred but not reported. The emergence period is measured as time between the emergence of impairment triggers and the time at which the loss is incurred.
Loss Given Default (LGD)	The estimated loss that will arise if a customer defaults. LGD comprises the actual loss (the part that is not expected to be recovered), after taking account of credit risk mitigation, for

	example, any security held over collateral and the economic costs associated with the recovery process.
Master Netting Agreement	An agreement between two counterparties that have multiple derivative contracts with each other that provides for the net settlement of all contracts through a single payment, in a single currency, in the event of default on, or termination of, any one contract.
Net Interest Income	The difference between interest received on assets and interest paid on liabilities.
Net Promoter Score (NPS)	A measure of satisfaction that ranges between -100 and +100 and represents the likelihood of respondents recommending Virgin Money, its products or services to others on a scale of between 0 and 10 (where 10 represents the most positive score). Those scoring 9 to 10 are categorised as Promoters, those scoring 0 to 6 as Detractors and those scoring 7 to 8 as Passives. The NPS is calculated by subtracting the percentage of respondents who are Detractors from the percentage of respondents that are Promoters. Passives count towards the total number of respondents and thus decrease the percentage of Detractors and Promoters.
Net Stable Funding Ratio (NSFR)	The ratio of available stable funding to required stable funding over a one year time horizon, assuming a stressed scenario. The ratio is required to be 100% with effect from 2018. Available stable funding would include such items as equity capital, preferred stock with a maturity of over 1 year, or liabilities with a maturity of over 1 year.
Percentage Point (pp)	Unit for measuring the difference of two percentages. A change from 1% to 2% is 1 percentage point.
Pillar 1	The part of CRD IV that sets out the process by which regulatory Capital requirements should be calculated for credit, market and operational risk.
Pillar 2	The part of CRD IV that ensures financial institutions hold adequate capital to support the relevant risks in their business. It also encourages financial institutions to develop and use enhanced risk management techniques in monitoring and managing their risks.
Pillar 3	The part of CRD IV that sets out the information banks must disclose in relation to their risks, the amount of capital required to absorb them, and their approach to risk management. The aim is to strengthen market discipline.
Probability of Default (PD)	The probability of a customer defaulting over a defined outcome period. Default occurs where a borrower has missed 6 months of mortgage repayments or 3 months of credit card repayments, or the borrower is deemed to be unlikely to repay their loan. The outcome period varies for assessment of capital requirements and for assessment of provisions.
Repurchase Agreements (Repos)	A form of short-term funding where one party sells a financial asset to another party with an agreement to repurchase at a specific price and date. From the seller's perspective such agreements are repurchase agreements (repos) and from the buyer's reverse repurchase agreements (reverse repos).
Risk Appetite	The risk appetite sets limits on the amount and type of risk that the Group is willing to take in order to meet its strategic objectives.
Risk-Weighted Assets	A measure of a bank's assets adjusted for their associated risks. Risk weightings are established in accordance with PRA rules and are used to assess capital requirements and adequacy under Pillar 1.
Securitisation	Securitisation is a process by which a group of assets, usually loans, are aggregated into a pool, which is used to back the issuance of new securities through an SPV.
Sovereign Exposures	Exposures to central governments and central government departments, central banks and entities owned or guaranteed by the aforementioned.
Standardised Approach	In relation to credit risk, a method for calculating credit risk capital requirements using External Credit Assessment Institutions (ECAI) ratings of obligors (where available) and supervisory risk weights. In relation to operational risk, a method of calculating the operational risk capital requirement by the application of a supervisory defined percentage charge to the gross income of specified business lines.

Stress Testing	Techniques where plausible events are considered as vulnerabilities to ascertain how this will impact the capital or liquidity resources which are required to be held.
Tier 1 Capital	A measure of banks financial strength defined by the PRA. It captures Common Equity Tier 1 capital plus other Tier 1 securities in issue, but is subject to deductions including in respect of material holdings in financial companies.
Tier 1 Capital Ratio	Tier 1 capital as a percentage of risk-weighted assets.
Tier 2 Capital	A further component of regulatory capital defined by the PRA for the Group. It comprises eligible collective assessed impairment allowances under CRD IV.
Term Funding Scheme (TFS)	The Bank of England launched the Term Funding Scheme in 2016 to allow banks and building societies to borrow from the Bank of England at rates close to Bank Base Rate. This is designed to increase lending to businesses by lowering interest rates and increasing access to credit.
Virgin	Virgin Group Holdings Limited.
Virgin Money Trademark Licence Agreement	The agreement under which Virgin Enterprises Limited grants perpetual licence to Virgin Money to use the “Virgin” and “Virgin Money” trademarks.
WLR	WLR IV VM LLC and WLR IV VM II LLC, together formerly major shareholders of the Company.

Abbreviations

AGM	Annual General Meeting	**FRC**	Financial Reporting Council	**LIBOR**	London Inter-Bank Offered Rate
AIRB	Advanced Internal Ratings Based	**FSCS**	Financial Services Compensation Scheme	**LCR**	Liquidity Coverage Ratio
AT1	Additional Tier 1	**FTE**	Full Time Equivalent	**LGD**	Loss Given Default
BBR	Bank Base Rate	**FTP**	Funds Transfer Pricing	**LTIP**	Long-Term Incentive Plan
BOE	Bank of England	**GHG**	Greenhouse Gas	**NIM**	Net Interest Margin
CET1	Common Equity Tier 1 Capital	**HMRC**	Her Majesty’s Revenue and Customs	**NPS**	Net Promoter Score
CML	Council of Mortgage Lenders	**HPI**	House Pricing Index	**NSFR**	Net Stable Funding Ratio
CONC	Consumer Credit Sourcebook	**HQLA**	High Quality Liquid Assets	**OTC**	Over-the-Counter
CRD	Capital Requirements Directive	**IAS**	International Accounting Standards	**PCA**	Personal Current Account
CRR	Capital Requirements Regulation	**IASB**	International Accounting Standards Board	**PD**	Probability of Default
CVA	Credit Valuation Adjustment	**ICAAP**	Internal Capital Adequacy Assessment Process	**PRA**	Prudential Regulation Authority
DTR	Disclosure Guidance and Transparency Rules	**IFDS**	International Financial Data Services Limited	**RoTE**	Return on Tangible Equity
EBO	Everyone better off	**IFRS**	International Financial Reporting Standards	**RMBS**	Residential Mortgage Backed Securities
EAD	Exposure At Default	**ILAA**	Individual Liquidity Adequacy Assessment	**SME**	Small or Medium-sized Enterprise
ECA	Essential Current Account	**IPO**	Initial Public Offering	**SPV**	Special Purpose Vehicle

EPS	Earnings per share	**IRRBB**	Interest Rate Risk in the Banking Book	**TFS**	Term Funding Scheme
FCA	Financial Conduct Authority	**ISA**	Individual Savings Account	**TSYS**	Total System Services, Inc
FLS	Funding for Lending Scheme	**ISDA**	International Swaps and Derivatives Association		
FPC	Financial Policy Committee				

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