VIRGIN MONEY GROUP ANNUAL REPORT AND ACCOUNTS

2016

Virgin money

THERE'S MONEY AND THERE'S VIRGIN MONEY

At Virgin Money, our ambition is to build a bank that makes 'everyone better off.'

Customers, colleagues, communities, corporate partners and our company.

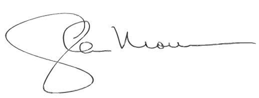
About us

With a powerful brand, strong balance sheet, customer-focused culture and an experienced team, we have created a business which delivers our unique approach to banking and financial services to 3.3 million customers.

Virgin Money Lounge, Sheffield

What's in this report?

The 2016 Annual Report and Accounts incorporates the Strategic Report and the consolidated financial statements, both of which have been approved by the Board of Directors.



On behalf of the Board

Glen Moreno
Chairman
27 February 2017

Cover image: Virgin Money Lounge, Fargate, Sheffield

2012 - 2016 Highlights

5 years of making 'everyone better off'

In 2012, five years on from the beginning of the financial crisis, public confidence and trust in the banking industry was at an all-time low. In that same year, Virgin Money started on a journey to make banking better with an ambition to make 'everyone better off' (EBO).

Virgin Money acquired the loss-making Northern Rock plc from HM Treasury in January 2012, and work began on creating a new force in UK banking.

The business transformation began straightaway. We launched a customer manifesto, all Northern Rock branches were turned into Virgin Money Stores and the integration of the businesses was completed successfully.

We returned the business to a solid footing by deploying our core competencies of risk management - focused on balance sheet and asset quality - product design and pricing, and multi-channel distribution.

We now have 3.3 million customers and our overall Net Promoter Score (NPS), the likelihood of customers recommending us, has improved considerably to +29 since 2012, making us one of the leading UK retail banks for customer satisfaction.

We created Virgin Money Lounges – spaces designed for customers to relax and for local communities to come together. With a total footfall of around 50,000 per month across all seven Virgin Money Lounges, they drive excellent customer satisfaction ratings and an NPS of +86.

We have helped tens of thousands of people get onto and move up the housing ladder and more than doubled mortgage balances to £29.7 billion. We have a thriving savings business and have grown deposit balances from £16.2 billion to £28.1 billion. We have also created a credit card business from scratch and now have £2.4 billion in customer balances.

Virgin Money Giving, our not-for-profit online donation service, has helped fundraisers raise more than £500 million since it launched, and we set up the Virgin Money Foundation in 2015, an independent charitable foundation focused on housing, homelessness and youth employment.

When we listed on the London Stock Exchange in 2014, we said that we would deliver a strategy founded on three fundamental and equally important principles: growth, quality and returns. Despite a number of headwinds, including the introduction of the bank tax surcharge and the lower for longer interest rate environment, we have continued to deliver strong asset growth, while maintaining our high-quality balance sheet and prudent risk appetite.

This has helped us deliver significant growth in shareholder returns and a solid double-digit return on tangible equity.

As a result of the strength of the business and our continued ability to manage costs and optimise operational leverage, we remain well positioned to continue to grow in a wide range of market conditions.

We are proud of what we have achieved over the last five years and we look forward to continuing our journey to make banking better for all of our stakeholders – the company, customers, colleagues, corporate partners and the communities in which we work.

Eliud Kipchoge KEN, the winner of the Elite Men's Race with second place athlete Stanley Biwott KEN just after crossing the line.
Photo: Virgin Money London Marathon

2016 Highlights and strategic priorities

Results 2012-16		2016	2015	2014	2013	2012
Growth						
Gross mortgage lending	£bn	**8.4**	7.5	5.8	5.6	4.9
Mortgage balances	£bn	**29.7**	25.5	21.9	19.6	16.8
Credit card balances	£bn	**2.4**	1.6	1.1	0.8	–
Total assets	£bn	**35.1**	30.2	26.5	24.6	21.8
Deposit balances	£bn	**28.1**	25.1	22.4	21.1	18.0
Quality						
Cost of risk	%	**0.13**	0.12	0.07	0.15	0.02
Common Equity Tier 1 capital ratio	%	**15.2**	17.5	19.0	15.5	15.5
Total capital ratio	%	**20.4**	20.2	22.1	18.6	19.1
Leverage ratio	%	**4.4**	4.0	4.1	3.8	3.6
Returns						
Underlying total income	£m	**586.9**	523.5	438.1	365.1	233.8
Statutory total income	£m	**581.4**	521.9	438.3	383.0	261.6
Underlying profit/(loss) before tax	£m	**213.3**	160.7	104.7	43.6	(10.0)
Statutory profit before tax	£m	**194.4**	138.0	34.0	185.4	160.2
Net interest margin	%	**1.60**	1.65	1.50	1.26	0.54
Cost: income ratio	%	**57.2**	63.5	72.5	80.1	103.0
Return on tangible equity	%	**12.4**	10.9	7.4	2.6	(1.2)
Statutory basic earnings per share	p	**29.4**	22.9	(0.4)	42.4	59.3
Underlying basic earnings per share	p	**32.7**	26.8	18.5	5.6	(2.0)

TOTAL CUSTOMER LOAN BALANCES GREW BY
19%

LOW COST OF RISK OF
0.13%

COMMON EQUITY TIER 1 RATIO OF
15.2%

LEVERAGE RATIO OF
4.4%

RETURN ON TANGIBLE EQUITY OF
12.4%

Alternative performance measures

These results 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

- IPO share based payments;
- Strategic items;
- Simplification costs; and
- Fair value (losses)/gains on financial instruments.

Underlying profit and total income are now presented excluding the fair value (losses)/gains on financial instruments, which reflect timing differences on fair value movements on derivatives where these are held to maturity. Prior periods presented have been adjusted, however the change has no material impact on those periods. Further information on the underlying results, including reconciliations of the Group's statutory and underlying results, is reported on page 54 and in note 2 to the consolidated financial statements.

A number of other Alternative Performance Measures (APMs), in addition to underlying profit, are used in the analysis and discussion of the Group's financial performance and position. APMs do not have standardised definitions and may not be directly comparable to any measures defined within IFRS. Details of all APMs disclosed, including the rationale for their use and their bases of calculation, are set out on page 267.

In 2016, we delivered strongly to all of our stakeholders, living up to our ambition to make everyone better off.

Highlights include:

COMPANY AND SHAREHOLDERS

Growth of
33%
in underlying profit before tax to £213.3 million, with return on tangible equity increasing from 10.9% to 12.4%.

Growth of
41%
in statutory profit before tax to £194.4 million.

Final Dividend

Recommended final dividend payment of 3.5 pence per ordinary share. This will result in a total dividend for 2016 of 5.1 pence per ordinary share, an increase of 13% compared to 2015.

COLLEAGUES

Over
3,000
colleagues now work for Virgin Money, and we maintained our excellent engagement score of 81%.

CUSTOMERS

Increased our overall customer base by 15 per cent to
3.3 million
We delivered growth in customer numbers across every product category and improved our customer experience, satisfaction and advocacy, with an overall NPS of +29, from +19 in 2015.

COMMUNITIES

Virgin Money Giving helped to raise
£92 million
Our not-for-profit online donation service has helped to raise more than £500 million for charities since launching in 2009.

CORPORATE PARTNERS

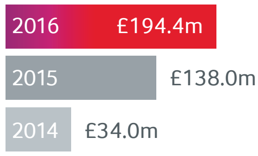
Awarded
5 stars
at the 2016 Financial Adviser Service Awards and awarded the 'Best Lender for Partnership' at the L&G Mortgage Club annual awards for the second year in a row.

Financial highlights

Strong financial performance

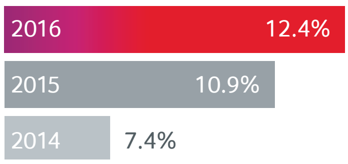
Underlying net interest income
14%
growth

Statutory profit before tax
41%
growth

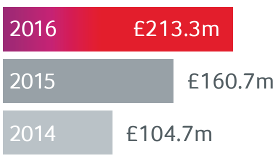


Underlying total income
12%
growth

Return on tangible equity
14%
growth



Underlying profit before tax
33%
growth

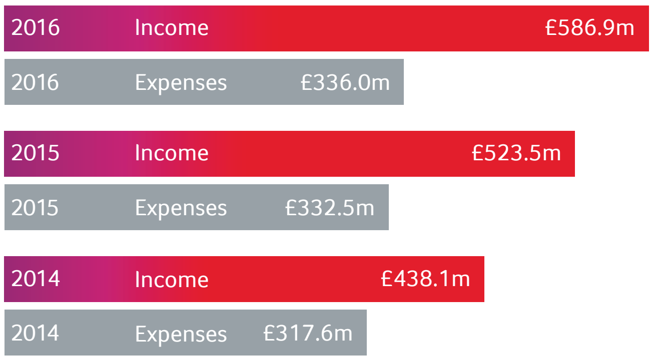



Virgin Money Lounge, Sheffield

Positive JAWS

11%

12% growth in underlying total income against 1% growth in expenses



Cost: income ratio

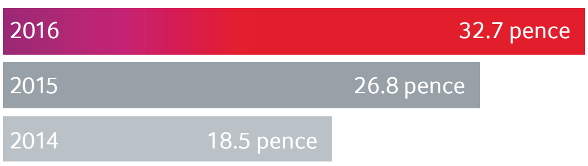
6.3pp

reduction

Underlying earnings per share

22%

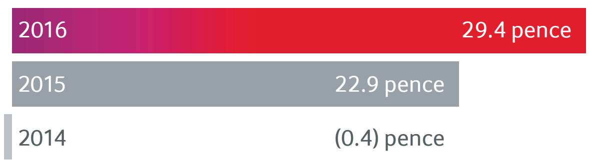
growth



Statutory basic earnings per share

28%

growth



Customer highlights

During 2016, we delivered growth in customer numbers across every product category and increased our overall customer base by 15 per cent to 3.3 million.

Customers

During 2016, we have seen strong growth in our customer numbers, increasing by 15 per cent to 3.3 million customers. While the number of customers in every product category has grown, the main driver for our successful expansion has been the accelerating growth in our credit card, travel insurance and current account businesses.

Our aim is always to provide our customers with competitive and straightforward products, supported by outstanding customer service. During the year, we have seen our continued focus on improving our offer to customers lead to new highs in customer satisfaction and advocacy. Our overall Net Promoter Score (NPS) improved from +19 in 2015 to +29 in 2016.

During the year, a real focus on enhancing the customer experience in our mortgage and credit card businesses, as well as a whole-bank focus on customer service, improved our transactional NPS, which measures specific points of customer engagement, from +60 to +64 year-on-year.

We increased customer acquisition by 32 per cent and at the same time saw account closures fall by around 7.5 per cent. Sales to existing customers grew by 50 per cent and our improvements in retention reflect the successes we have seen in our customer engagement activity, which have allowed us to make customers more aware of the unique benefits of being a Virgin Money customer.

The use of mobile devices to access our products and services increased to over 50 per cent and we continue to see this increasing on a quarter by quarter basis.

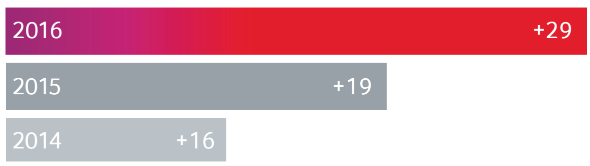
Our customers want to be able to access our products when, where and how they like and our focus on constantly improving our digital journeys across all platforms reflects this.

Whilst we are continually developing our in-store sales, our website remains the most popular channel for customers, with over 22 million website visits, up from 17 million in 2015. 82 per cent of sales were carried out digitally in 2016.

The Virgin Money Lounges continued to be a standout success and we opened our seventh Lounge in Sheffield in July. Lounges deliver strong customer satisfaction with an NPS of +86. Around 50,000 customers visit our Lounges every month and footfall increased by 34 per cent in 2016. Stores co-located with a Lounge broadly outperform the overall network based on sales performance.

Customer satisfaction (NPS)

Strong and improving customer advocacy, with an increase to +29 in our overall NPS in 2016.



Increased our customer base to

3.3 million

customers

New products sales to existing customers

2016 growth rate

49.9%

Mortgages 2016 growth rate **10.3%**	**Savings** 2016 growth rate **5.5%**	**Credit cards** 2016 growth rate **38.1%**
Investments and pensions 2016 growth rate **0.3%**	**Insurance** 2016 growth rate **27.1%**	**Essential Current Account** 2016 growth rate **203.2%**

Our digitally led business model, supported by our efficient national Store footprint, continues to be a key factor in growing the business cost effectively.

22 million

website visits

82%

digital sales

50%

use their mobile device to access our products and services

Strategic priorities

We will continue to build on our customer-focused strategy of Growth, Quality and Returns

Growth

Delivering sustainable growth

We will continue to grow our customer base and balance sheet strongly within our existing risk appetite. We focus on prime mortgage business and 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. We will continue to increase the penetration of our insurance, investment and financial services to our existing customer base, acquire new customers and explore the potential for further growth in this business line. Our customers want to be able to access our products when, where and how they like and our focus on constantly improving our digital capability across all platforms reflects this.

Quality

Maintaining our high-quality balance sheet

Maintaining our high-quality balance sheet is at the core of our strategy. Our approach to risk management is based on rigorous and continuous data analysis and takes a far-sighted approach to asset quality, including strict affordability metrics and prudent underwriting. Supported by our risk appetite and strong risk culture, we maintain stringent control over a range of criteria including credit scoring, customer indebtedness, geographic concentration, business mix and loan-to-value ratios for mortgages. We are proud of our unique position as a customer-focused, low risk UK retail bank, unburdened by legacy conduct issues and we will continue to protect that position and provide our customers with good value, straightforward and transparent products, supported by outstanding customer service.

Returns

Improving returns to shareholders

Our disciplined pursuit of growth and continuing operational leverage are at the heart of our strategy to generate strong and sustainable returns for shareholders. We will maintain a consistently low appetite for risk, continue our resolute focus on cost management and operational efficiency and explore opportunities for further growth in our financial services business.

EBO

Business as a force for good

Our aim is to make ‘everyone better off’ (EBO) by delivering good value to our customers, treating colleagues well, making a positive contribution to society, building positive relationships with our partners and delivering sustainable profits to our shareholders.

Iwan Thomas MBE, Dame Kelly Holmes, Danny Mills, James Cracknell OBE, at the start of the Virgin London Marathon 2016

Photo: Virgin Money London Marathon

Business overview

Mortgages

Mortgages are sold primarily through our intermediary partners. Intermediated distribution is supplemented by direct distribution. The quality of our intermediary service was recognised by winning numerous awards in 2016.

Mortgage balances increased to
£29.7 billion growth of 17%

Market share
3.4% of gross mortgage lending

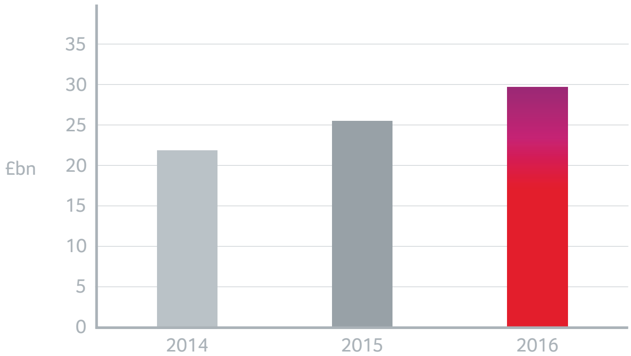
Retention
70% compared to 64% in 2015

Supporting first time buyers
21% growth in lending to first time buyers

Mortgage portfolio LTV
55.4% stable year-on-year

Cost of risk
0.01% flat year-on-year

Mortgage balances



Savings

Savings are sold primarily through our digital channels, supplemented by our Store network. Our lending growth was supported by a strong performance in retail deposits in 2016.

Deposit balances increased to
£28.1 billion growth of 12%

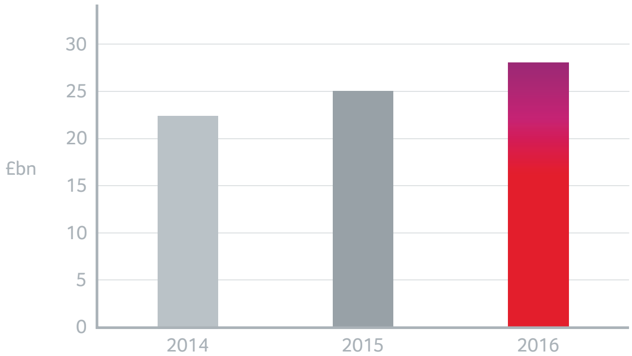
Strong cash ISA performance
33% share of new market flows

Retention
89% compared to 85% in 2015

Total cost of funds
130bps from 143bps in 2015

Essential Current Account
3 times the number of ECA accounts opened, compared to 2015

Deposit balances



Credit cards

Credit cards are sold primarily through our digital channels. Our card portfolio comprises of a mix of balance transfer and retail credit cards.

Card balances increased to

£2.4 billion 55% higher than 2015

Market share

3.5% share of the £68 billion cards market

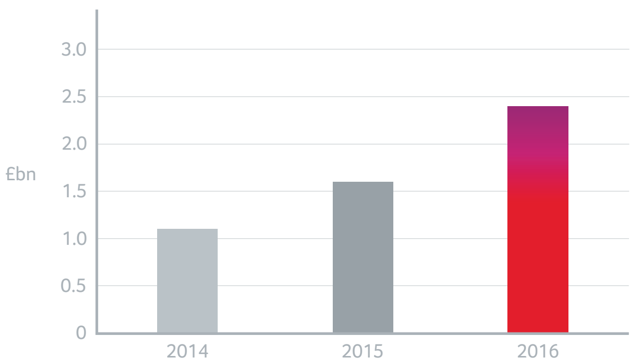
Retail cards made up

30% of new accounts during the year

Cost of risk

1.70% compared to 2.00% in 2015

Credit card balances



Financial Services

We work with a number of partners to provide insurance, investment and currency services.

Funds under management

£3.4 billion 12% higher than 2015

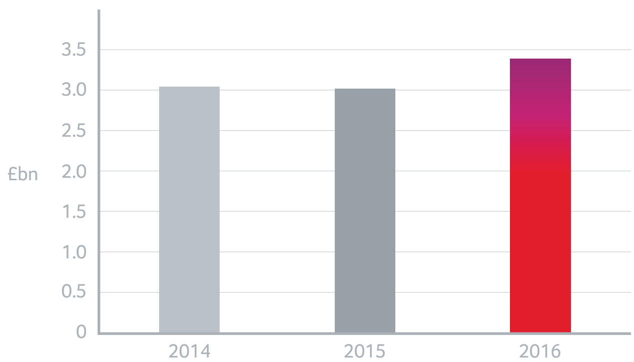
Travel insurance

450,000 new sales in 2016

Home insurance

17,000 new sales in 2016

Funds under management



Chairman's statement

Glen Moreno Chairman

During a year of significant political change and economic uncertainty, I am pleased to report that Virgin Money continued to deliver on its promises to shareholders as a result of our continuing focus on growth, quality and returns.

The excellent performance of the business in 2016 demonstrates the benefits of the Group's position as a customer-focused, low risk UK retail bank, unburdened by legacy conduct issues.

As a result of our business performance, the Board has recommended a final dividend of 3.5 pence per ordinary share. This will result in a total dividend for 2016 of 5.1 pence per ordinary share.

In 2016, we delivered a strong financial performance, demonstrating the benefits of our customer-focused strategy, low risk business model and differentiated approach to banking.

Despite expectations to the contrary, the UK economy proved resilient during the second half of the year and the housing market remained stable, with residential sales increasing slightly year-on-year. Two significant influences on the housing market in 2016 were the introduction of stamp duty for second homes and the EU referendum result.

The Government's policy to tackle the UK's housing shortage and control house price inflation resulted in the introduction of higher rates of stamp duty on additional properties in April 2016. This led to a surge in housing transactions in the first quarter of the year. In the months following the change, activity levels reduced and then weakened further in the wake of the referendum. The Bank of England took swift action to mitigate the uncertainty related to the outcome of the vote, with transactions and approvals recovering towards the end of the year.

Given the turbulent external environment and the changing shape of the mortgage market, I was particularly pleased that we continued to grow strongly, with £8.4 billion of gross lending written to our high-quality credit standards, representing a 3.4 per cent share of the total mortgage market.

Our strategic objective as we progress towards our target of £3 billion credit card balances by the end of 2017 is to ensure the high quality of the book. As a result, we strengthened our credit card underwriting in the second half of the year to protect asset quality against the uncertain economic outlook and continued to make solid progress towards our target as card balances increased to £2.4 billion.

During the year we continued to take advantage of our operating leverage, whilst providing outstanding service to all of our customers. We delivered strong growth across our core markets, maintained the high quality of our balance sheet and delivered significant growth in underlying profitability.

Our three strategic pillars of growth, quality and returns give us the platform to adapt to potential changes in the operating environment. To mitigate against the impact of adverse macro-economic conditions that may transpire, the Board and Executive Team decided to strengthen the balance sheet further with the issuance of £230 million of Additional Tier 1 (AT1) capital. This resulted in a leverage ratio of 4.4 per cent at the end of 2016, compared to 4.0 per cent at the end of 2015.

We also established contingency plans and implemented appropriate risk monitoring and oversight activities.

I would like to extend my thanks to the Board, the management team and all colleagues across the Group for their contribution.

Dividends and shareholders

As a result of the outstanding performance of the business, the Board has recommended a final dividend of 3.5 pence per share. This will result in a total dividend for 2016 of 5.1 pence per ordinary share, an increase of 13 per cent compared to 2015. Our objective is to continue to increase dividend distributions over time as we grow our capital base and earnings.

Having been a long-term shareholder in Virgin Money, WL Ross and Co. sold down its remaining holding in November. I would like to thank them for their support over a number of years, which was an important factor in the development of Virgin Money into the business it is today.

Governance

The Board has made a firm commitment to high standards of corporate governance and this is explained further in the corporate governance report on page 79.

We believe that strong governance should prevail throughout the business and we pay particular attention to supporting our EBO philosophy and culture, a vital ingredient in the long-term success of the Group.

EBO sits at the heart of our business model and strategy and means delivering good value to our customers, treating colleagues well, making a positive contribution to society, building positive relationships with our partners and delivering sustainable profits to our shareholders.

We have a strong and skilled management team, a well-balanced, experienced Board and a strong commitment to good governance, enabling us to continue to deliver sustainable success for all of our stakeholders.

Directors

In December 2016, we announced the appointment of two new Independent Non-Executive Directors to the Board, Eva Eisenschimmel and Darren Pope. Eva brings to the Board an extensive background in strategic marketing across retail banking, financial services, digital and the fast moving consumer goods (FMCG) industry. Darren has significant retail banking knowledge and experience of transformational change. These appointments form part of our medium-term Board succession plan and will help to ensure the Board is well placed to meet the challenges and opportunities ahead as we continue to grow the business.

Marilyn Spearing, an Independent Non-Executive Director and Chair of the Remuneration Committee, notified the Company of her intention to retire from the Board and stand down at the 2017 annual general meeting (AGM).

Upon Marilyn's retirement from the Board, Norman McLuskie, Senior Independent Director, will become Chairman of the Remuneration Committee and Darren Pope will become Chairman of the Audit Committee during 2017, following an orderly transition. I would like to thank Marilyn for her significant contribution to the Board over the last three years and for her leadership of the Remuneration Committee.

Colleagues and diversity

We have highly-engaged colleagues who are focused on delivering the needs of our customers and stakeholders. The Board is clear that diversity helps to improve the quality of decision making and we are committed to increasing the diversity of Independent Non-Executive Directors on the Board.

Diversity at all levels of the business remains a priority as we strive to ensure that those who work for our business reflect the customers we serve, enabling us to provide a relevant, practical and personal banking service. In order to achieve this we have set targets, broadened our use of technology to support and enable flexible working and invested in the development of our people managers to ensure they value and enable diversity.

A responsible business

We are dedicated to supporting the communities in which we work to help them flourish, both socially and economically. Our commitment to being a socially responsible business, not just through our lending to customers, but also through our investment in the communities we serve, is epitomised by Virgin Money Giving and the Virgin Money Foundation, an independent charitable foundation.

Remuneration

The remuneration structure at Virgin Money is designed to ensure rewards are aligned with the long-term success of the business and the interests of our shareholders. Variable pay for Senior Executives is delivered through a combination of annual bonus and a Long Term Incentive Plan linked to future business performance (both with appropriate deferral).

Chairman's statement

All deferred awards are subject to a further risk assessment before release, with clawback provisions applying thereafter.

More information on how we ensure our approach to remuneration supports the business strategy can be found in our remuneration report on page 105.

Looking ahead

Notwithstanding the uncertainty in the wake of the vote to leave the European Union, we believe the strength of our franchise – a robust capital position, strong asset quality and operating leverage – combined with our highly-skilled and engaged colleagues, give us the platform and flexibility to adapt to possible changes in the operating environment.

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

Our strategic planning addresses the new structural and regulatory changes which come into force over the next few years. We will continue to work with our regulators as requirements evolve, and our position on CRD IV capital buffers and MREL is well understood and reflected in our strategic plans. We are also mindful of the increased threat of cyber-crime. Our resilience strategy was approved by the Board during the year and we will continually enhance our control environment to protect the business.

Our position as a straightforward bank, unburdened by legacy conduct issues, benefiting from ongoing operational leverage, and generating returns in excess of our cost of equity, makes us unique in UK banking. This differentiates us from the major banks and other mainstream challengers and will enable us to compete effectively throughout any economic uncertainties ahead.

Our plan to invest in new digital capability will provide further differentiation and enhance our position as a leading competitor in the UK retail banking market.

I would like to reiterate my thanks to colleagues across the Group for their hard work, commitment and contribution to everything we have achieved together in 2016.

Glen Moreno
Chairman
27 February 2017

Finishers of the Virgin London Marathon 2016
Photo: Virgin Money London Marathon

Chief Executive's review

Jayne-Anne Gadhia CBE Chief Executive

Our customer focused strategy continues to deliver excellent financial performance. We delivered record lending in 2016, a 33 per cent increase in underlying profit before tax to £213.3 million and our return on tangible equity strengthened from 10.9 to 12.4 per cent.

Underpinned by our commitment to responsible and prudent lending, we have grown our mortgages and credit cards businesses successfully and without compromising asset quality.

Our continued focus on delivering excellent customer service led to new highs in customer satisfaction and supported growth in customer numbers across every product category. Our overall Net Promoter Score (NPS) improved from +19 in 2015 to +29 in 2016.

We will continue to put EBO at the heart of everything we do and remain on track to sustain a double-digit return on equity in 2017.

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.

Chief Executive's review

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.

Chief Executive's review

Improving returns to shareholders

As a result of the successful delivery of our strategy for 2016, our 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 which 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
27 February 2017

Virgin Money Lounge, Glasgow

Women in Finance Charter

We are passionate about fairness, equality and inclusion and committed to achieving a 50:50 gender balance throughout the business by 2020.

Aim

I was privileged to be asked to review the progress of women in senior managerial roles in financial services on behalf of HM Treasury. As part of that review it became clear to me that there are significant barriers to the progress of women and that breaking down these barriers would improve results both for the financial services sector and individual businesses, including Virgin Money.

As the Chief Executive, I have taken personal responsibility for addressing this issue at Virgin Money and during the year we made good progress towards achieving our 2020 target of a 50:50 gender balanced workforce (within a 10 per cent tolerance).

At Virgin Money there are two particular areas that require focus. The first is the team that reports into the Executive Committee continues to be dominated by men. Men account for 68 per cent of the Executive Committee and its direct reports (excluding personal assistants) and 78 per cent of the wider senior management team. To address this, all members of the Executive Team have objectives to improve this balance through recruitment, promotion and development over the next four years. There is no intention to promote or hire women over men. The desire is to have a genuinely level playing field where both men and women can succeed on merit.

This is consistent with our second area of focus - colleague gender balance at junior levels. 75 per cent of our colleagues at the lowest end of our pay scale are women. Many work in our Stores and contact centres and we are committed to ensuring these places of work are equally attractive to men and women.

What gets measured gets done

Gender imbalance has a direct impact on average male and female salaries and it is measured transparently by the gender pay gap – the difference between average female and male pay.

Looking at April 2016 pay, Virgin Money had a gender pay gap of 36 per cent. We are confident that men and women are paid on equal terms for doing the same jobs across the business, but the under-representation of women in the senior leadership team and of men in more junior areas of the business, creates this pay gap. This is not acceptable and we are committed to remedying it.

Empowering productivity

When researching and writing 'Empowering Productivity: Harnessing the Talents of Women in Financial Services', it became clear there are a number of key issues across the industry that must be addressed in order to develop a fully inclusive workforce at all levels.

They include the need to create the right culture, developing supportive line managers and having the technology to support a flexible working environment. During 2016 we made progress on these key issues.

Encouraging a flexible culture

> we introduced a flexible matching recruitment policy which commits to match senior candidates' current flexible working arrangements. We have appointed both male and female candidates on this basis in 2016;

> we continued to promote Shared Parental Leave which enables partners to take paid parental leave; and

> we launched a 'Gender Agenda Network' with the aim of delivering events designed to educate colleagues and break down barriers.

Enhanced line manager capability

> we delivered 'unconscious bias' training to all senior leaders, helping them to understand the potential for personal bias and highlighting strategies to eliminate it within their teams;

> we require all recruitment agencies to provide diverse candidate lists;

> we require all candidate profiles to be anonymised so that hiring managers make recruitment decisions based on skills and experience alone; and

> we incorporated a gender analysis tool in our annual pay process, helping managers clearly see the impact salary and bonus decisions have on the gender pay gap of their team.

Using technology to encourage flexibility

> we upgraded our technology to make flexible and home working easier;

> we accelerated the replacement of desktops with laptops and we have improved the ease with which resources can be accessed remotely;

> we launched an app that enables employees on maternity or paternity leave to stay in touch and easily access personalised advice and information; and

- we improved access to our learning materials through a mobile platform which can be accessed from personal devices, supporting the development of colleagues without the restriction of being in the office.

Meeting the Charter commitments

I am responsible and accountable for gender diversity and inclusion at Virgin Money. A gender-balanced workforce is good for business, customers, profitability and workplace culture. To meet our Charter commitments:

- we have committed to achieve 50:50 gender balance (within a 10% tolerance) throughout the business by 2020;
- we will publish our progress against our 50:50 target annually; and
- we have linked part of annual performance related pay to commitments to promote gender diversity for all members of the Executive Committee.

The last commitment reflects the fact that having a fairer gender balance should be addressed as a business issue and rewarded as such. As the CEO one of my five personal objectives in 2016 was to lead the business towards fairness, equality and balance across gender and the other diversity categories. As a result, any bonus that I receive in respect of 2016 business performance will reflect the progress that we have made.

Priorities for 2017

Looking ahead to 2017 we intend to make further progress and we will continue our focus on management capability, a flexible working culture and identifying and removing barriers to fairness, equality and inclusion within the business. In particular, we will:

Management capability

- set bonus targets for all senior leaders to improve gender balance;
- extend 'unconscious bias' training to all people managers;
- have a formal requirement for a gender mix in all interview panels and candidate shortlists; and
- include diversity training as part of preparing colleagues to undertake people management duties.

Flexible working culture

- promote flexible working arrangements – for example, where possible we will commit to any full time colleague who is able, to work from home one day each week;
- increase job sharing through the establishment of a flexible working register; and
- continue to upgrade our IT to enable more colleagues to work flexibly.

Removing barriers

- enhance the skills of our future business leaders through gender balanced development programmes;
- establish mentoring and coaching support for women who are seen as being potential successors to Executive Committee roles, targeting improved balance at a senior level across all business areas;
- offer maternity mentoring for all colleagues following a successful pilot in 2016; and
- develop insight and build confidence through our 'Gender Agenda Network', including events to profile and discuss the key issues relating to fairness and inclusion.

I believe that it is important to be held to account to deliver the Charter commitments both at Virgin Money and across the financial services industry. We will continue to report on our progress in the years ahead, both within our annual report and on our website and supplement this with disclosure and an explanation of our April 2017 gender pay gap in the first half of 2017.

I will continue to champion HM Treasury's Women in Finance Charter and I encourage all financial services companies to sign up to its recommendations.

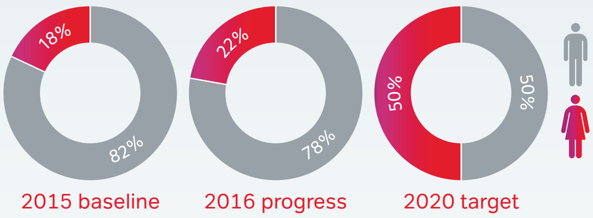
J A Gadhia

Jayne-Anne Gadhia CBE
Chief Executive
27 February 2017

Women in Finance Charter

Reporting gender balance

Senior management (including CEO) gender balance



We support the Hampton-Alexander report recommendation for companies to disclose the gender balance of the management group comprising the Executive Committee and their direct reports (excluding personal assistants). As at 1 January 2017, this group comprises 43 males and 19 females – 31 per cent female representation.

The full year 2016 gender breakdown, on a statutory basis, is as follows:

	Gender	2016 Number	2016 %
Board	Male	**5**	**62.5%**
	Female	**3**	**37.5%**
Senior management (excluding CEO)	Male	**114**	**78.6%**
	Female	**31**	**21.4%**
All colleagues	Male	**1,381**	**44.0%**
	Female	**1,758**	**56.0%**

The table below shows progress against our stated aim of achieving a 50:50 gender balance (within a 10% tolerance) throughout the business by 2020:

Level	Reward Group	Headcount %			
		Male 2016	Male 2015	Female 2016	Female 2015
Executive	Exec 1	**73%**	73%	**27%**	27%
	Exec 2	**79%**	83%	**21%**	17%
Management	Band A	**78%**	82%	**22%**	18%
	Band B	**57%**	60%	**43%**	40%
Non Management	Band C	**66%**	65%	**34%**	35%
	Band D	**48%**	48%	**52%**	52%
	Band E	**25%**	26%	**75%**	74%

The start line for the Virgin Money Giving Mini London Marathon.
Photo: Virgin Money London Marathon

Market overview

As a UK retail bank we are focused on serving domestic customers and continue to support and benefit from the robust UK economy and housing market.

UK economy

The UK economy showed considerable momentum in the first half of the year and has shown significant resilience since. The vote to leave the European Union initially cast a shadow over the country's growth prospects and its position in the global economy.

Despite the volatility, uncertainty and fears of a recession in the immediate aftermath of the referendum, the Office for National Statistics (ONS) estimated that the economy grew by 0.6 per cent in the fourth quarter of 2016, with robust consumer demand and the expansion of the services sector underpinning the economy. The UK economy grew by 2 per cent in 2016, down from 2.2 per cent in 2015.

Given the period of uncertainty after the EU referendum, the Bank of England announced a package of measures in August 2016 to support the economy, including a cut in the Bank Base Rate to the historic low of 0.25 per cent.

To help reinforce the transmission of the rate cut and ensure that households, firms and the real economy would benefit, the Monetary Policy Committee (MPC) launched the Term Funding Scheme (TFS) to provide funding for banks at interest rates close to Bank Base Rate.

Supported by the measures announced by the MPC and more positive economic activity indicators, financial conditions and asset prices recovered from the deterioration seen straight after the Brexit vote and shored up consumer confidence.

UK unemployment fell to 1.6 million in December 2016 – the lowest level since September 2005. The number of people in jobs remains at its highest ever level of 31.8 million.

Although the UK economy performed better than expected after the EU referendum, economic prospects are likely to remain uncertain until a clear picture emerges regarding Brexit plans and future trading arrangements.

Headwinds to economic growth include higher inflation and stagnant wage growth. According to the ONS, rising air fares and food prices helped to push the annual rate of Consumer Prices Index (CPI) inflation to 1.6 per cent in December 2016, its highest rate since July 2014. Consumer-led growth in the UK economy is likely to be tempered by higher inflation and growing household debt weighing on consumer spending.

As a UK retail bank focused on serving domestic customers the decision to exit the EU does not directly impact on our business. We have however, implemented monitoring activities and established contingency plans to mitigate against a deterioration in the macro-economic environment, should it materialise.

Based on the HM Treasury consensus view, which we use and consider in our strategic planning, we believe the most likely outlook is slightly slower GDP growth in 2017, compared to 2016. The current consensus for 2017 GDP growth is 1.4 per cent.

Housing and mortgages

During 2016, household spending remained resilient and the housing market was stable.

The Council of Mortgage Lenders (CML) estimates that gross mortgage lending for 2016 was £245 billion, an 11 per cent increase on 2015 and the highest annual gross lending figure since 2008.

The resilience of the UK economy, strong employment levels and low mortgage rates continue to support customer affordability. Developments in the housing market and consumption are closely linked given decisions to consume or buy property are driven by common factors such as confidence and income growth.

The current benign environment, with lower-for-longer interest rates and rising house prices, combined with the consistent application of our prudent underwriting criteria, contributed to our low arrears performance and low cost of risk in 2016.

The Government's housing agenda is targeting several key segments – including shared ownership and starter homes. This will give supply-side support to stock and transaction growth. The CML expects gross lending of £248 billion in 2017, which reflects general economic uncertainty as well as regulatory changes in the housing and mortgage markets.

Buy-to-let transactions may cool slightly in 2017 given the changes to the tax regime, both those implemented, such as the extra 3 per cent in stamp duty from April 2016, and forthcoming changes to mortgage interest tax relief from April 2017. While lenders have tightened underwriting practices and affordability criteria recently, the fundamental consumer demand for rented accommodation remains strong, and this will continue to underpin this segment of the market.

Overall, we anticipate house purchase transactions to remain broadly flat, remortgage activity to grow as customers take advantage of price incentives to get a better deal and buy-to-let to see modest growth, primarily as a result of remortgage activity.

Savings

During 2016, the UK savings market continued to grow. There was a substantial increase in activity immediately before and after the EU referendum, as households held more savings to protect against future uncertainty.

The potential for higher inflation, lower employment levels, and subdued wage growth is likely to put pressure on household disposable incomes which could impact savings levels in 2017.

Government policy, including increased ISA limits, the new personal savings allowance, Help to Buy ISA and reduced pension tax relief should continue to increase the relative attractiveness of cash savings.

The lower-for-longer interest environment is challenging for savers. We take our responsibility to our savings customers very seriously and aim to offer them both competitive and fair rates in the context of prevailing market conditions.

Virgin Money Lounge, Sheffield

Business model and strategy

Our business model

Our ambition to make 'everyone better off' is at the heart of our business model. By leveraging our strategic assets and capabilities we aim to deliver good value to our customers, treat colleagues well, build positive and mutually beneficial relationships with our corporate partners, make a positive contribution to society and deliver solid double-digit returns for shareholders.

Company, Customers, Colleagues, Corporate Partners and Community:

> Our powerful brand and EBO ethos differentiate us strongly in the market. We are well positioned to continue disrupting the market and compete effectively with the major incumbent banks.

> Our experienced management team and highly-engaged colleagues underpin our differentiated approach to banking.

> We continue to protect our unique position as a low risk UK retail bank, unburdened by legacy conduct issues. As a result, we aim to offer good value, straightforward and transparent products, supported by prudent underwriting and outstanding customer service.

> Our customers want to be able to access our products when, where and how they like and our focus on constantly improving our digital journeys across all platforms reflects this.

> We continue to protect our high-quality balance sheet. The application of strict underwriting and our data driven approach to risk management supports controlled and high-quality asset growth. We are unburdened by legacy conduct issues that continue to weigh down other UK banks.

> Our size and scale is a competitive advantage. We are big enough to compete strongly and take our planned share in our core markets and more agile than the major banks. Our strategic commercial approach and agility allows us to optimise business volume and mix and selectively target growth opportunities in specific value accretive market segments, according to customer needs and prevailing economic and market conditions.

> We benefit from ongoing operational leverage. Strong cost discipline, operational efficiency and leverage minimises cost growth. Maximising operational leverage creates value for everyone – it flows through into pricing efficiency, shareholder returns, our capacity to invest in good causes and the sustainability of our business model.

> 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.

Core strengths of our operating model

Our strategy

Progress in 2016

Continued to deliver strong growth across core markets

We have:

Delivered a strong gross mortgage lending performance of £8.4 billion, 12 per cent higher than in 2015, and a net lending performance of £4.3 billion, 20 per cent higher than 2015;

Achieved 17 per cent growth in mortgage balances to £29.7 billion;

Achieved 55 per cent growth in credit card balances, representing a 3.5 per cent share of the £68 billion card market;

Increased deposit balances by 12 per cent to £28.1 billion, demonstrating the strength of our franchise; and

Increased our customer base by 15 per cent to 3.3 million customers.

Maintained excellent asset quality

We have:

Maintained the excellent quality of our mortgage portfolio:

- Mortgages over three months in arrears of 0.15 per cent compared with latest industry average of 1.00 per cent
- The average loan-to-value of the overall portfolio is now 55.4 per cent.
- The average loan-to-value of our buy-to-let book is now 54.8 per cent

Maintained the high quality of our credit card book:

- Credit card balances two or more payments in arrears of 0.78 per cent, compared with latest industry average of 2.4 per cent
- Maintained our low cost of risk at 13bps reflecting excellent asset quality.

Delivered a 33 per cent increase in underlying PBT

We have:

Reduced our average weighted cost of funds to 130bps from 143bps in 2015, resulting in a net interest margin of 160bps for 2016;

Limited underlying cost growth during the year to 1 per cent, reflecting our operating leverage and stringent cost management;

Improved our cost:income ratio to 57.2 per cent, from 63.5 per cent in 2015;

Delivered a 33 per cent increase in underlying profit before tax as a result of strong growth in lending, excellent asset quality and strong customer satisfaction and retention;

Delivered statutory profit before tax of £194.4 million, compared to £138.0 million in 2015; and

Strengthened our return on tangible equity from 10.9 per cent to 12.4 per cent as a result of the successful delivery of our business plan for 2016.

Strategic intent

Growth

Delivering sustainable growth

We will continue to grow our customer base and balance sheet strongly within our existing risk appetite. We focus on prime mortgage business and 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. We will continue to increase the penetration of our insurance, investment and financial services to our existing customer base, acquire new customers and explore the significant potential for further growth in this business line. Our customers want to be able to access our products when, where and how they like and our focus on constantly improving our digital capability across all platforms reflects this.

Quality

Maintaining our high-quality balance sheet

Maintaining our high-quality balance sheet is at the core of our strategy. Our approach to risk management is based on rigorous and continuous data analysis and takes a far-sighted approach to asset quality, including strict affordability metrics and prudent underwriting. Supported by our risk appetite and strong risk culture, we maintain stringent control over a range of criteria including, credit scoring, customer indebtedness, geographic concentration, business mix and loan-to-value ratios for mortgages. We are proud of our unique position as a customer-focused, low risk UK retail bank, unburdened by legacy conduct issues and we will continue to protect that position and provide our customers with good value, straightforward and transparent products, supported by outstanding customer service.

Returns

Improving returns to shareholders

Our disciplined pursuit of growth and continuing operational leverage are at the heart of our strategy to generate strong and sustainable returns for shareholders. We will maintain a consistently low appetite for risk, continue our resolute focus on cost management and operational efficiency and explore opportunities for further growth in our financial services business.

Delivering to our stakeholders

Customers

We always look to build strong, lasting relationships with our customers by treating them as individuals not numbers, delivering a consistently high standard of service and continually striving to exceed their expectations.

Aim

Our aim is to be positively different from the major banks and traditional providers by offering straightforward products with fair and transparent pricing, supported by the delivery of outstanding customer service.

Achievements in 2016

> delivered growth in customer numbers across every product category and increased our overall customer base by 15 per cent to 3.3 million;

> attracted younger and more affluent customers, driven by our credit card, insurance and current account businesses and saw consistently strong customer growth in our mortgage and savings businesses;

> delivered superior customer satisfaction and advocacy with an overall Net Promoter Score (NPS) of +29, and resolved 99 per cent[1] of complaints within eight weeks;

> opened a new Lounge in Sheffield, in July 2016. The NPS for our award-winning Lounges was +86;

> won four credit card awards at the uSwitch awards, including Best Overall Customer Service, Best Application Process and Best for Balance Transfers;

> won Best Use of Voice of the Customer (VoC) at the prestigious 2016 Engage Awards;

> winner of the UK Business Awards in the customer centric organisation category for our VoC initiatives; and

> recognised by the Reputation Institute as one of Britain's most trusted banks;

[1]Excluding speculative PPI complaints.

Priorities for 2017

> continue to invest in building our customer service capability and maintain a culture where customer service is a priority;

> empower colleagues to deliver market-leading customer satisfaction;

> continue to provide straightforward, transparent products that result in positive outcomes for customers;

> continue to recognise issues relating to accessibility, financial inclusion and responsible lending; and

> continue to develop our digital strategy and capability for customers.

Award winning year

"Virgin Money is the perfect case study to highlight what can be achieved when an organisation and all of its colleagues are focused on listening and responding to the Voice of the Customer. Virgin Money is more than deserving of the accolades it has received from the Engage and UK Business Awards."

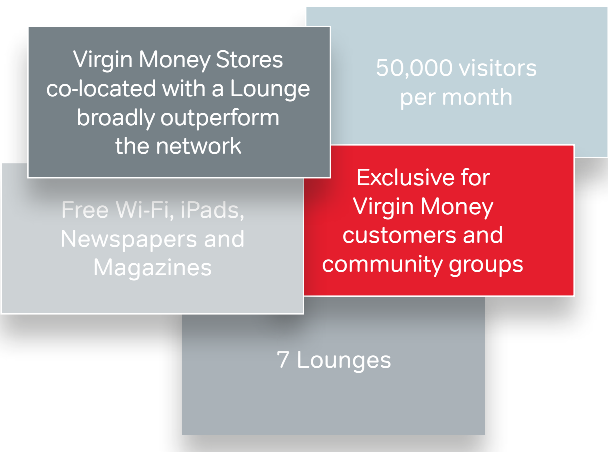
John O'Hara
President of NICE - EMEA

Financial inclusion

Opening a Basic Bank Account can be the first step towards financial inclusion for many people. As part of our ambition to make 'everyone better off' we launched the Virgin Essential Current Account (ECA) in 2015. The ECA supports financial inclusion by setting a new standard for Basic Bank Accounts in the UK with no unpaid item fees and a fair rate of credit interest. It is a free basic bank account designed to help our customers stay in control of their money. The performance of the ECA was particularly strong during the year. We almost tripled new accounts opened, compared to 2015. We work at a local level with partners such as ScotCash, Citizens Advice Bureau, the Job Centre and a number of debt charities to raise the visibility of the ECA. We will continue to build on this and will target both local and national partners in 2017.

Virgin Money Lounges

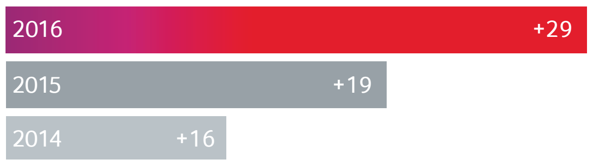
Virgin Money Lounges continue to deliver strong customer satisfaction with an NPS of +86 and we opened our seventh Lounge in Sheffield in the second half of the year. Stores co-located with a Lounge broadly outperform the overall network based on sales performance.



Customer satisfaction (NPS)

Strong and improving customer advocacy, with an increase to +29 in our overall NPS in 2016.

Net Promoter Score (NPS)



We measure customer satisfaction using the industry standard Net Promoter Score. We also use internal customer dashboards, which provide monthly information about customers' experiences and opinions relating to our products and services. We aim to continually improve our customer service, experience and advocacy.

Virgin Money Lounge, Sheffield

Delivering to our stakeholders

Colleagues

Virgin Money's success is built firmly on the commitment, skill and attitudes of all our people and our shared purpose of building a better bank which will make 'everyone better off'.

Aim

Our colleagues are integral to our success and it is through their strong engagement and advocacy that we are able to deliver a strong and sustainable business performance. We aim to provide an environment which nurtures a high performing, diverse and committed workforce, enabling all colleagues to reach their full potential.

Achievements in 2016

Investing in colleague development

- our 'Future Business Leaders' talent acceleration programme created a pipeline of talent for leadership succession, winning the Personnel Today award for Talent Management; and
- we made our online Learning Lounge accessible from any device to improve colleague access to learning and development solutions.

Building colleague commitment

- we maintained strong colleague engagement with an overall engagement score of 81 per cent, which benchmarks strongly against UK high performing companies; and
- we improved transparency on our approach to determining pay and bonus outcomes through personalised 'Total Reward' statements, a 'Pension Planner' and a series of roadshows.

Creating a diverse workforce

- we held our first 'mental health awareness week', showcased the work of Heads Together, our Corporate charity for 2016/17, and we achieved the new Disability Confident accreditation; and
- we committed to matching flexible working arrangements for senior positions, to ensure those joining the business can balance their work/life commitments.

Further information on how we aim to achieve gender parity throughout the business - a 50:50 split - by 2020 can be found on page 26.

2016 gender pay gap

Virgin Money welcomes the UK government initiative to improve pay equality through collecting and reporting gender pay data, as at April each year. Whilst these requirements come into effect from April 2017, we are voluntarily disclosing our gender pay gap, as at April 2016.

We have reviewed gender pay across the Company in 2016 and are confident men and women are paid fairly for the same and similar jobs. Virgin Money's mean gender pay gap in April 2016 was 36 per cent (median 39 per cent). As explained by the Chief Executive on page 26, the gender pay gap at Virgin Money is driven primarily by two factors:

- The under representation of women in the senior leadership team; and
- The under representation of men in more junior roles.

Consistent with the regulations we show below the gender distribution across four equally sized quartiles based on pay.

We are committed to addressing gender imbalance and the resulting gender pay gap.

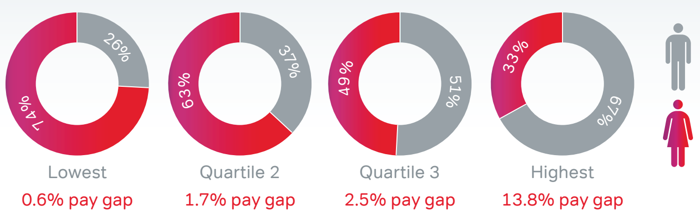
Priorities for 2017

Investing in colleague development

We will continue our investment in colleague development through:

- our new Apprenticeship Programme, which creates career development opportunities for colleagues and provides a diverse pipeline of entry level talent;
- our 'My Career' programme, which provides colleagues with the ability to develop skills and expertise for both their current role and possible future roles;
- our 'Coaching Academy,' which provides all colleagues with access to targeted coaching and mentoring to accelerate the development and progression of under-represented groups;

2016 gender pay gap analysis



This illustration divides staff into four groups based on pay and discloses the gender balance in each quartile. There are significantly more women in the lowest quartile and the average pay for men and women is the same. In the highest quartile there are more men and the average gender pay gap is 13.8 per cent.

- our 'Me As A Manager' programme, which develops people managers and aspiring people managers to create the right conditions for all colleagues to flourish; and
- our 'Me As A Leader' programme, which builds senior team capability through the development of key skills such as personal resilience and a growth mind-set.

Building colleague commitment

Our annual colleague survey told us that we need to listen more carefully to all minority groups to understand their needs better. We will continue to seek higher levels of engagement from all colleagues through:

- our colleague Affinity Group, which will be a catalyst for colleagues to come together to identify and support minority colleague interests;
- we will work with external experts to ensure we take action that will make a real difference to minority colleague interests; and
- we have appointed Executive sponsors for each minority group to ensure that debate and action is championed at the highest level:
  - Tim Arthur, Creative Director (LGBT+)
  - Marian Martin, Chief Risk Officer (Ethnicity)
  - Hugh Chater, Chief Commercial Officer (Disability)

Creating a diverse workforce

We believe a diverse workforce will drive better business outcomes, bring different perspectives to our decision making, and create a colleague base which is more representative of broader society. Colleague engagement and performance will be enhanced if colleagues feel able to be themselves at work, in an inclusive environment which promotes both physical and mental wellbeing.

In 2016 we improved the representation of ethnic minority and LGBT+ colleagues within the company. To maintain this progress in 2017, we will:

- set targets and deploy recruitment strategies to drive a greater diversity of candidate interest in roles;
- develop all our people managers to value and enable diversity and be mindful of their own unconscious bias;
- broaden our use of technology to support and enable flexible working and improve contact with absent colleagues; and
- deliver an online portal where colleagues can receive greater support in relation to physical and mental wellbeing.

Initiatives relating to gender equality are covered in the Women in Finance update on page 26.

"We are passionate about creating a bank that reflects the diversity of broader society and engages people of all backgrounds equally.

During 2016, we improved the diversity of our work force and narrowed the difference in engagement levels of our ethnic minority and LGBT+ colleagues to the Company average. We remain committed to improving both greater diversity and equal inclusion across the Company in 2017.

We will continue to support the British Black Business Awards which recognise and celebrate the outstanding achievements of black people in UK business. In 2017, this partnership will extend to delivering a pan-industry programme to improve BAME representation at senior levels. We will also be a founding partner of EMpower, which will promote equality of opportunity and inclusion through the empowerment of ethnic minority employees.

Support of our LGBT+ community will continue through our new Affinity Group, ongoing participation in Pride events across the UK, and partnerships with OUTstanding, the Scottish Business in the Community Network and Stonewall.

We intend to be early adopters of the UK government's new gender pay gap reporting requirements and support the findings of both the Hampton-Alexander and Parker reports, which advocate action to generate improved gender and ethnic equality in business.

We will continue to celebrate difference and work to ensure every colleague feels equally valued and able to thrive at Virgin Money."

Matt Elliott
People Director, Virgin Money

Delivering to our stakeholders

Corporate partners

We look to partner with businesses that genuinely understand and share our philosophy of making ‘everyone better off ’.

Aim

We aim to maintain our strong track record in managing mutually beneficial relationships with corporate partners in order to complement our own business and core banking capabilities with our partners’ technical product expertise and infrastructure.

Achievements in 2016

- delivered a new retention platform for intermediaries and our direct mortgage business through our innovative ‘Mortgage Lab’. Net mortgage lending increased by 20 per cent to £4.3 billion, driven by both strong gross lending and improved customer retention during the year;
- won the ‘Best Lender for Partnership with Mortgage Club’ at the L&G Mortgage Club annual awards for the second year in a row and our intermediary NPS improved from +40 in 2015 to +55;
- won ‘Best Intermediary Lender Award’ at the Mortgage Finance Gazette Awards;
- received 'Five Stars' in the Mortgage category at the Financial Adviser Service Awards;
- won the ‘Innovation Culture’ Award at the Corporate Entrepreneur Awards and the ‘Innovation Award’ at the Mortgage Finance Gazette Awards for our Mortgage Lab;
- won the Best Direct Travel Insurance provider at the Your Money Awards and we were proud to provide travel insurance to the UK Invictus Games Team when they competed in Florida; and
- signed a four-year deal with Manchester United Football Club to become its official UK retail financial services partner. Our Champions Bond was shortlisted at the Financial Innovation Awards and the partnership has been a strong commercial success.

Priorities for 2017

- continue to innovate and deliver outstanding levels of service to our network of professional mortgage intermediary partners;
- continue to strengthen relationships with, and oversight of, our corporate partners;
- enhance our customer communication strategy through our print and communications partner, Communisis, with a focus on enhancing our digital communication capabilities; and
- continue to strengthen our non-interest income product lines, including the launch of a new Life Insurance proposition and creating broader awareness of our Travel Money and International Money Transfer services.

Strategic corporate partners

We operate strategic partnerships that enable us to combine the Virgin Money philosophy, brand and core banking capabilities with partners’ technical product expertise and infrastructure. We also partner with a number of providers to support our non-interest income product lines. This is particularly relevant when it is more efficient for us to partner with an established provider, than to build our own infrastructure.

Modern Slavery statement

Virgin Money has a zero tolerance towards slavery, servitude, forced labour and human trafficking (Modern Slavery) and is committed to conducting business with honesty and integrity and treating everyone with dignity and respect. The review of our existing policies, processes and contracts showed that they embrace the principles of the act and we work closely with our partners and suppliers to ensure this is the case.

We will continually review our policies, processes and controls, improve the mapping of our supply chain to identify areas of risk and develop key performance indicators (KPIs) to measure the effectiveness of our approach. To read our Modern Slavery statement in full please visit virginmoney.com.

"Virgin Money continues to put the Intermediary at the heart of everything they do. They have invested heavily in the right systems and processes to make it easier for an Intermediary to do business and have been working with brokers in their Mortgage Lab to make sure that this happens every time."

Stephen Smith
Director, Housing Partnerships
Legal & General

"Mapfre Asistencia is proud to be a long standing partner of Virgin Money for the delivery of the Travel Insurance proposition. We've shared a strong and profitable relationship over several years, which has delivered a market leading customer proposition and strong growth to both parties. Virgin Money's EBO philosophy and customer focus mirrors that of Mapfre Group and we continue to enjoy a successful and transparent trading relationship.

Our partnership with Virgin Money is our pre-eminent market relationship and we look forward to extending that relationship and continuing to support the business in its exciting plans for development and growth."

Jair Marrugo
Managing Director UK & IRE
Mapfre

Delivering to our stakeholders

Communities

Our community activity raises awareness of the Virgin Money brand and business as a force for good and covers four key areas; fundraising; investing in education, employability and enterprise; supporting local communities, and supporting colleague engagement in their local communities.

Aim

We are committed to supporting the communities in which we work to help them flourish, both socially and economically.

Achievements in 2016

- £92 million was donated to charities through Virgin Money Giving, our not-for-profit online donation service, taking the total raised for charities since its launch in 2009 to over £500 million;
- runners in the 2016 Virgin Money London Marathon raised £59.4 million for charity, up from £54.1 million in 2015, setting a new world record for an annual, single day charity fundraising event for the tenth successive year;
- the Virgin Money Foundation, launched in August 2015, awarded grants totalling almost £1 million in 2016 to organisations in the North East of England working in the areas of housing and homelessness and youth employment;
- the national roll-out of the 'LifeSavers' financial education programme commenced. With Virgin Money's financial support it will help 30,000 children learn more about money over the next three years. The 'LifeSavers' programme supports primary schools to embed financial education within the whole school curriculum and encourages parents and the wider community to get involved in children's financial education;
- over 350 schools and over 17,000 young people participated in our Make £5 Grow programme, and the launch of a new website extended the reach of the programme. Make £5 Grow is Virgin Money's enterprise education programme which aims to give young people aged between nine and eleven years old the experience of starting a small business using a £5 loan from Virgin Money;
- over 48,000 young people participated in the 2016 'Fiver Challenge', delivered by Young Enterprise and funded by Virgin Money. The 'Fiver Challenge' is a national competition for primary schools aimed at introducing the world of enterprise to young people;
- Virgin Money participated in two new Business in the Community programmes; a UK-wide initiative to promote the benefits of employing ex-servicemen and women, and the National Action Plan for Responsible Business in Scotland; and
- colleagues volunteered 1,679 days to good causes.

Priorities for 2017

- continue to invest in Virgin Money Giving to help charities and fundraisers raise more for good causes in the UK;
- extend the reach of the Virgin Money Foundation beyond the North East of England;
- continue to invest in a range of programmes which support young people in developing financial and entrepreneurial skills; and
- support colleagues engaging in local community projects.

Over £500 million

raised through Virgin Money Giving, since launch in October 2009

Charity of the year

Chosen by colleagues, our Charity of the Year for 2015/2016 and the official charity of the 2016 Virgin Money London Marathon was the NSPCC. The NSPCC is the leading children's charity fighting to end child abuse in the UK and Channel Islands. They raised over £2.1 million through their partnership with Virgin Money, including £218,933 raised by Virgin Money colleagues. The money raised helped the NSPCC's Childline service to recruit and train more counsellors to reduce waiting times and ensure they can provide support to every child who needs them.

Our Charity of the Year for 2016/2017 and the official charity of the 2017 Virgin Money London Marathon is the 'Heads Together' campaign, spearheaded by The Duke and Duchess of Cambridge and Prince Harry to end stigma around mental health.

"The NSPCC was delighted to raise over £2 million from the 2016 Virgin Money London Marathon. The money raised is going towards a project to transform our Childline service. The money raised by our incredible marathon runners will pay for our trained volunteer counsellors to answer 500,000 children's calls for help to Childline. Thank you to Virgin Money for giving us this fantastic opportunity to make a difference to the lives of so many vulnerable children."

Peter Wanless
Chief Executive
NSPCC

Kenenisa Bekele at the Virgin Money London Marathon
Photo: Virgin Money London Marathon

Delivering to our stakeholders

Environment

At Virgin Money we are committed to taking positive action to eliminate the impact our activities have on the broader environment and target Net Zero Greenhouse Gas (GHG) Emissions by 2030.

Aim

Our aim is to protect the environment by conducting our business in a sustainable, ethical and responsible way. We will contribute towards a lower carbon, more resource efficient economy by measuring, monitoring and controlling our consumption of resources.

Achievements in 2016

- finalised a transparent methodology to define total GHG Emissions for the Group;
- engaged with the Major Energy Users Council, Energy Savings Trust and Business in the Community to help develop our strategic proposals and made progress against our plan to achieve Net Zero GHG Emissions by 2030 by:
  - completing the deployment of modern desktop and mobile software to all colleagues, enhancing both efficiency and security;
  - commencing a programme of removing over 200 servers from our infrastructure; and
  - securing 100% renewable energy for electricity contracts within our direct control.
- raised awareness of environmental initiatives across the Company to ensure that all colleagues are empowered to make a difference. This included the provision of new tools such as 'Skype for business' which reduces the need for travel;
- ensured all suppliers understand the part they can play in reducing the impact their operations have on the environment by incorporating an environmental assessment into our procurement process; and
- completed our first submission to the Carbon Disclosure Project (CDP) and achieved a C rating, a solid base from which to progress.

Priorities for 2017

- finalise the strategy to achieve Net Zero GHG Emissions by 2030;
- continue to reduce the need for unnecessary business travel and be more conscious regarding the way we allocate and consume our resources;
- continue the streamlining of our internal processes and promote the behavioural changes required to drive a reduction in energy use;
- incorporate further environmental considerations into the assessment process for all new contracts; and
- engage CDP to help us to identify areas for improvement in our supply chain and further reduce our impact on the environment.

Managing our emissions

The Group is required to report on GHG emissions under the Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013 (the Regulations). The Group follows the principles of the GHG Protocol Corporate Standard and the Department for Environment, Food and Rural Affairs (DEFRA) Voluntary Reporting 2012 Guidelines (the Guidelines) to calculate its emissions in Scope 1, 2 and 3.

We have reported comprehensive data on GHG emissions within Scope 1 and 2, and business travel within Scope 3, since 2014. During 2016, we have continued to improve our performance and reduce our total GHG emissions.

Scope for disclosure

- **Reported Scope 1 emissions:** cover emissions generated from the gas and oil used in all buildings from which the Group operates; emissions generated from Group-owned vehicles used for business travel; and fugitive emissions arising from the use of air-conditioning and chiller/refrigerant equipment to service the Group's property portfolio;
- **Reported Scope 2 emissions:** cover emissions generated from the use of electricity in all buildings from which the Group operates; and
- **Reported Scope 3 emissions:** relate to business travel undertaken by all colleagues using rail, private vehicles, hired vehicles, contracted taxi services and air travel.

Omissions

The data gathering process for figures within our Scope 1 and 2 reporting is continuous and calculated using the most accurate information available at the time. If more accurate data becomes available or updated CO_2 emission factors are applied, this may lead to a restatement of data. As a result of a comprehensive energy consumption review at our Gosforth site performed during 2016, we have restated the Scope 2 comparative disclosure.

Compliance with the Regulations

We have achieved full compliance with the Regulations for the whole of its property portfolio. Estimated emissions relate to energy consumption in two properties where the supply is controlled by the landlord and the Group is subsequently recharged. In these properties, energy costs are allocated on a floor area basis.

Fugitive emissions arise from the use of air conditioning and chiller/refrigerant equipment to service our property portfolio.

Leakage rate and emission factors from the Guidelines have been applied to each asset on the register according to the gas type used. This information is gathered and reported by the Group's maintenance supplier. The data is included within the Scope 1 segment of the GHG table listed below.

GHG emissions CO_2e tonnes

Scope	2016	Restated 2015
Scope 1	1,753.8*	1,868.7
Scope 2	4,933.0	5,720.7▲
Scope 3	998.8	1,188.7
Total	7,685.6	8,778.1

Intensity ratio

We have chosen to use an intensity ratio of GHG per Full Time Equivalent (FTE). FTE is straightforward to calculate and verify and also normalises consumption in a growing business. We are encouraged by the reduction in this ratio in 2016.

Scope	2016	Restated 2015
GHG emissions per average FTE	2.66 tCO_2e	3.11 tCO_2e

Independent assurance

Although not required by the Regulations, we appointed PricewaterhouseCoopers LLP (PwC) in 2016 to undertake a limited assurance engagement under the ISAE 3410 assurance standards for Scope 1 GHG data highlighted in this report with a (*). Their assurance report is available on virginmoney.com[1].

Use of resources

The table below shows actual consumption in 2016 compared with 2015.

		2016	Restated 2015
Energy	Stated in Gwh % from renewable sources	19.6 56%	20.2▲ 51%
Travel	Total miles travelled	5.7m	6.4m
Waste	Tonnes produced % sent to landfill	567.6 2%	532.9 6%
Water	Cubic metres per FTE	**12.7**	18.7

Energy – % renewable energy use stated for office, Store and Lounge locations.

Travel – includes all air, rail, taxi and public transport processed through either our corporate travel provider or claimed through personal expenses.

Waste – includes trade and secure waste for offices, Stores and Lounges.

Water – consumption is for metered sites only, the 2015 leak which was highlighted at the main office site in Gosforth has been fully resolved.

▲ Identifies figures which have been restated.

1 The level of assurance provided for a limited assurance engagement is substantially lower than a reasonable assurance agreement. A summary of the work PwC performed is included within their assurance opinion. Non-financial performance information, GHG quantification in particular, is subject to more inherent limitations than financial information. It is important to read the data in the context of PwC's full statement and Virgin Money's reporting guidelines available at virginmoney.com.

Risk overview

Risk management

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).

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 macro-economic 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 macro-economic 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

Risk overview

Risk management

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

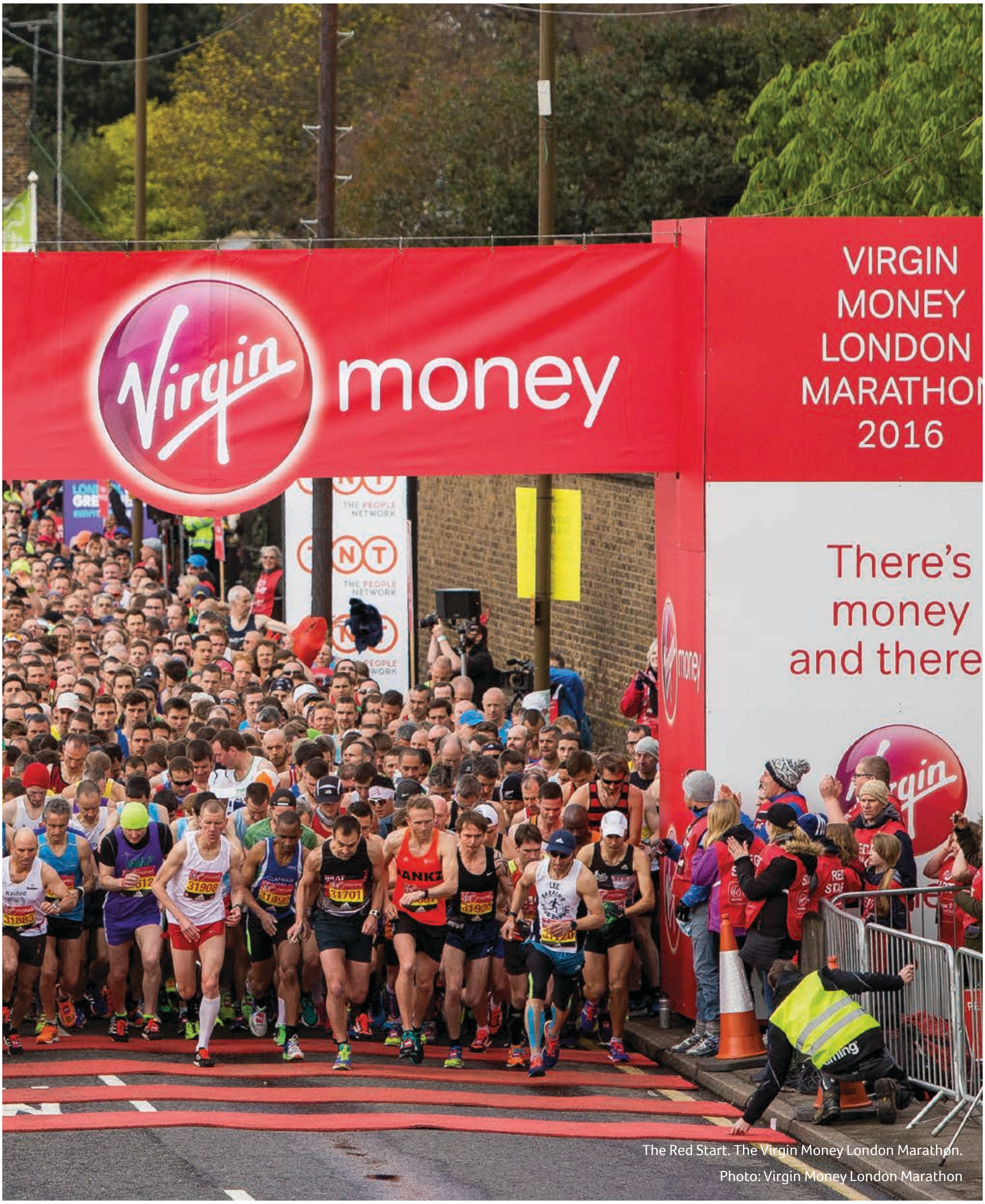
Our focus on asset quality and balance sheet stability will continue as the business grows. Credit policy and decision systems are regularly reviewed and tested to ensure they develop in response to changes in customer and competitor behaviours, maintaining the quality of the portfolios. This focus will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

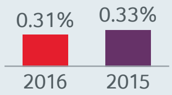


The Red Start. The Virgin Money London Marathon.
Photo: Virgin Money London Marathon

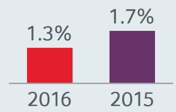
Risk overview

Principal risks	Key mitigating actions	
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.	> 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.
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.	> 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.
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.	> 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 cyber-attack;	> 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.
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.	> 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.
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.	> 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.

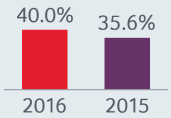
Key risk indicators



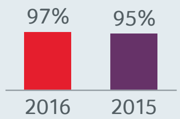
Impaired as a % of total secured balances



Impaired as a % of total unsecured balances



Provisions as a % of impaired balances



Debt securities % AA or above

Commentary

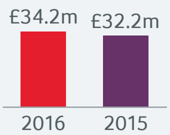
Impaired loans as a percentage of overall balances has remained stable in 2016.

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.

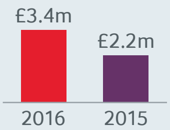
We will maintain our 'no loss' position for the wholesale credit portfolio.



IRRBB - Capital at Risk

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.

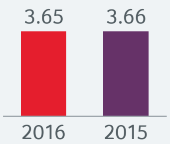
We will look to refine our interest rate risk management systems and approaches to reflect the evolving regulatory landscape.



Operational losses

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

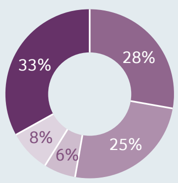
We will continue to invest in cyber-crime defence, fraud and anti-money laundering infrastructure.



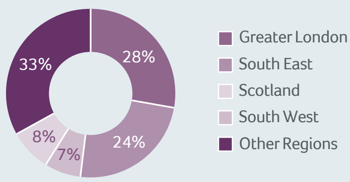
Total complaints (per 1,000 accounts)

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

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



Mortgage concentration 2016



Mortgage concentration 2015

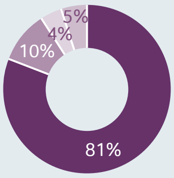
The average LTV in Greater London (49.3 per cent) and South East (53.8 per cent) is lower than the average portfolio LTV of 55.4 per cent.

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

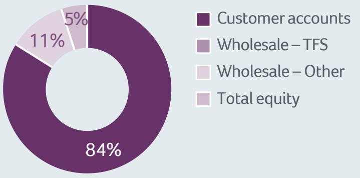
Risk overview

Principal risks	Key mitigating actions
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.	> 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.
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.	> 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.

Key risk indicators



Funding mix 2016



Funding mix 2015

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 metrics	2016	2015
CET 1	15.2%	17.5%
Total capital ratio	20.4%	20.2%
Leverage ratio	4.4%	4.0%

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

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

Financial results

Virgin Money Lounge, Sheffield.

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 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 benefited 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.

Financial results

Summary of Group results

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.

Financial results

Summary of Group results

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.

Financial results

Summary of Group results

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.

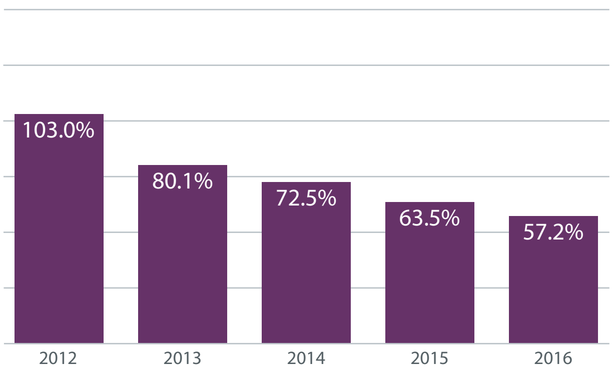
Other income increased by 0.7 per cent to £67.9 million reflecting an increase from our investment funds business.

Costs remained tightly controlled

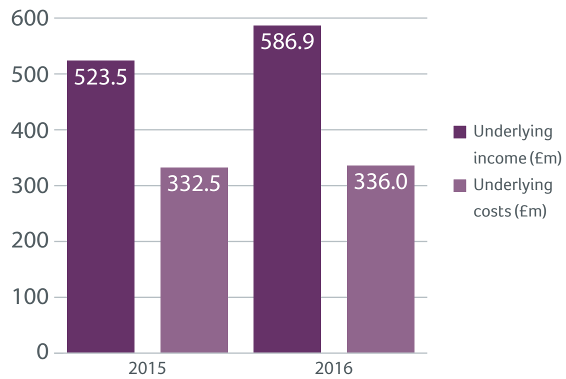
	2016 £m	2015 £m	Change
Costs	**336.0**	332.5	1.1%
Cost:income ratio	**57.2%**	63.5%	(6.3)pp

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.



Cost: income ratio



Operating JAWS

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.

Financial results

Summary of Group results

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
27 February 2017

Financial results

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.

Financial results

Divisional results

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').

Financial results

Divisional results

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.

Financial results

Divisional results

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%

The financial metrics in this section are presented on an underlying basis unless labelled as statutory.

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.

The financial metrics in this section are presented on an underlying basis unless labelled as statutory.

Financial results

Divisional results

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.

Financial results

Divisional results

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)%

Governance

Virgin Money London Marathon.
Photo: Virgin Money London Marathon

Board of Directors


1


2


3


4


5


6


7


8

Additional Directors (since 31 December 2016)


9[1]


10[2]

Company Secretary


11

KEY			
Member of Nomination Committee	N	Member of Remuneration Committee	R
Member of Audit Committee	A	Committee Chair	
Member of Board Risk Committee	Ri		

1 From 25 January 2017

2 From 1 March 2017

Directors

1 Glen Moreno

N

Chairman

Appointed:
January 2015 (Board), May 2015 (Chairman)

Skills and experience:
Glen has over 40 years' experience in business and finance gained from senior positions in a wide range of industries. He was previously Chairman of Pearson plc, Deputy Chairman of the Financial Reporting Council, and Senior Independent Director and Deputy Chairman at Lloyds Banking Group plc. Glen was also the Chief Executive of Fidelity International Limited.

External appointments:
Non-Executive Director of Fidelity International Limited and an Independent Non-Executive Director and Chair of the Audit Committee of Promotora de Informaciones SA.

2 Norman McLuskie

N R Ri A

Senior Independent Non-Executive Director (SID)

Appointed:
January 2010

Skills and experience:
Norman has over 35 years of experience in financial services in the UK listed environment. He is a chartered accountant and a fellow of the Chartered Institute of Bankers in Scotland. He previously held a number of Board level roles at the Royal Bank of Scotland Group (RBS), including Deputy Chief Executive and a Non-Executive Director of RBS Insurance. He was also Chairman of MasterCard Europe.

External appointments:
None.

3 Colin Keogh

N A Ri

Independent Non-Executive Director (INED)

Appointed:
January 2010

Skills and experience:
Colin has an extensive knowledge of banking operations drawn from over 30 years in financial services, during which he has held a number of senior management and board positions. Colin was Chief Executive of Close Brothers plc. He previously held Non-Executive Director roles at Bràit SE (a specialist investment company listed in Johannesburg and Luxembourg), New World Resources plc and Emerald Plantation Holdings Ltd.

External appointments:
Senior Independent Director and Chair of the Remuneration Committee of Hiscox Limited, Chairman of Premium Credit Limited and Independent Non-Executive Director of M&G Group Limited.

4 Marilyn Spearing

N A Ri R

Independent Non-Executive Director (INED)

Appointed:
January 2014

Skills and experience:
Marilyn's specialist knowledge in payments, cash management and related technology platforms has been acquired over a lengthy executive career. She also has extensive general financial services experience, particularly in managing organisational, operational and structural change. Marilyn was the Global Head of Trade Finance and Cash Management at Deutsche Bank AG and Global Head of Payments and Cash Management at HSBC. She also held positions on the Boards of Swift (UK) Limited and VOCA Limited.

External appointments:
None.

5 Geeta Gopalan

Ri A R N

Independent Non-Executive Director (INED)

Appointed:
June 2015

Skills and experience:
Geeta has wide-ranging experience and knowledge of the financial services industry, particularly around payments and digital innovation. Geeta was Director of Payment Services with HBOS plc and previously Managing Director, UK Retail Bank and Business Development Head EME at Citigroup. Geeta was formerly the Chair of Monitise Europe. She is a chartered accountant.

External appointments:
Independent Non-Executive Director of Vocalink Holdings Limited and its subsidiary Advanced Payment Technology Limited, and Non-Executive Member and Vice Chair of the England Committee of the Big Lottery Fund.

Board of Directors

Directors and Company Secretary

6 Gordon McCallum

N

Non-Executive Director

Appointed:
January 1998

Skills and experience:
Gordon has extensive board, financial and management experience from a range of sectors including media, telecommunications, financial services and aviation. As a senior executive in the Virgin Group, he led its strategic development from 1998 to 2012. He was previously a management consultant at McKinsey & Company and an investment banker at Baring Brothers in London and Asia.

External appointments:
Non-Executive Director at Virgin Atlantic Limited and serves in a Non-Executive capacity on the boards of a number of non-Virgin companies. These include John Swire & Sons Limited and Hunter Boot Limited in the UK and the Advisory Board of Aldo Group in Canada. He is also a Senior Advisor to private equity firm, Searchlight Capital.

7 Patrick McCall

Non-Executive Director

Appointed:
January 2012

Skills and experience:
As a senior executive in the Virgin Group, Patrick has extensive board, financial and management experience across a range of sectors including financial services, retail, travel and healthcare. Patrick was previously an investment banker at SG Warburg.

External appointments:
Senior Managing Director of the Virgin Group and Non-Executive Director at Virgin Active, Virgin Rail Group, Virgin Trains East Coast, Virgin Galactic and OneWeb.

8 Jayne-Anne Gadhia CBE

Executive Director and Chief Executive

Appointed:
March 2007

Skills and experience:
Jayne-Anne has nearly 30 years of experience in finance and banking. She was one of the founders of Virgin Direct, launching the Virgin One Account in 1998. Following the acquisition by RBS of the Virgin One Account, she went on to lead a number of RBS business units, ultimately joining the RBS Retail Executive Board where she was responsible for RBS's mortgage business. Jayne-Anne re-joined Virgin Money as Chief Executive in 2007. She is a chartered accountant.

External appointments:
Trustee of Tate[3] (Government appointment), Deputy Chairman of The Great Steward of Scotland's Dumfries House Trust, and Non-Executive Director of Scottish Business in the Community[3]. Jayne-Anne has a number of advisory roles and is the Government's Women in Finance Champion.

9 Eva Eisenschimmel

Ri A R N

Independent Non-Executive Director (INED)

Appointed:
January 2017

Skills and experience:
Eva has 30 years' experience as a brand and marketing professional. She was previously Managing Director of Marketing, Brands and Culture at Lloyds Banking Group plc, Chief Customer Officer at Regus plc, and Chief People and Brand Officer at EDF Energy. Eva has also held senior executive positions at Allied Domecq and British Airways.

External appointments:
Independent Non-Executive Director of Water Plus Limited, a joint venture between Severn Trent and United Utilities.

10 Darren Pope

Ri A R N

Independent Non-Executive Director (INED)

Appointed:
To be appointed on 1 March 2017

Skills and experience:
Darren has over 30 years' experience in retail banking and financial services. He has held executive and senior roles during recent transformational projects, having taken a lead role in the design and divestment of the TSB business from Lloyds Bank, and its subsequent IPO and takeover. Darren was previously Chief Financial Officer of TSB.

External appointments:
Independent Non-Executive Director of Equiniti Group plc.

11 Katie Marshall

Company Secretary

Appointed:
September 2013

Skills and experience:
Katie joined Virgin Money in 2009, following ten years as a corporate lawyer at Eversheds LLP. Katie was appointed Company Secretary in September 2013. She is a qualified solicitor.

3 Body not for commercial purposes.

Virgin Money Executive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Board member

1 Jayne-Anne Gadhia CBE

Chief Executive

Jayne-Anne joined the Board in March 2007 as Chief Executive.

Further details can be found on page 76.

Non Board members

2 Peter Bole

Chief Financial Officer

Peter is a chartered accountant. Following roles with Deloitte and Standard Life, Peter joined RBS where he held a variety of senior finance roles, latterly in RBS Insurance. In 2009, he joined Tesco Bank where he established the finance function and played a key role in the leadership of the business as it was migrated from RBS infrastructure. Peter joined Virgin Money in 2016, bringing his extensive retail financial services experience and expertise. Peter became Chief Financial Officer in January 2017.

3 Marian Martin

Chief Risk Officer

Marian is a chartered accountant and qualified with Ernst and Young. She joined the Britannia Building Society where she was an Internal Audit Manager, before spending four years at the Britannic Group where she was Head of Group Audit and Risk. Marian joined RBS in 2004 and served as Risk Director of RBS's consumer finance businesses, the RBS mortgage business and then Tesco Personal Finance. Marian joined Virgin Money as Chief Risk Officer in 2007 and has been in that role throughout the period of business growth and development.

4 Matt Elliott

People Director

Matt's early career was at RBS, where he worked on HR policy and employment issues, before supporting the HR transformation programme following the acquisition of NatWest. Matt held senior HR roles in several RBS operating businesses including the Consumer Finance division and Tesco Personal Finance. In 2007, Matt moved to BP as Senior Manager for Corporate and Functions before becoming HR Vice President for BP in North Africa. Matt joined Virgin Money as People Director in 2011.

Virgin Money Executive

5 Michele Greene
Director of Strategic Development

Michele is a chartered accountant and qualified with KPMG. She spent three years at Credit Lyonnais as a financial accountant before joining Goldman Sachs as group accountant. Michele then spent over 15 years at MBNA, most recently as Chief Finance Officer, where she was a member of the board and closely involved in setting the strategic direction of the business. Michele joined Virgin Money in October 2013.

6 Hugh Chater
Chief Commercial Officer

Hugh has over 25 years' experience in financial services. He was an executive founder at MBNA Europe, joining in 1993 from KPMG Management Consulting. At MBNA Hugh held executive roles in HR, Credit Management, Customer Satisfaction and Marketing before becoming Chief Operating Officer and then UK Managing Director. In 2007 Hugh joined RBS Retail to run the consumer credit card business. He subsequently ran the current account, savings, investments and insurance products. Hugh joined Virgin Money in June 2016.

7 Mark Parker
Chief Operating Officer

Mark's first IT Director role was at British Sugar. In 2001, Mark joined the HBOS Group, now part of Lloyds Banking Group. After serving as Group Services Director and Chief Information Officer, he then became Managing Director of Intelligent Finance. Mark joined Northern Rock as Chief Operating Officer in 2009 and subsequently joined Virgin Money in January 2012.

8 Andrew Emuss
General Counsel

Andrew qualified as a solicitor in 1996. He started his career at Clifford Chance, qualifying as a corporate lawyer, and has spent 20 years acting on corporate and capital markets deals. He spent over ten years at Nomura and served as its Head of Corporate Development for EMEA, executing strategic deals. Andrew joined Virgin Money as General Counsel in June 2014.

9 Caroline Marsh
Director of Culture

Caroline has over 30 years' experience in banking. Her early career was at Barclays where she spent 12 years in management roles. In 1999, she joined Virgin One as Sales Director. Following the acquisition of Virgin One by RBS in 2001, Caroline became Sales and Operations Director for the RBS consumer finance business, before leading RBS's intermediary mortgage business. Caroline returned to Virgin Money in 2007 and has led the cultural agenda for the Virgin Money business as Director of Culture since the acquisition of Northern Rock in 2012.

10 Tim Arthur
Creative Director

Prior to joining Virgin Money, Tim was Global Chief Executive (CEO) of Time Out. He led its expansion across Asia and the US and was responsible for transforming the brand from a print media business to a global digital platform. Before Time Out, Tim was CEO of Cardboard Citizens, and CEO/Artistic Director of two arts venues. He is also a playwright and author. Tim joined Virgin Money in 2016.

Corporate Governance Report

"We believe that strong governance should prevail throughout the business, and we pay particular attention to supporting our EBO philosophy and customer-focused culture, vital ingredients in the long-term success of the Group."

Dear Shareholders

I am pleased to present our Corporate Governance Report for 2016. This report sets out our approach to governance in practice, the work of the Board in 2016 and includes reports from the Nomination Committee, the Audit Committee and the Board Risk Committee. Information about the work of the Remuneration Committee is included in the Directors' Remuneration Report on pages 105 to 125.

This report also explains how the Group applies the highest principles of corporate governance, in particular those laid down in the 2014 edition of the Financial Reporting Council UK Corporate Governance Code (the Code). The Code can be accessed at www.frc.org.uk.

I am pleased to report that during the year the Board and its Committees met their objectives and carried out their responsibilities effectively. Set out below are the principal corporate governance matters considered in 2016.

Culture

At Virgin Money, we are proud of our culture, at the heart of which is our ambition to make 'everyone better off' (EBO). This means delivering good value to our customers, treating colleagues well, making a positive contribution to society, building positive relationships with our partners and delivering sustainable profits to other shareholders.

Part of the Board's responsibilities is to ensure that this strong culture is at the core of everything that Virgin Money does.

Board focus in 2016

The Board has spent considerable time in 2016 discussing the strategic priorities for the business over the next four years.

The Group's focus remains on strong organic growth, maintaining our excellent asset quality and building the Virgin Money Digital Bank. We also decided during the year that it would be prudent to defer our small and medium-sized enterprise (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.

Although the UK economy has performed better than expected in 2016, economic prospects are likely to remain uncertain as a result of geopolitical uncertainty and the UK's exit from the European Union. Against this backdrop, the Board and the Executive have implemented appropriate monitoring and oversight activities and have established contingency plans to mitigate the impact of adverse macro-economic conditions that may result. Further detail can be found in the Risk Management Report.

A key emerging risk relates to the threat of cybercrime. The use of technology has become critical in delivering customer services, and we need to be able to respond effectively to the increased threat of cybercrime associated with digital expansion whilst maintaining pace with industry trends. As such, the Board spent time considering our information technology strategy, including investment in our existing systems, as well as our cyber resilience strategy. The Board will review delivery against both plans in the coming years.

Board composition and succession

During 2016, succession planning and the composition of the Board and its Committees have remained a key focus. I am pleased to be welcoming Eva Eisenschimmel and Darren Pope as Independent Non-Executive Directors. Eva joined the Board on 25 January 2017, and Darren will join the Board on 1 March 2017. Eva and Darren bring extensive banking and financial services experience, helping to ensure the Board is well placed to make the most of the opportunities that exist and meet the challenges of the future.

Marilyn Spearing has notified the Board that she does not intend to seek re-election at our 2017 Annual General Meeting (AGM) and therefore will retire from the Board in

Corporate Governance Report

May. Marilyn leaves with the Board's thanks and best wishes for the future. Norman McLuskie will become Chair of the Remuneration Committee in May 2017, with Darren Pope becoming Chair of the Audit Committee during 2017 following an orderly transition.

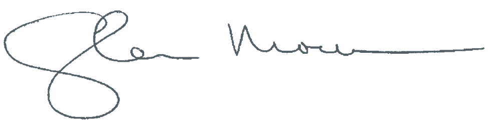
Board effectiveness

I am pleased to report that the changes introduced and implemented from the 2015 Board Effectiveness Evaluation have led to improvements in a number of areas. Details of the 2016 Board Effectiveness Evaluation, together with information about our progress against the 2016 roadmap (recommendations and priorities) are on pages 89 and 90. Board effectiveness will remain a key focus.

Looking ahead

We will implement the actions from the 2016 Board Effectiveness Evaluation, including making further progress on the longer-term Board succession planning. We will also ensure we are ready for the implementation of structural reform (ring-fencing) and other regulatory capital reform.

Finally, I would like to thank the Board, our employees and our shareholders for their support and commitment throughout 2016, and as always, I am open to engagement with our shareholders over the course of 2017.



Glen Moreno
Chairman
27 February 2017

2016 Governance Focus

Corporate Governance Framework

Our corporate governance framework is reviewed annually to ensure it remains effective and appropriate as the business evolves.

Read more on page 82.

Succession planning

Our approach to succession planning ensures the desired mix of skills and experience of Board members now and in the future. The 2016 Board composition review has led to two new appointments onto the Board.

Read more on pages 94 and 95.

Risk Management and viability statement

The Board, via the Board Risk Committee, is responsible for the Group's risk management and internal controls and for reviewing their effectiveness. The Board, in conjunction with the Audit Committee, is also responsible for assessing the going concern and longer term viability of the Company and the Group.

Read more on page 98.

Audit

The Board, via the Audit Committee, oversees internal and external audit processes, including the relationship with the external auditors.

Read more on page 100.

Remuneration

The Board ensures, via the Remuneration Committee, that there is a clear link between remuneration and the delivery of the Group's strategy.

Read more in the Directors' Remuneration Report on pages 105 to 125.

Diversity

Diversity and inclusion is a strategic priority for Virgin Money. The Board recognises the importance of diversity in enabling Board effectiveness.

Read more on the Group's approach to diversity and inclusion on page 37 of the Strategic Report and the Board's performance against the Board Diversity Policy on page 96.

The Board, its members and additional support

Purpose and responsibilities

The Board is collectively responsible for the long-term success of Virgin Money. It achieves this by setting the strategy and overseeing delivery against it. It establishes the culture, values and standards of the Group, effectively managing risk, monitoring financial performance and reporting and ensuring that appropriate and effective succession planning arrangements and remuneration policies are in place.

The role of the Directors

Set out below are the key roles and responsibilities of the Chairman and other Board members. There is a clear division of responsibility at the head of the Group. The Chairman has overall responsibility for the leadership of the Board while the Chief Executive manages and leads the business.

Chairman	Chief Executive
Glen Moreno was appointed Non-Executive Chairman in May 2015. The Chairman: – has overall responsibility for the leadership of the Board and promotion of the highest standards of corporate governance; – has responsibility for leading the development of the Group's culture as a whole; – sets the Board's agenda to ensure that the Board devotes its time and attention to the right matters; – builds an effective and complementary Board; – plans succession and Board appointments in conjunction with the Nomination Committee; and – ensures effective communication with shareholders.	Jayne-Anne Gadhia was appointed Chief Executive in March 2007. The Chief Executive: – manages the Group on a day-to-day basis in accordance with the strategy and long-term objectives approved by the Board; – makes decisions on all areas affecting the operations, performance and strategy of the Group's business (with the exception of those matters reserved to the Board); – provides leadership and direction to senior management; – co-ordinates all activities to implement the Group's strategy and to manage the business in accordance with the risk appetite set by the Board; and – has responsibility for overseeing the adoption of the Group's culture in the day-to-day management of the Group.
Non-Executive Directors	**Senior Independent Director**
The Non-Executive Directors are listed on pages 75 and 76. Non-Executive Directors: – challenge constructively; – help to develop and set the Group's strategy; – participate actively in the decision-making process of the Board; – scrutinise the performance of Management in meeting agreed goals and objectives; – provide entrepreneurial leadership of the Group within a framework of prudent and effective controls; – satisfy themselves as to the integrity of financial information and systems of risk management; and – determine appropriate levels of remuneration of the Executive Director via the Remuneration Committee.	Norman McLuskie was appointed Senior Independent Director (SID) in January 2010. The SID: – helps resolve any shareholder concerns; – acts as a sounding board for the Chairman and Chief Executive on Board and shareholder matters; – is a conduit, as required, for the views of the other Directors on the performance of the Chairman; – is available to shareholders if they have concerns that contact through the normal channels has failed to resolve or for which such contact is inappropriate; – if required, attends meetings with major shareholders and financial analysts to understand issues and concerns; and – conducts the Chairman's annual performance appraisal.

Corporate Governance Report

The role of the Chief Financial Officer (CFO)

The CFO is responsible for the financial management of the Group, and the day-to-day management of the balance sheet. The CFO ensures that the Group meets statutory reporting obligations, delivers regulatory capital and liquidity requirements and identifies opportunities to improve the commercial performance of the business, within the agreed risk appetite.

In January 2016, the Group announced the appointment of Peter Bole as CFO. Peter joined Virgin Money in November 2016, and after a period of transition was appointed as CFO on 1 January 2017, following the retirement of Dave Dyer.

The role of the Company Secretary

The Company Secretary is accountable to the Board. The Company Secretary provides practical support to the Directors, both as individuals and as a collective, with particular emphasis on supporting the Non-Executive Directors in maintaining appropriate standards of probity and corporate governance. The Company Secretary is also responsible for facilitating communications with shareholders, as appropriate, and ensuring due regard is paid to their interests. All Directors, including Non-Executive Directors, have access to the advice and services of the Company Secretary in relation to the discharge of their duties.

Access to advice

The Group also provides access, at its own expense, to the services of independent professional advisers in order to assist the Directors in their roles whenever this is deemed necessary.

Authority and delegation

Corporate governance framework

The Group's corporate governance framework comprises the Board authority and the delegated executive authority.

Board authority

The Board authority sets out the matters reserved to the Board. This includes decisions concerning the strategy and long-term objectives of the Group, capital and financial budgets, significant contracts and transactions and various statutory and regulatory approvals. The approval of remuneration policy, risk appetite and risk management framework are also matters reserved to the Board. The Board authority delegates responsibility for day-to-day management of the business to the Chief Executive and sets out the basis for delegation of authorities from the Board to Board Committees.

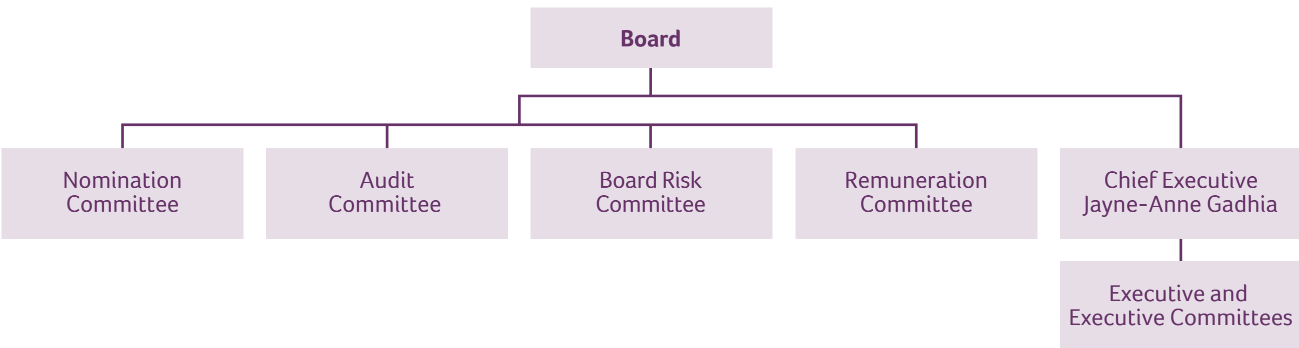
Further details of Board reserved matters can be found at virginmoney.com/virgin/investor-relations.

Delegated executive authority

The Chief Executive delegates aspects of her own authority, as permitted under the corporate governance framework, to members of the Executive.

As well as regularly discussing business performance, the Executive Committees meet monthly to consider key business matters. Certain Executive Committees meet more frequently as required.

The Internal Audit Director and the Company Secretary attend all Executive Committee meetings to ensure that there is appropriate internal audit oversight and that the highest standards of corporate governance are maintained.



The role of the Board Committees

The Board is supported by its Committees which make recommendations to the Board on matters delegated to them, in particular in relation to internal control, risk management, financial reporting, governance, succession planning and remuneration matters. The current Board Committees are set out on page 82.

Each Board Committee, other than the Nomination Committee, comprises Independent Non-Executive Directors only. The Nomination Committee also comprises the Chairman and a Non-Executive Director nominated by the controlling shareholder, the Virgin Group (the Virgin Group Nominee Director).

Each Board Committee Chair reports to the Board on the activities of the Committee. Reports from the Board Committees can be found on pages 93 to 104, and information about the work of the Remuneration Committee is included in the Directors' Remuneration Report on pages 105 to 125. The terms of reference for each of the Committees can be found on the website (virginmoney.com/virgin/investor-relations).

Subsidiary governance

The Group's banking business of residential mortgages, savings and credit cards is conducted through Virgin Money plc (the Bank) which is regulated by the Financial Conduct Authority (FCA) and Prudential Regulation Authority (PRA).

The composition of the Board of the Bank replicates that of the Company, save that the two Non-Independent Non-Executive Directors are not members. The Chief Risk Officer (CRO) and CFO (from 30 January 2017) are additional Executive Directors of the Bank.

The main Board Committees are replicated at the Bank level with the exception of the Nomination and Remuneration Committees that operate at the main Board level only and consider appointments, succession and remuneration matters on a Group-wide basis.

The Group's financial services business of investments, insurance and pensions is conducted through Virgin Money Unit Trust Managers Limited (VMUTM) and Virgin Money Personal Financial Service Limited (VMPFS). VMUTM and VMPFS are both regulated by the FCA.

During 2016, a review of the governance arrangements of VMUTM was undertaken, leading to a number of enhancements including the introduction of Group Non-Executive Directors onto the VMUTM Board to bring further depth and breadth of experience of investment management.

Virgin Money Giving Limited (VMG) is a not-for-profit company within the Group and the vehicle for Virgin Money's charity fundraising and donations website. VMG has two Independent Non-Executive Directors on its board.

Board composition

Board size

The Board is of sufficient size and composition to reflect a broad range of views and perspectives whilst allowing all Directors to participate effectively in meetings.

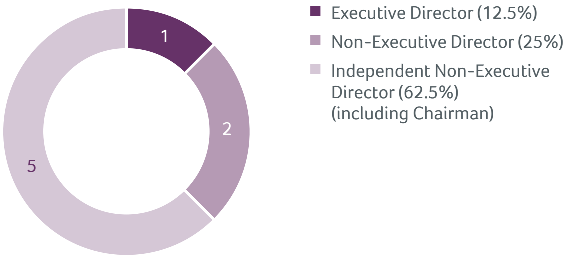
The number and quality of Independent Non-Executive Directors on the Board facilitates effective challenge to the Executive. As at 31 December 2016, the Board comprised of one Executive Director, six Non-Executive Directors (four of whom are considered to be independent) and the Chairman, who was independent on appointment.

Further details on independence and succession planning are set out in the Nomination Committee Report at pages 94 and 95.

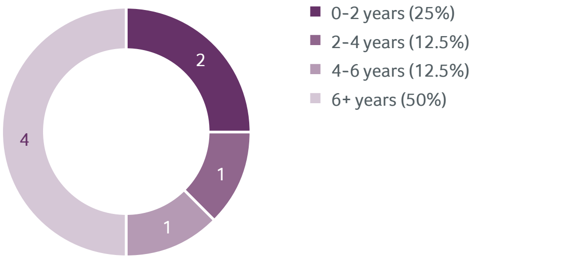
Corporate Governance Report

Board composition as at 31 December 2016

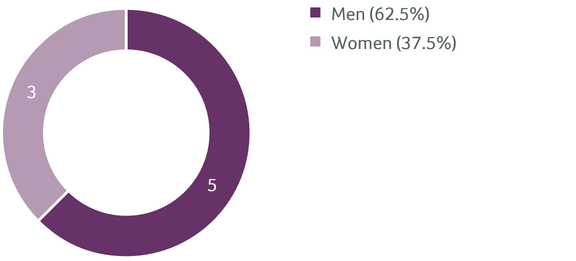
Board composition by role



Board composition by tenure



Board composition by gender



This Board composition data will change when the 2017 Board changes referenced below take effect.

Board appointments

There were no changes to the Board's membership in 2016.

Board and Committee changes in 2017

During 2016, the Nomination Committee continued to keep under review succession planning and the effectiveness of the Board and its Committees.

The following changes to the Board and Committees have been or are to be made during 2017:

> Eva Eisenschimmel joined the Board as an Independent Non-Executive Director on 25 January 2017 and was appointed as a member of the Audit, Board Risk, Remuneration and Nomination Committees;

> Darren Pope will join the Board on 1 March 2017 and will become a member of the Audit, Board Risk, Remuneration and Nomination Committees;

> Marilyn Spearing has notified the Board that she does not intend to seek re-election at the 2017 AGM. Marilyn is currently Chair of the Remuneration Committee and a member of the Audit, Board Risk and Nomination Committees;

> Norman McLuskie, SID, will succeed Marilyn as Chair of the Remuneration Committee, effective in May 2017, on her retirement from the Board; and

> Darren Pope will succeed Norman McLuskie as Chair of the Audit Committee during 2017, following a period of transition.

More information on the Board composition and the appointment process is set out in the Nomination Committee Report on pages 93 to 96.

Executive Director service agreement and Non-Executive Director terms of appointment

The Chairman and Non-Executive Directors are appointed for a specified term and are subject to annual re-election by shareholders. Non-Executive Directors may have their appointment terminated in accordance with the Articles of Association of the Company (Articles), their letters of appointment or statute at any time without compensation.

The Chief Executive is able to terminate her appointment by giving twelve months' notice. The Chairman has a six month notice period. The Non-Executive Directors' letters of appointment, and the service agreement of the Executive Director, are available for inspection by shareholders at the Company's registered office.

Election and re-election

All Directors appointed since the 2016 AGM will stand for election at the 2017 AGM. All other Directors will retire and those wishing to serve again will stand for re-election by shareholders at the 2017 AGM. Marilyn Spearing has indicated that she will not seek re-election.

The Virgin Group will be entitled to vote on the ordinary resolutions at the AGM for the re-election of the Independent Non-Executive Directors. However, for the purposes of the Listing Rules, each such resolution will also require approval by a majority of the votes cast by the Company's independent shareholders (being the shareholders excluding the Virgin Group) in order to be valid. The outcome of both of these vote counts will be announced following the 2017 AGM.

Directors' and Officers' liability insurance

Information on the Group's insurance cover and indemnity arrangements for Directors is provided on page 127 of the Directors' Report.

Diversity policy

Diversity and inclusion is a strategic priority for the Group. The Board is clear that diversity helps to improve the quality of decision making and is committed to continuing to increase the diversity of the Board.

Information on the Group's approach to diversity and inclusion, including its consideration in Board appointments, is set out in the Nomination Committee Report on pages 93 to 96, and the Strategic Report on pages 36 and 37.

Conflicts of interest

The Directors must avoid any situation which might give rise to a conflict between their personal interests and those of the Group. Prior to appointment, potential conflicts of interest are disclosed and assessed to ensure that there are no matters that would prevent the incoming Director from taking the appointment.

Directors are responsible for notifying the Chairman and the Company Secretary as soon as they become aware of any actual or potential conflicts.

In addition, changes to the commitments of all Directors are reported to the Board and a register of potential conflicts is regularly reviewed by the Chairman to ensure the authorisation remains appropriate.

If any potential conflict arises, the relevant Director will excuse him/herself from any meeting or discussions where the potential conflict is considered, and all relevant material will be restricted. All potential conflicts authorised by the Board are recorded in a register of Directors' Conflicts of Interest.

There were no potential conflicts arising in 2016 which required a relevant Director to excuse him/herself from any meeting or discussion on such matter.

Time commitments

Each Non-Executive Director is required to devote such time as is necessary for the effective discharge of their duties to a minimum of 36 days per year and may be expected to relinquish other appointments to ensure that they can meet the time commitments of their role.

During 2016 the Chairman became an Independent Non-Executive Director and Chair of the Audit Committee of Prisa (Promotora de Informacional SA). The Chairman's role with the Group remains his primary role, and he limits his other commitments to ensure he can spend as much time as the role requires.

Executive Directors must seek authorisation from the Board before accepting any additional responsibilities or external appointments, and are restricted to holding no more than two Non-Executive Director roles (excluding roles with bodies not for commercial purposes). At 31 December 2016, the Executive Director was compliant with this requirement and continues to be at the date of this report.

Corporate Governance Report

Key matters considered by the Board

The following table provides an overview of the key matters considered by the Board in 2016:

Financial	Strategy and customer focus	Regulatory
– Approval of Budget for 2017 – Approval of results and analyst presentations – Approval of dividends – Approval of the Internal Capital Adequacy Assessment Process – Approval of funding and capital issuances	– Review of progress against the Group's strategy – Approval of three year strategic and funding plans – Consideration of potential acquisition opportunities and strategic initiatives – Monitoring of conduct, culture and values – Overseeing digital transformation, including approval of the partnership with 10x Future Technologies	Overseeing the implementation of measures to ensure compliance with: – Ring-fencing – Recovery and resolution – Senior Managers & Certification Regime – MREL and other regulatory changes
Risk management	**Governance**	**Investors**
– Approval of the Group's risk appetite and risk management framework – Review of the Group's aggregate risk exposures, risk/return and emerging risks – Review of internal control systems – Monitoring cyber resilience – Approval of stress test results	– Review of Board and Committee structure and composition – Review of the corporate governance framework – Overseeing Board and Executive succession planning and appointment – Overseeing Board Effectiveness and Chairman's performance reviews	– Receiving Investor Relations updates – Oversight of debt and equity investor reporting – Receiving AGM briefing and approval of AGM Notice

Training

Board induction

All Directors are expected to make an informed contribution based on an understanding of the Group's business model and the key challenges it faces. The Chairman ensures that all Directors receive a full induction on joining the Board, facilitated by the Company Secretary and comprising:

> a corporate induction, including an introduction to the Board and a detailed overview of the Group, its strategy, the competitive environment, operational and governance structures and main business activities and products;

> training on the roles and responsibilities of a Director, including statutory duties and responsibilities as a Senior Manager and/or an FCA approved person; and

> a detailed induction programme across Risk and Finance focusing on: risk appetite and the Group's risk profile, culture and framework, compliance and conduct risk, financial analysis and controls, capital, stress testing, liquidity, recovery and resolution planning and regulatory developments.

The induction is tailored to the individual needs of the Director with regard to their specific role and experience to date. This takes the form of reading materials, meetings with members of the Board and the Executive and site visits.

Professional development and training

The Board receives regular training and information sessions on current or emerging issues. The Company Secretary maintains a training and development log for each Director.

The Chairman is responsible for the training and professional development of Board members. The training programme delivered throughout the year comprises both formal and informal sessions, and tailored sessions on specific business topics are a key component of the programme.

Site visits also play an important role by helping to connect Directors with the business, our colleagues, and our customers' needs. Directors are also invited to attend courses, management meetings and one-to-one meetings with key Executives.

Board agenda and attendance

Attendance at meetings

In 2016, a total of eleven Board meetings were held (nine were scheduled and two were ad-hoc meetings). Where a Director is unable to attend a meeting, he/she has the opportunity to review any papers and provide comments to the Chairman, who then endeavours to represent the Director's views at the meeting.

The attendance of Directors at Board and Committee meetings during the year is set out below. The number of meetings held during the period that the Director held office is shown in brackets. The Chairman attends all Committee meetings, at the invitation of the Committee Chairs.

Virgin Money Holdings (UK) plc	Board meetings[1]	Remuneration Committee	Nomination Committee	Board Risk Committee	Audit Committee
Current Directors who served during 2016					
Glen Moreno	11 (11)	–	7 (7)	–	–
Norman McLuskie	11 (11)	6 (6)	7 (7)	7 (7)	7 (7)
Colin Keogh	11 (11)	–	7 (7)	7 (7)	7 (7)
Marilyn Spearing	11 (11)	6 (6)	7 (7)	7 (7)	7 (7)
Geeta Gopalan	11 (11)	6 (6)	7 (7)	7 (7)	7 (7)
Gordon McCallum	10 (11)[2]	–	6 (7)[2]	–	–
Patrick McCall	11 (11)	–	–	–	–
Jayne-Anne Gadhia CBE	11 (11)	–	–	–	–

1 The number of Board meetings includes two ad hoc meetings held in June. The first in relation to a potential strategic opportunity and the second in relation to the UK's exit from the European Union.

2 Conflict with external appointment.

Corporate Governance Report

Setting the Board agenda

The Chairman is responsible for setting the Board agenda. Prior to each Board meeting, the Chairman reviews the agenda and time allocation with the Company Secretary and discusses key items of business with the Chief Executive. Board agendas are structured to allow adequate time for discussion, in particular of strategic matters.

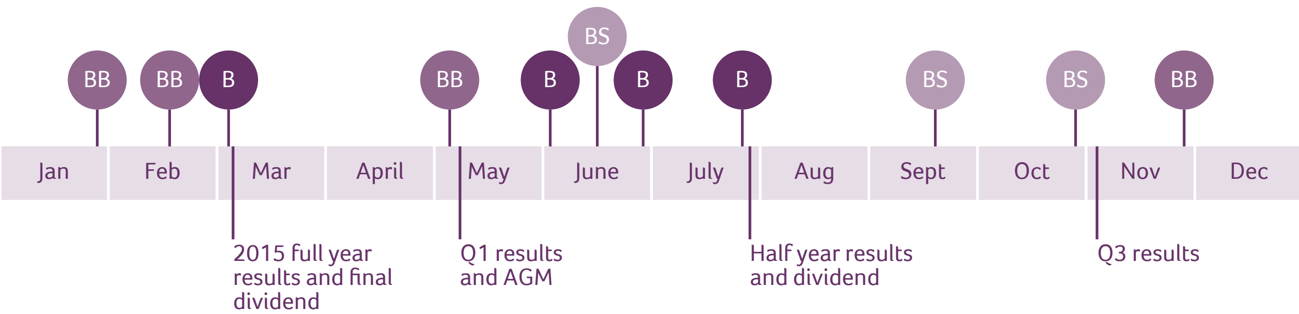
The Chairman engages with the Independent Non-Executive Directors and the Chief Executive before each scheduled meeting to discuss any matters they wish to raise.

Effective use of the Board's time

The Board agenda was re-designed in 2016 following a key recommendation of the 2015 Board Effectiveness Evaluation. The changes make more effective use of the Board's time by prioritising critical issues. In addition a variety of Board forums, including Chief Executive/Chairman/Independent Non-Executive Director only meetings and Non-Executive Director only meetings, were held during 2016.

Board meetings and activity in 2016

The following timeline provides an overview of the Board meetings and activity in 2016:



Key

Board meeting — B

Board meeting and tailored briefing — BB

Board meeting and strategy discussion — BS

Tailored briefings

> Credit cards business model
> Cyber resilience
> Internal Capital Adequacy Assessment Process (ICAAP)
> Recovery and resolution plans
> IFRS9

Site visits

> Mortgage Lab
> Mortgage Operations
> Contact Centre
> Security Operations

Board Strategy Review

During 2016 the Board spent considerable time discussing the Group's strategy. The strategic review included the four year financial and funding plans, the 2017 budget and the external environment (including the potential impact of the UK's exit from the EU).

The following matters were all discussed in detail: risk oversight and appetite, with an increased focus on cyber resilience; the impact of the macro and regulatory environment on base rates and our capital; the need to continue managing costs tightly whilst maintaining appropriate levels of investment; growing our financial services business; the development of the Virgin Money Digital Bank, and potential acquisition opportunities. The Board also spent time considering the updates received from the Board Committees on the Group's strategy.

The Board's key focus during these discussions was to ensure that Virgin Money's strategy supports its ambition to make 'everyone better off'.

Cyber resilience

It is Virgin Money's determination to be consistently one of the safest banks in the UK. The Board plays an important role overseeing the Group's cyber resilience approach and the level of investment into cyber security, and has appointed Geeta Gopalan as the accountable Non-Executive Director responsible for leading on cyber security at Board level.

The Board provides robust challenge and scrutiny to ensure that the Group is adequately mitigating the threats it faces, and Virgin Money's cyber resilience strategy is reviewed by the Board on an annual basis with specific detailed reporting on progress provided quarterly. The review takes into account the latest cyber threat intelligence assessment. This ensures that the strategy remains fit for purpose to combat the potential cyber threats the Group may face, as well as remaining aligned to the overall business objectives of the Group.

Board effectiveness

Skills and experience of the Board

As illustrated by the Board biographies on pages 75 and 76, the Non-Executive Directors on our Board have a broad range of skills and experience.

Annual Board Effectiveness Evaluation

In 2015 the Board engaged an external facilitator, Dr Tracy Long CBE of Boardroom Review Limited, to undertake an independent review of the Board's current strengths and future challenges. The key recommendations, and priorities arising, were agreed by the Board in January 2016, and set out in the 2015 Annual Report and Accounts. The next external evaluation is not due until 2018, but in the intervening years it is usual for the annual evaluation to be led by the Chairman, with support from the Company Secretary.

A summary of the evaluation methodology and process followed for the 2016 Board Effectiveness Evaluation and key findings and recommendations are set out below.

Board Evaluation

The Chairman, with support from the Company Secretary, undertook a review of Board governance, encompassing the workings of the combined Company and Bank Boards during 2016.

The scope of the review was predominantly focused on assessing progress against the key recommendations and priorities identified in the evaluation roadmap. The output from the Board evaluation, as summarised below, was considered by the Nomination Committee in February 2017, and reflected in the updated roadmap for 2017.

Board Committee Evaluation

The review of Board Committee performance included an assessment of whether each Committee had met its required responsibilities; and a qualitative review seeking views on the effective running of each Committee. Feedback and key themes were discussed at the respective Committee meetings, and the key recommendations for 2017 were agreed.

Director annual reviews

The Chairman met with each Non-Executive Director in early 2017 to discuss their contributions and effectiveness, and reported to the Nomination Committee on the output. The Chairman also conducted the Chief Executive's annual performance appraisal. This activity supported the annual review of Board composition and recommendations on Director election/re-election to be put to the shareholders at the 2017 AGM. In parallel, the SID assessed the Chairman's performance, seeking input from the other Directors and updated the Nomination Committee in early 2017.

Corporate Governance Report

Key conclusions from 2016 Board Effectiveness Evaluation: Progress against the 2016 Roadmap (priorities/ recommendations)

A need to balance strategic, operational and governance items and prioritise critical areas:

- Better balance achieved in 2016 with appropriate and proportionate Board focus on strategic, risk and control, remuneration and governance matters.
- Significant Board interaction and engagement on strategy, threats and opportunities and risk appetite.
- The forward agendas will continue to be developed collaboratively with consultation between the Chairman, Chief Executive, Committee Chairs and Company Secretary.

The importance of the Board as a team

- A well balanced Board in terms of skills, experience and independence, strengthened further by the two new Board appointments.
- Positive progress made in creating a strong Board culture with mutual trust and respect, open communications, committed contribution, challenge and support by all members. This will remain an ongoing priority for the Chairman.
- The variety of Board forums, introduced in the 2016 Board schedule, have worked well.

Greater clarity and visibility on Board succession and appointments

- Considerable focus and progress made in 2016 on Board composition, with the medium-term succession plans aligned to the current and future strategy.
- Senior Board Leadership and succession planning will remain a key focus for 2017 and beyond, led by the Chairman in conjunction with the SID.

Deeper focus on the external landscape (market environment, competition, regulatory agenda)

- Significant progress made on increasing Board time and focus on the external environment.
- Increased focus in the risk agenda on scenario planning, stress testing and crisis management, supporting both strategic planning process and ICAAP.
- Concluded a series of Board briefings on topics including cards business model, resolution planning, cyber resilience and areas of regulatory and accounting change.
- Increased 'line one' reporting and representation at Board and Committees enhancing further the Board's assessment of risk and prioritisation of critical issues.

Continued focus on leadership and ensuring that talent development and succession planning are aligned with the current and future strategy

- Ongoing review of Executive talent, capability and succession plans to ensure alignment to current and future strategy. Further strengthening of the Executive in 2016; detail on key appointments is set out on page 84.
- Greater visibility requested by the Board in 2017 on leadership and talent development programmes to ensure the Group continues to create opportunities for current and future leaders.

Board basics, agenda setting and quality of information

- Continued high quality of Board information, with transparent information flow.
- Increased efficiency in Board processes and meetings.
- Comprehensive and formal written reporting to Board on Committee business.

Further information regarding the 2016 Board Effectiveness Evaluation is set out in the Committee reports on pages 93 to 104.

Shareholder engagement and relationships

The Board recognises the need for a programme of engagement which offers all shareholders opportunities to receive information directly and enable them to share their views with the Board.

Please see page 272 for details of the breakdown of the Company's share register.

Controlling shareholder

During 2016 the Group's 'controlling shareholder' was Virgin Group Holdings Limited (Virgin Group). Virgin Money is party to a Relationship Agreement with Virgin Group.

The principal purpose of the Relationship Agreement is to ensure that the Group is capable of carrying on its business independently of its controlling shareholder. The Relationship Agreement provides for the appointment of a nominee director by Virgin Group through whom the Chairman and other Non-Executive Directors are kept up to date during the year with the views of the Virgin Group.

The Chairman and Chief Executive have an ongoing dialogue with the Virgin Group Nominee Director throughout the course of the year.

So far as the Company is aware, the independence provisions contained in the Relationship Agreement have been complied with by the Virgin Group (and its associates), and the Company has complied with the terms of the Relationship Agreement.

The Group was previously party to a Relationship Agreement with WLR. All terms of this agreement ceased to apply when WLR divested its remaining shareholding on 21 November 2016.

Investor relations

The Investor Relations Director has primary responsibility for co-ordinating day-to-day communications with existing shareholders, potential investors and analysts. These communications are effected through a combination of briefings to analysts and institutional investors, individual discussions with shareholders and potential investors, regulatory announcements, press releases and updates on the Group's website.

The Investor Relations Director reports regularly to the Board to ensure it is informed of significant market developments, share price performance and changes in the shareholder base.

Investor contact

In 2016, the Group has engaged in active discussions with corporate shareholders and potential investors on an individual basis, through investor presentations and attendance at investor conferences. The Group will maintain an active dialogue with shareholders, potential investors and analysts to discuss the performance of the Group, its strategy and new developments in 2017.

Additionally, the Group engaged with institutional investors or their representatives on governance and remuneration matters in advance of the 2016 AGM and intends to do so in advance of the 2017 AGM.

The Group has an Investor Relations section on its website which contains information on all disclosures made to the market, including results presentations, annual reports, interim results and trading statements.

Shareholders, potential investors and analysts are able to ask questions about the Group through the Investor Relations function or the Group Secretariat.

The SID is also available to meet with shareholders, and may be contacted through the Company Secretary at Jubilee House, Gosforth, Newcastle upon Tyne, NE3 4PL.

Company Secretary and retail shareholders

The Company Secretary oversees communications with individual retail investors.

The Group's registrar, Equiniti Limited, provides a dedicated shareholder online and telephone dealing service to assist shareholders in managing their investments. Further detail can be found on page 272.

During the year the Group has made specific contact with shareholders in relation to the interim and final dividends, and the 2016 AGM.

The Annual General Meeting

The AGM is the principal opportunity for shareholders to engage directly with the Board. It is commonly used by retail shareholders as an opportunity to share views and raise questions during the meeting, but afterwards there is an opportunity to meet the Directors and members of the Executive.

The Company's AGM was held in London in May 2016 and in excess of 77% of total voting rights were exercised by shareholders. All of the resolutions put to shareholders were passed with votes in favour representing over 95% of the votes cast, save for the resolution to approve the Directors' Remuneration Policy in respect of which votes in favour represented over 91% of the votes cast.

All Board members attended the 2016 AGM and those seeking (re-)election plan to attend the 2017 AGM. All shareholders will be invited to attend the 2017 AGM which will be held on 3 May 2017 at the London offices of Allen & Overy LLP. Information on the business to be considered at the AGM will be set out in the Notice of Meeting which will be issued to shareholders, together with any related documentation, in due course.

Internal control

The Board is responsible for the Group's system of internal control. The system is designed to facilitate effective and efficient operations and to ensure the quality of internal and external reporting and compliance with applicable laws and regulations.

The Group uses a "Three Lines of Defence" model. Further detail can be found on page 133.

The Directors and Executive are committed to maintaining a robust control framework as the foundation for the delivery of effective risk management. The Directors acknowledge their responsibilities in relation to the Group's systems of risk management and internal control and for reviewing their effectiveness and conducted such a review during the year. In addition, in 2015 Deloitte LLP (Deloitte) produced an External Quality Assurance Review (EQAR) report in relation to the Group's Internal Audit function and significant progress has been made during 2016 in respect of the report's findings.

Corporate Governance Report

In establishing and reviewing the system of internal control, the Directors consider the nature and extent of the risks facing the Group, the likelihood of a risk event occurring and the potential financial impact of failure. A system of internal control is designed to manage, rather than eliminate, the risk of failure to achieve business objectives. It therefore can provide only reasonable but not absolute assurance against the risk of material mis-statement or loss.

The policies supporting the Group's risk management framework define minimum standards for controls for all material risk classes.

Business areas and support functions assess on a quarterly basis the internal controls in place to address all material risk exposures across all risk classes. This review considers the effectiveness of these material controls, including financial, operational and compliance controls.

Further information on risk control and management is set out in the Risk Management Report on pages 132 to 192.

Statement of compliance

UK Corporate Governance Code

The 2014 Code applied to the Group's 2016 financial year. The Directors have considered the contents and recommendations of the Code and confirm that throughout the year the Group has applied the main principles and complied with the provisions of the Code.

The Group intends to comply with the 2016 Code when it comes into force, and will report on compliance in the Group's 2017 Annual Report and Accounts.

The British Bankers' Association Code for Financial Reporting Disclosure

The Group has adopted the British Bankers' Association Code for Financial Reporting Disclosure and its 2016 Annual Report and Accounts has been prepared in compliance with its principles.

Committee reports

The following pages contain reports from each of the Board's Committees with information about the work of the Remuneration Committee included in the Directors' Remuneration Report.

Nomination Committee Report

"We continue to work hard on the composition of the Board to ensure the desired mix of skills and experience of Board members both now and in the future"

Glen Moreno
Chair, Nomination Committee

Membership and meetings

	Independent	Meetings attended (held) in 2016[1]
Committee Chair		
Glen Moreno	Yes (on appointment)	7 (7)
Committee members		
Norman McLuskie	Yes	(7)(7)
Colin Keogh	Yes	(7)(7)
Marilyn Spearing	Yes	(7)(7)
Geeta Gopalan	Yes	(7)(7)
Gordon McCallum	No	(6)(7)[2]
Eva Eisenschimmel	Yes	N/A[3]

1 Number of meetings held during the period the member held office.
2 Conflict with an external appointment.
3 Eva Eisenschimmel joined the Committee on 25 January 2017.

Chairman's overview

During 2016, succession planning and the composition of the Board and its Committees remained a key focus. Key highlights of the Nomination Committee's activities included:

- the appointment by the Board, on recommendation of the Committee, of Eva Eisenschimmel and Darren Pope as Independent Non-Executive Directors;
- approval of Norman McLuskie as new Chair of the Remuneration Committee, effective in May 2017, upon the retirement from the Board of Marilyn Spearing at the 2017 AGM;
- approval of Darren Pope as Chair of the Audit Committee, to take effect in 2017, following an orderly transition from Norman McLuskie;
- the appointment by the Bank Board in January 2017 of Peter Bole as an Executive Director; and
- consideration of Executive succession planning and overseeing the further strengthening of the Executive.

Further details on the new Board appointments and the Group's approach to Board and Executive succession planning can be found on pages 94 and 95.

The Committee also considered progress against the recommendations and priorities from the 2015 Board Effectiveness Evaluation. I am pleased to report that the changes introduced and actions arising from the review have led to improvements in a number of areas and other Board members find the annual review process extremely valuable and insightful. Further detail can be found on pages 89 and 90.

Committee purpose and responsibilities

The purpose of the Committee is to keep the Board's composition, skills, experience, knowledge, independence and succession arrangements under review, and to review the succession plans for the Executive. The Committee makes recommendations to the Board to ensure that the Group's arrangements are consistent with good corporate governance standards. The Committee's role also extends to appointments to the Boards of the Group's material subsidiaries, including the Bank.

The key activities of the Committee during the year are set out below. Full details of the Committee's responsibilities are set out in the Committee terms of reference and can be found on the website at virginmoney.com/virgin/investor-relations.

During the year the Committee met its key objectives and carried out its responsibilities effectively, as confirmed by the annual effectiveness review.

Corporate Governance Report

Nomination Committee Report

Committee composition, skills and experience

To ensure a broad representation of independent views, including perspectives from each of the Committees, membership of the Committee comprises the Chairman, all Independent Non-Executive Directors and the Virgin Group Nominee Director. The Chief Executive, the remaining non-Independent Non-Executive Director (Virgin NED) and, if required, the People Director attend meetings as appropriate.

How the Nomination Committee spent its time in 2016

Board and Executive succession

Approach

The Committee recognises that good succession planning contributes to the delivery of the Group's strategy by ensuring the desired mix of skills and experience of Board members now and in the future. Just as importantly, internal talent needs to be recognised and nurtured within Executive and Management levels across the Group. The Group's annual talent and capability reviews and 'Future Business Leaders' Programme allows the Group to identify talent and have the right succession plans and development programmes in place to ensure the Group creates opportunities for current and future leaders.

Process

The Committee supports the Chairman in keeping the composition of the Board and its Committees under regular review and in leading the appointment process for nominations to the Board.

Following the 2015 Board Effectiveness Evaluation, the Chairman undertook a review of Board tenure, succession planning and an assessment of the collective technical and governance skills required from the Non-Executive Directors to support the future business strategy. Two additional Independent Non-Executive Directors were appointed to the Board as a result of this review. Further detail is set out on page 95.

The Chairman is responsible for developing a succession plan in relation to the Chief Executive, who is in turn primarily responsible for developing and maintaining a succession plan for key leadership positions in the Executive. The Committee considers the adequacy of such succession arrangements. Details of the appointments to the Board in 2017 are set out on page 84.

To support the continued development of our business, the Executive was further strengthened by the following appointments:

- Hugh Chater joined the business as Chief Commercial Officer in June 2016;
- Tim Arthur joined the business as Creative Director in September 2016; and
- Peter Bole joined the business in November and became CFO and an Executive Director of the Bank Board in January 2017.

Details of their experience is set out on pages 77 and 78.

The Board is well placed to meet the challenges and opportunities ahead, and the Committee and the Board are satisfied that the Executive is staffed appropriately. The Committee will continue to ensure that succession planning remains under review.

Board succession in practice

In late 2015, as a result of the Board succession planning process referred to on page 94, the Chairman identified the need for two additional Non-Executive Directors.

In early 2016 the search for a Non-Executive Director was commenced. Ridgeway Partners (Ridgeway) (who have no other connection with the Group) was appointed to support the search. The specification for the role was agreed by the Chairman, in conjunction with the Chief Executive and Committee members. Key attributes for the position included extensive and recent banking or financial services experience, marketing, technology and digital expertise.

Ridgeway analysed the market for possible candidates with a breath of diversity, experience and background with candidates considered from North America, Asia and other overseas locations as well as the UK. During the second half of 2016 a short list of potential candidates met with the Chairman and Chief Executive, following which Eva Eisenschimmel was identified by the Committee as the preferred candidate.

In parallel, a specification for the second Non-Executive Director position was agreed with a focus on strong retail banking experience and financial technical strength, preferably a former Chief Financial Officer (CFO), to support Audit Committee Chair succession. Darren Pope was identified by the Chairman and Chief Executive as a potential candidate given his strong fit to the specification (as former CFO of TSB Bank Group). Ridgeway was appointed to undertake full due diligence, independent benchmarking and referencing on Darren Pope.

Both individuals then met with Committee members and certain members of the Executive. Following this comprehensive process which was overseen by the Committee, Eva Eisenschimmel and Darren Pope were appointed by the Board in December 2016 as Non-Executive Directors. Details of their experience is set out on page 76.

Effectiveness

In January 2016, the Committee reviewed the findings of the 2015 Board Effectiveness Evaluation and agreed the roadmap (recommendations and priorities) for 2016. Progress against the roadmap was reviewed during the year and the Chairman will meet with Dr Tracy Long CBE, the 2015 external facilitator, in 2017 to discuss progress.

For the 2016 Board Effectiveness Evaluation, the Committee made recommendations to the Board on the process and timing of the review. The key conclusions of the review reported to the Committee in February 2017 were that the Board and Committees continue to operate effectively, although there are opportunities to further improve effectiveness. Full details of the evaluation and key recommendations are set out on pages 89 and 90. The Committee will monitor the Board's progress against the agreed roadmap in 2017.

Corporate governance

The Committee oversaw the implementation of the responsibilities map and individual Board statements of responsibility, required under the Senior Managers and Certification Regime (SMCR).

Independence and time commitments

The independence of the Non-Executive Directors, and the election or re-election of Directors and their suitability to continue in office, were reviewed. A rigorous independence review was undertaken in respect of Norman McLuskie and Colin Keogh, given both are now in the seventh year of their tenure.

In assessing independence, the Committee did not rely solely on the Code criteria but considered whether the Non-Executive Director was demonstrably independent and free of relationships and other circumstances that could affect their judgment. It did this with reference to the individual performance and conduct in reaching decisions. It also took account of any relationships that had been disclosed to the Board. Based on its assessment for 2016, the Committee is satisfied that, throughout the year, Colin Keogh, Norman McLuskie, Marilyn Spearing and Geeta Gopalan remained independent as to both character and judgment.

The Virgin Group Nominee Director is not considered to be independent due to his relationship with the Group's controlling shareholder, Virgin Group. The Virgin NED is also not considered to be independent since he was appointed to the Board as the representative director of Virgin Enterprises Limited (VEL) pursuant to the Virgin Money Trade Mark Licence Agreement.

Corporate Governance Report

Nomination Committee Report

The Committee reviewed the roles, including capabilities and time commitments, of the Chairman, SID, Non-Executive Directors and Chief Executive, considering amongst other matters, the impact of limits placed by CRD IV on the number of directorships that can be held by the Directors, and found them to be appropriate.

The Committee is recommending the re-election of all Directors who served during 2016 and who wish to continue to serve, together with the election of Eva Eisenschimmel and Darren Pope, to shareholders at the 2017 AGM. Marilyn Spearing will retire from the Board at the 2017 AGM, having completed her three-year term in January 2017.

Diversity

Diversity and inclusion is a strategic priority for the Group. The Committee and Board recognise the importance of diversity in enabling Board effectiveness and improving the quality of decision making, and are committed to increasing the diversity of the Board.

During the course of the year, the Board reviewed the Group's performance against the Board approved Diversity Policy which sets out the approach to diversity for each of the main Boards within the Group. Under the policy, the Committee is responsible for reviewing the composition of the Group's Boards to ensure it is diverse, and reflects an appropriate balance of skills, experience, knowledge and background.

Board appointments are always based on merit, with candidates being considered against objective criteria. During 2016, female representation on the Board at 37.5% significantly exceeded the objective of 25% set out in the Board Diversity Policy. In February 2017, the Committee approved a revised Board Diversity Policy with an objective for a balanced Board with representation of either gender making up no less than 33% (one in three) of the Board. In addition, the Group has a stated goal that by 2020 the Board's gender balance should be 50/50 with a 10% tolerance. Following Darren Pope joining the Board in March 2017 and Marilyn Spearing's retirement from the Board in May 2017, female representation will still meet the revised objective of 33%.

The Group supports the Parker Review 'Beyond One by '21' recommendation that FTSE 100 and 250 company boards should have at least one ethnically diverse director by 2021 and 2024 respectively, and the Company is already compliant with this requirement.

Please see pages 36 and 37 of the Strategic Report for details of the Group's approach to diversity, and inclusion and diversity initiatives.

Glen Moreno
Chair, Nomination Committee
27 February 2017

Audit Committee Report

"The transition of external auditors from KPMG to PricewaterhouseCoopers was successfully completed with a smooth handover process."

Norman McLuskie
Chair, Audit Committee

Membership and meetings

	Independent	Meetings attended (held) in 2016[1]
Committee Chair		
Norman McLuskie	Yes	7 (7)
Committee members		
Colin Keogh	Yes	7 (7)
Marilyn Spearing	Yes	7 (7)
Geeta Gopalan	Yes	7 (7)
Eva Eisenschimmel	Yes	N/A[2]

1 Number of meetings held during the period the member held office.
2 Eva Eisenschimmel joined the Committee on 25 January 2017.

Chairman's overview

We have continued to focus on the issues relevant to the Group's financial reporting, considering emerging trends, and overseeing the Group's internal control framework to ensure it remains robust and fit for purpose. In particular, I would highlight the following activities:

– a successful and smooth auditor transition from KPMG LLP (KPMG) to PricewaterhouseCoopers LLP (PwC);
– review and challenge of the key estimates and judgements of Management relevant to the Financial Statements;
– oversight of the control framework with particular focus on cyber resilience, including review and discussion of internal audit reports and Management's response;
– oversight of the Internal Audit function, including the work to address the recommendations of the External Quality Assurance assessment carried out by Deloitte;
– review of emerging guidance and regulation (including IFRS9 and the EU Audit Directive) and oversight of implementation plans.

During 2016, following the review by the Financial Reporting Council (FRC) of the Group's 2015 Annual Report and Accounts (as part of its normal cycle of reviews), the Group received confirmation from the FRC that it had no queries to raise. It should be noted that the FRC's role in this review was not to verify the information provided in our Report and Accounts but only to consider compliance with reporting requirements and hence the review is not intended to provide assurance over the Annual Report and Accounts.

Finally, I would like to take this opportunity to welcome Peter Bole as Chief Financial Officer (CFO) from 1 January 2017 and I look forward to working with him. I would also like to thank Dave Dyer, following his retirement, for his considerable contribution to the Group during his tenure as CFO.

Committee purpose and responsibilities

The purpose of the Committee is to monitor and review the Group's financial reporting arrangements, the effectiveness of its internal controls and risk management framework, its internal and external audit processes and its whistleblowing procedures. The Committee reports to the Board on its activities and makes recommendations, all of which have been accepted during the year.

The key activities of the Committee are set out below and full details of the Committee's responsibilities are detailed in the Committee terms of reference which can be found on the website at virginmoney.com/virgin/investor-relations. In 2016, the Committee met its objectives and carried out its responsibilities effectively, as confirmed by the annual effectiveness review.

Committee composition, skills and experience

The Committee acts independently of Management. This ensures that the interests of shareholders are properly protected in relation to financial reporting and internal control. The Committee now comprises five Independent Non-Executive Directors.

Each Committee member has extensive experience of banking and financial services, therefore, as a whole, the Committee has recent and relevant competence in the sector in which the Group operates. In addition to the Chair, who is a chartered accountant, individual Committee members also bring specialist knowledge and proficiency which enhance capability and effectiveness, particularly in relation to the oversight of the internal control framework.

Corporate Governance Report

Audit Committee Report

Darren Pope will join the Committee on 1 March 2017 and, following an orderly transition, will take over as Committee Chair during 2017.

Full biographies of the Committee members can be found on pages 75 and 76.

In addition to relevant members of the Executive, the Internal Audit Director and external auditors attend all Committee meetings. During the year, the Committee held a number of private sessions with the external audit team (without Executives present) and with each of the Chief Executive, CFO and the Internal Audit Director.

How the Audit Committee spent its time in 2016

Financial reporting

During 2016, the Committee considered the following key financial issues and judgements in relation to the Group's financial statements and disclosures, with input from Management and the external auditors:

Key issues/judgements in financial reporting	Audit Committee review and conclusions
Going Concern and Viability The Board is required to confirm whether it has a reasonable expectation that the Company and the Group will be able to continue to operate and meet their liabilities as they fall due for a specified period. The disclosure must set out the basis for directors' conclusions and explain why the period chosen is appropriate.	The Committee reviewed and challenged the going concern and viability assessment undertaken by Management, which was based on the Group's capital, funding and strategic plans. The assessment also included consideration of the principal and emerging risks which could impact the performance of the Group, and the liquidity and capital projections over the period. The Committee advised the Board that it was satisfied with the viability statement and that three years was a suitable period of review. Further details of the viability assessment can be found on pages 126 and 135.
Fair, balanced and understandable The Group must ensure that the financial statements (including the Annual Report) are fair, balanced and understandable.	The Committee spent time reviewing the Annual Report and Accounts and challenged Management on the presentation of financial and non-financial information. The Committee received an early draft of the Annual Report to allow sufficient time for review and comment. The Committee considered Management's own assessment of compliance with alternative performance measures guidelines and the fair, balanced and understandable requirements. The Committee concluded that, based on the information supplied to it and in its judgement, the Annual Report and Accounts, when taken as a whole, were fair, balanced and understandable.
Effective interest rate (EIR) Interest earned on loans and receivables is recognised using the EIR method. The application of the EIR method of accounting is judgemental and requires Management to make a number of assumptions.	The Committee spent considerable time understanding the judgements taken and EIR methodology applied by Management, including expected future customer behaviours. Following review and challenge, the Committee agreed that Management's judgement, following review of the latest customer trends, was appropriate and there have been no changes to the EIR accounting policies applied for mortgages and credit cards during 2016. The disclosures relating to EIR are set out in note 1.10 to the Financial Statements.

Key issues/judgements in financial reporting	Audit Committee review and conclusions
Allowance for impairment losses on loans and receivables Determining the appropriateness of impairment losses is judgemental and requires the Group to make a number of assumptions.	The Committee considered and challenged the provisioning methodology applied by Management, including the results of statistical loan loss models to support the impairment provisions for both the secured and unsecured portfolios. The Committee considered the calibration of model parameters in the light of economic indicators including house price movements, and underlying book performance. Consideration was also given to the appropriateness and use of post model adjustments. The Committee was satisfied that the impairment provisions, including Management's judgements, were appropriate. The disclosures relating to impairment provisions are set out in note 1.10 to the Financial Statements.
Capitalisation and impairment of intangible assets Determining the appropriateness of costs that qualify for recognition as intangible assets requires Management judgement. Management is also required to make ongoing assessments of whether any assets are impaired. No assets were identified as impaired through reviews for indicators of impairment.	Over the course of 2016 a wide range of change projects were delivered including a number with significant capital spend, in particular in relation to digital development, fraud, cyber-crime and investment in new office software for employee workstations. As in prior years, the Committee has considered and is satisfied with the appropriateness of the accounting recognition of these investment costs, including that those costs qualify for recognition as intangible assets in line with the criteria prescribed by accounting standards. The Committee has also considered Management's reviews for indicators of impairment and is satisfied with the conclusion that no assets require impairment adjustment. The disclosures relating to the movement in intangible asset balances during the year are set out in note 1.10 to the Financial Statements.
Recoverability of the deferred tax asset The Group continues to recognise deferred tax assets and liabilities in respect of timing differences in the main trading subsidiaries. Based on the Group's forecast taxable profit, the losses are expected to be fully utilised in the near to medium term.	The Committee considered the recognition of deferred tax assets and liabilities in respect of timing differences in the main trading subsidiaries, in particular the forecast taxable profits based on the Group's strategic plan. The Committee agreed with Management's judgement that the deferred tax assets were appropriately supported by forecast taxable profits, taking into account the Group's long-term financial and strategic plans. There have been no changes in this approach during the year, and the size of the deferred tax asset continues to reduce as losses are utilised. The disclosures relating to deferred tax assets are set out in note 1.10 to the Financial Statements.
Fair value of financial assets and liabilities The Group uses estimates and judgements in the calculation of fair values for assets and liabilities where not all inputs to calculations are observable in the market, or where there are factors specific to an individual instrument that impact fair values.	The Committee spent time understanding and assessing judgements applied and agreed with Management's judgement regarding the calculation of fair values, including the use of appropriate market rate impacts to fair value conditions. The disclosures relating to fair value are set out in note 1.10 to the Financial Statements

Internal control and risk management

Full details of the internal control and risk management systems in relation to the financial reporting process are given within the Corporate Governance Report on pages 91 and 92 and the Risk Management Report on pages 132 to 192. Specific matters that the Committee considered during the year included:

> the effectiveness of systems for internal control, financial reporting and risk management;

> the major findings of internal reviews into control weaknesses, fraud or misconduct and Management's response alongside any control deficiencies identified;

Corporate Governance Report

Audit Committee Report

- in 2016, this included a focus on the IT control environment in light of the increased threat from cyber-crime; and
- helpful preliminary observations from PwC on business processes and controls.

The Committee is satisfied that internal controls over financial reporting and risk management systems were appropriately designed and operating effectively during the period under review.

Internal audit

In monitoring the activity, role and effectiveness of the Internal Audit function and its audit programme, the Committee:

- oversaw the progress against the action plan to address the observations from the independent external assessment on the effectiveness of the Internal Audit function carried out in 2015 by Deloitte. The Committee is satisfied that significant progress has been made against the agreed action plan;
- approved the audit plan and budget and monitored progress against it at regular intervals, confirming that appropriate resources and capability were in place to execute the plan effectively, and considered Internal Audit to have sufficient standing in the Group;
- considered the regular Internal Audit reports, including thematic and routine reviews on prudential and regulatory compliance, customer conduct, credit risk, IT and financial controls, discussing major findings and Management's responses; and
- approved the updated Internal Audit Charter.

Whistleblowing

The Committee received and considered reports from Internal Audit on the Group's whistleblowing arrangements including summaries of reported cases. The Committee was satisfied with the action taken with the reports having been considered and approved by the Board's Whistleblowing champion, the Committee Chair.

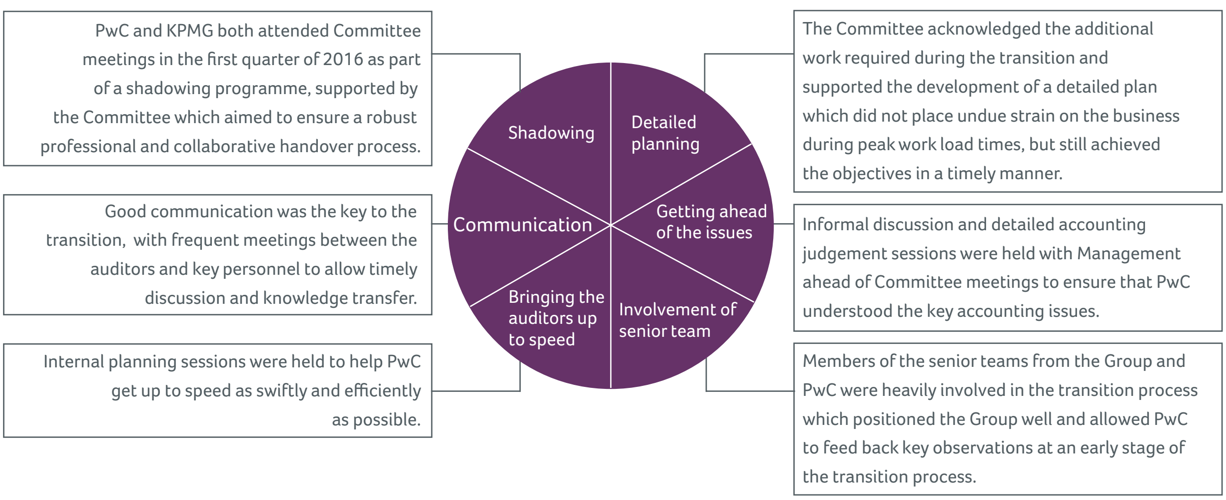
The Committee also approved a revised Whistleblowing policy which complies with the PRA and FCA policy statements on whistleblowing published in October 2015 and which became effective during 2016.

External audit

The Committee oversaw the relationship with the external auditors and considered the terms of engagement (including remuneration), its effectiveness, its continued independence and objectivity. In particular, the Committee oversaw the transition from KPMG to PwC. Further detail on the transition process is set out below.

The Committee approved the interim and annual audit plan and negotiated and agreed the auditors' remuneration, reviewed the findings of the external auditors and considered Management's responsiveness to such findings and recommendations.

The Committee also considered the continued effectiveness of the audit process and the external auditors' performance during the 2016 interim results process, including technical competence, strategic knowledge, quality control, communication and reporting through an internal effectiveness review.



The Committee concluded that it was satisfied with the auditors' performance and recommends their re-appointment by shareholders at the 2017 AGM.

External Auditors tenure

Following a formal audit tender process conducted in 2015, shareholders approved the appointment of PwC as external auditors at the AGM held on 4 May 2016 for the year ending 31 December 2016.

The Committee is satisfied that the Company has complied with the provisions of the Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitor Tender Processes and Audit Committee Responsibilities) Order 2014, during the financial year under review and up to the date of this report.

External Audit transition

The appointment of new auditors provided an opportunity to benefit from a new perspective. The Committee oversaw and monitored the transition process, receiving regular updates from Management and PwC during the transition period on progress and key areas of auditor focus. Further detail on the transition process is illustrated in the diagram on the previous page.

The committee considered the findings from the FRC's review of KPMG's audit of the 2015 financial statements.

Auditor independence and remuneration for non-audit services

Both the Board and the external auditors have safeguards in place to protect the independence and objectivity of the external auditors. A policy (refreshed in November 2016 to comply with the EU Audit Directive) is in place to regulate the use of the auditors for non-audit services which:

> details the nature of work that the external auditors may not undertake and sets a limit (£25,000) under which permissible non-audit work may be undertaken without prior permission from the Committee. All other non-audit services are subject to prior approval by the Committee;

> determines that the overall fee level for non-audit services will continue to be monitored by the Committee and should not exceed 70% of the average audit fee over the prior three year period; and

> includes restrictions on the employment of former external auditors' staff to further preserve the independence of the external auditors.

In some cases, the external auditors may be selected over another service provider for a particular engagement due to its detailed knowledge and understanding of the business.

The total amount paid to the external auditors in 2016 was £1.2 million. Details of the payments for audit and non-audit services provided in 2016 is shown in note 6 to the Financial Statements.

Regulatory change

The Committee also monitored emerging regulation and legislation, assessed the impact on the business and oversaw the development of policies and procedures to comply. For example, this included work to progress compliance with IFRS9; specifically in November 2016, the Committee had a session with the Group finance team and the external auditors to review and discuss the requirements of IFRS9 and the implementation plan to meet the Group's obligations under the revised standard.

Norman McLuskie
Chair, Audit Committee
27 February 2017

Corporate Governance Report

Board Risk Committee Report

"The Committee continues to focus on strong risk management and culture as a fundamental part of achieving our strategic objectives for all of our stakeholders."

Colin Keogh
Chair, Board Risk Committee

Membership and meetings

	Independent	Meetings attended (held) in 2016[1]
Committee Chair		
Colin Keogh	Yes	7 (7)
Committee members		
Norman McLuskie	Yes	7 (7)
Marilyn Spearing	Yes	7 (7)
Geeta Gopalan	Yes	7 (7)
Eva Eisenschimmel	Yes	N/A[2]

1 Number of meetings held during the period the member held office.

2 Eva Eisenschimmel joined the Committee on 25 January 2017.

Chairman's overview

During 2016, the Board Risk Committee assisted the Board in addressing all aspects of risk management across the Group, balancing its agenda between existing and emerging risks. In particular, I would highlight the following activities:

- continued monitoring of the Group's risk management and governance framework. This included an ongoing review of the Group's key authority documents, risk limits and policies;
- increased monitoring of the external economic environment in light of increased uncertainty and changes in the macroeconomic outlook;
- increased monitoring and oversight as part of contingency planning for the EU referendum and its outcome;
- continued oversight of the stress and scenario testing undertaken to provide comfort on the Group's ability to mitigate potential risks, including those considered in relation to the Internal Capital Adequacy Assessment Process (ICAAP);
- continued focus on the Group's asset quality through monitoring performance against the Group's risk appetite;
- reviewing and monitoring the funding and liquidity risks faced by the Group and ensuring the Group maintains a prudent mix of funding sources including the use of TFS;
- continued monitoring of ongoing changes in the regulatory environment;
- reviewing risks relating to the resilience of IT systems and cyber security, which is a key priority of the Group; and
- continued focus on conduct risk, including the monitoring of outsourcing arrangements and oversight of key strategic programmes.

Committee purpose and responsibilities

The purpose of the Committee is to monitor and review the Group's compliance with the Board's approved risk appetite, risk management framework and risk culture.

This includes carrying out the annual review of risk appetite alongside the strategic plan to reflect the Group's latest commercial, economic and regulatory views, and considering the statements and risk appetite metrics under each category of identified risk. The Committee considers the Group's approach to risk management alongside regulatory developments and has a key role in setting risk management tone and ensuring that the risk culture is embedded throughout the Group.

The Committee monitors the Group's risk management framework, including policies, and methodologies, overseeing proposed changes and any action arising from material breaches. Details of the Group's approach to risk management can be found on pages 132 to 192. The Committee reports to the Board on its activities and makes recommendations, all of which have been accepted during the year.

Full details of the Committee's responsibilities are set out in the Committee terms of reference which can be found on our website at virginmoney.com/virgin/investor-relations.

During the year, the Committee met its objectives and carried out its responsibilities effectively, as confirmed by the annual effectiveness review.

Committee composition, skills and experience

The Committee now comprises five Independent Non-Executive Directors who have a variety of industry backgrounds, with a strong presence in banking and financial services experience. The Chair is also a member of the Audit Committee. Darren Pope will join the Committee on 1 March 2017. Full biographies of Committee members can be found on pages 75 and 76.

In addition to relevant members of the Executive, the Internal Audit Director attends the meetings to ensure that attendees from all three lines of defence are represented. The external auditors also attend most meetings. During the year, the Committee held private sessions with the Chief Risk Officer (without other Executives present).

Significant risks considered by the committee

Further details can be found in the Risk Overview on pages 44 to 51.

How the Board Risk Committee spent its time in 2016

Over the course of the year, the Committee considered a wide range of risks facing the Group, both existing and emerging, across all key areas of risk management. As part of the review, certain risks were identified which required further detailed consideration. A summary of these matters is set out below and includes the key considerations and conclusions of the Committee. In respect of the Group's approach to risk management, the Committee also reviewed the capability, resources, remit and authority levels of the risk function. The Committee concluded that the risk function was adequately resourced and continued to be sufficiently independent with appropriate authority and standing within the Group.

Committee review and conclusions on significant risks

Retail Credit risk

The Committee monitored retail credit risk performance against the Group's risk appetite metrics and policies. This included the introduction of additional reports to monitor macroeconomic volatility and impact on customers' behaviour pre and post the EU referendum, and in response to the changing macroeconomic outlook. In response, credit scoring for some segments of new credit card lending was tightened to protect credit quality. Additional scenario planning and stress testing was also undertaken to inform the Group's strategic planning.

Market Risk

The Committee monitored, reviewed and challenged monthly interest rate risk positions against risk appetite metrics and policies. The Committee oversaw the implementation of a revised suite of stresses for basis risk and monitors this on a regular basis.

Operational risks

The Committee received regular updates across all aspects of operational risk including financial crime, incident management, outsourcing management and security infrastructure.

The Committee continued to oversee the delivery of the Group information security programme and cyber resilience strategy to mitigate the threat of cyber attack. A variety of reviews and exercises were undertaken to test the resilience of IT and cyber security arrangements, with the Committee reviewing Management's recommendations to enhance systems and procedures and mitigate risks. This included sessions with Management and risk colleagues to evaluate the current status of systems and processes and identify and prioritise improvement programmes where required.

Work on financial crime prevention capability continued with the Committee providing insight and support to the approach and action plan.

The Committee monitors risks inherent with major outsource providers and received regular updates on their performance and resilience. Where deficiencies in operation and/or performance were identified, the Committee increased the focus to ensure resolution was prioritised.

Conduct risk and compliance

The Committee spent a considerable amount of time focusing on conduct risk matters including the procedures and practices of major outsourcing providers to ensure that the required standards are applied. This included consideration of complaints, regulatory reports and remediation and product governance, supporting the Board in its wider consideration and decision making on conduct matters.

In respect of compliance matters, the Committee received regular detailed updates from Management on regulatory developments and upstream risk, including structural reform, Minimum Requirement for Own Funds and Eligible Liabilities (MREL), and capital changes. The Committee assessed the impact of those developments on the Group's balance sheet, operational processes, systems and controls.

Corporate Governance Report

Board Risk Committee Report

Committee review and conclusions on significant risks

Funding and liquidity risk

The Committee reviewed and challenged the current and forecast funding and liquidity positions. The Committee considered reports on funding sources to ensure a prudent mix was maintained within risk appetite and policy limits. Balance sheet growth has been supported by RMBS, AT1 and FLS/TFS drawdown in 2016.

The Committee increased the monitoring of the external economic environment in light of increased uncertainty and changes in the macroeconomic outlook.

Strategic and financial risk

Credit concentration risk is monitored against risk appetite metrics and challenged by the Committee. The quality of lending and detailed reports on exposures to areas where there is concentration risk were reviewed regularly. These reviews led to the Committee approving changes to Group policy or risk appetite to reduce exposures in these areas.

Capital

The Committee monitored, reviewed and challenged Management reports concerning the Group's capital position. The Committee considered the quality of the capital base, and the projected capital resources to ensure that the Group complies with current regulatory capital requirements and is well positioned to meet future requirements. In November 2016, the Group raised a further £230 million of AT1 capital to fund ongoing growth and support the Group's leverage ratio.

The Committee also reviewed the results of the PRA UK Variant Stress Test scenarios published during the year. In addition, the Committee focused on specific scenarios designed by Management. This work assisted the Committee in supporting the Board's strategic planning cycle, stress capital plan and risk appetite reviews.

The Committee reviewed and challenged Management's development of scenario planning and stress testing as part of the regulatory capital requirements and preparation of the Recovery and Resolution Plan (RRP) and ICAAP process. The Committee concluded that the Group's capital remained above minimum regulatory requirements and within the risk appetite set by the Board. The Committee noted the new individual capital guidance from the PRA.

Emerging Risks

Emerging risks are those which have the potential to increase in significance and affect the performance of the Group. Further details can be found in the Risk Overview on pages 44 to 51.

The Committee oversaw the Group's detailed EU referendum contingency planning to ensure that it was well positioned to deal with the potential impacts of a vote to leave the EU.

Risks arising from the implementation of banking sector structural reform legislation have also been considered, ensuring forward planning is undertaken to address anticipated risks.

The Committee concluded that the Group has a good understanding and oversight of its emerging risk position and is taking appropriate steps to mitigate where possible.

Colin Keogh
Chair, Board Risk Committee
27 February 2017

Directors' Remuneration Report

Statement by the Chair of the Remuneration Committee

Dear Shareholder,

On behalf of the Board and as Chair of the Remuneration Committee, I am pleased to present the Directors' Remuneration Report for the year ended 31 December 2016.

The Committee continues to balance the views of stakeholders with our duty to reward Directors fairly for their performance and support the delivery of the Group's strategy, ensuring that we are able to attract and retain talented people. This statement and the accompanying report demonstrate the context in which decisions have been made, the outcomes reached for the 2016 performance year and how the Committee intends to approach the year ahead. The Directors' Remuneration Policy was approved by shareholders in 2016 and no changes to the Policy are proposed for 2017.

2016 review

As outlined elsewhere in the annual report, 2016 was a very successful year for Virgin Money and the Group continues to deliver strongly against its objectives despite economic and political uncertainty. The Group has delivered growth and generated a significant increase in underlying profitability whilst maintaining a high-quality balance sheet.

These strong results translate to a FY16 bonus award to the Chief Executive of £1,000,000 (93% of fixed pay), which equates to 93% of the maximum bonus opportunity, the majority of which is delivered in shares. In March 2016 a share award was made to the Chief Executive under the FY16 Long-Term Incentive Plan (LTIP) subject to three-year performance conditions to 31 December 2018.

Overall, 69% of the Chief Executive's FY16 variable pay is deferred from 2020 through to 2024 (via a combination of deferred bonus awards and LTIP awards). Furthermore, 85% of this variable pay is delivered in shares. This ensures continued alignment with shareholders over a long-term horizon.

Looking forward to 2017

The Committee will operate within the existing approved Directors' Remuneration Policy in 2017.

Within that framework, the Committee has undertaken a review of the performance measures for incentives to ensure they are aligned to the Group's business strategy and incentivise the delivery of key strategic objectives.

The FY17 bonus metrics will be based on underlying profit before tax (50% weighting), Corporate Scorecard (25%) and Personal Strategic Objectives (25%). The FY17 LTIP measures will focus on underlying basic earnings per share (EPS) (35% weighting), return on tangible equity (RoTE) (35%) and non-financial scorecard metrics (30%). Targets have been set to provide a stretching incentive, which remain within the Company's risk appetite and are disclosed on page 116.

RoTE has been removed from the annual bonus award in response to shareholder feedback regarding duplication of bonus and LTIP measures. RoTE is retained as a measure in the LTIP as it is a key long-term measure of returns generated for shareholders. In addition, cost:income ratio has been removed from the 2017 LTIP measures given the progress already made to date and to enable continued investment in the Group's strategy of growth, quality and returns.

By reducing the number of incentive measures the Committee are continuing to simplify variable pay, whilst ensuring alignment with shareholder interests.

The salary for the Chief Executive will be £780,000 for 2017, representing a 4% increase. The Committee determined this was appropriate given the performance of the Chief Executive and taking into account the average salary increase of 4% in 2016 across all colleagues (as outlined on page 119). The Chief Executive had an outstanding year steering the Group through a challenging external environment while making strong progress against the Group's strategic goals. The proposed outcome is consistent with the pay approach for all colleagues in the forthcoming pay round, where the highest performers will receive up to a 6% increase.

Finally, changes are required to the vesting terms of share awards in order to comply with the European Banking Authority regulations applicable to FY17 remuneration arrangements for all Material Risk Takers including Executive Directors. To address these changes, the Committee will:

> extend the holding period for vested share awards (post-tax) for Executive Directors from six months to twelve months; and

> continue the existing approach of not paying dividend equivalents on unvested share awards.

The full details are outlined in the Implementation Report on page 113.

Remuneration Committee changes

Eva Eisenschimmel joined the Committee following her appointment to the Board in January 2017. In addition, Darren Pope will join the Committee upon his appointment in March 2017.

Directors' Remuneration Report

I do not intend to seek re-election at the 2017 AGM and will therefore retire from the Board in May having completed my initial three-year term in January. Norman McLuskie, who has been a member of the Board and Remuneration Committee since January 2010, will take on the role of Remuneration Committee Chair. Mr McLuskie's appointment along with the ongoing membership of Geeta Gopalan, will ensure the Committee retains continuity.

Consideration of shareholders' views

Shareholders have a vital role in developing responsible pay practices. The Committee received feedback from major shareholders ahead of the 2016 AGM which was reflected in the strong levels of shareholder support for remuneration related resolutions.

I am pleased to recommend this statement and the 2016 Remuneration Implementation Report on page 113 to shareholders, ahead of the 2017 AGM.

Marilyn Spearing
Chair, Remuneration Committee
27 February 2017

Directors' Remuneration Policy – abridged

Directors' Remuneration Policy and Principles

The current Directors' Remuneration Policy was formally approved by shareholders at the AGM on 4 May 2016. It is intended that approval of the Remuneration Policy will be sought at three yearly intervals, unless amendments to the policy are required in the interim, in which case appropriate shareholder approval will be sought.

The full policy is set out on pages 112 to 121 of the 2015 Annual Report and Accounts which is available at: http://uk.virginmoney.com/virgin/investor-relations/results-and-presentations/. For ease of reference, the remuneration policy tables for Executives and Non-Executive Directors from the policy are included in the following pages.

Information on how the policy will be applied in 2017 is included on pages 115 and 116 of the Implementation Report.

As set out in the previous Directors' Remuneration Report, the Group seeks to reward colleagues fairly for their contribution, whilst ensuring they are always motivated to deliver the best outcomes for stakeholders. To achieve this, colleagues are rewarded in line with UK listed financial services sector best practice, with no reward for inappropriate risk taking.

The Group's approach to remuneration for all colleagues, including Executive Directors, is designed to promote the long term success of Virgin Money for customers, corporate partners, shareholders and wider society. This reflects the culture and supports the delivery of the business strategy:

> to maintain capacity for growth, Virgin Money ensures it remains competitive in the financial services market through regular market reviews. The Group's remuneration strategy aims to motivate individual out-performance against transparent and challenging objectives that are rigorously applied;

> to ensure an appropriate approach to remuneration, and in particular variable pay, clear risk principles are applied which aim to drive sustainable growth. Risk considerations are a material factor in the determination of pay. Malus adjustments and clawback apply to all variable pay;

> the Group aims to treat its colleagues in the same way that it serves customers – with honesty, transparency and fairness. Virgin Money believes in creating a culture where customer service is the priority. To achieve this, all colleagues receive an annual bonus opportunity, with no product-focused sales incentives in place. Balanced objectives are used to assess annual performance; and

> to ensure the approach to senior remuneration is fair, competitive and supportive of the Group's strategy, Virgin Money undertakes annual reviews of its remuneration approach. This also ensures that the Group's position remains appropriate relative to competitors.

Virgin Money aims to support colleagues and their families whilst enabling them to plan for the future through a competitive benefits package. The benefits package helps ensure low staff turnover, higher engagement and supports the Group's overall operational and financial efficiency.

Directors' Remuneration Report

Summary of Remuneration Policy for Executive Directors

Base salary

Purpose and link to strategy	Base salary reflects the role of the individual taking account of responsibilities and experience.
Operation	Base salaries are normally reviewed annually. When determining and reviewing base salaries, the Committee considers: – corporate and individual performance; – the skills, experience and responsibilities of the Executive Director and their market value; – the scope and size of the role; – base salary increases for colleagues throughout the Group; and – external market factors.
Maximum potential	Whilst there is no maximum base salary, any salary increases in percentage terms will normally be in line with increases awarded to other colleagues, but may be higher in certain circumstances. The circumstances may include but are not limited to: – where a new Executive Director has been appointed at a lower salary, higher increases may be awarded over an initial period as the Executive Director gains experience in the role; – where there has been an increase in the scope or responsibility of an Executive Director's role; or – where a salary has fallen significantly below market positioning given current size and scale of the Group. Base salary levels may be amended to take into account any regulatory changes.
Performance measures	N/A

Fixed Allowance

Purpose and link to strategy	To ensure that total fixed remuneration is commensurate with the role and to provide a competitive reward package for Executive Directors with an appropriate balance of fixed and variable remuneration. Also to facilitate recruitment of an Executive Director if required.
Operation	The Fixed Allowance will be delivered in cash and /or shares normally on a monthly basis. The Fixed Allowance is not pensionable.
Maximum potential	The maximum allowance is 100% of base salary.
Performance measures	N/A

Pension

Purpose and link to strategy	To support the Executive Directors in building long-term retirement savings in a manner which does not expose the Group to any unacceptable financial risk.
Operation	Executive Directors are eligible to participate in the Group's defined contribution pension scheme. Alternatively, Virgin Money may make contributions to an Executive Director's personal pension arrangement. Only base salary is pensionable. An individual may elect, with the Group's consent, to receive some or all of their pension contribution as a cash allowance.
Maximum potential	The maximum allowance for Executive Directors is 30% of base salary.
Performance measures	N/A

Benefits

Purpose and link to strategy	To provide a competitive and cost effective flexible package delivered in a way which does not expose the Group to any unacceptable financial risk.
Operation	Virgin Money provides a range of benefits which may include private medical insurance, permanent health insurance and life assurance. The Committee retains the discretion to provide additional benefits as may be reasonably required. These may include national and international relocation benefits such as (but not limited to) accommodation, family relocation support and travel. The Executive Directors are entitled to a maximum of 30 days' holiday and any unused holiday may be bought back at the standard daily salary rate.
Maximum potential	The maximum value of benefits is based on the cost to the Group of providing each of the benefits in the 'Operation' section immediately above.
Performance measures	N/A

Annual Bonus and Deferred Bonus Share Plan

Purpose and link to strategy	The annual bonus is designed to reward performance, scored against annual weighted financial and non-financial measures.
Operation	Annual bonuses are discretionary and are based on Group and individual performance within the year. The determination of measures and their weighting are set annually and awards are determined by the Remuneration Committee at the end of the financial year. The Committee has discretion, in exceptional circumstances, to amend targets, measures, or number of shares under award if an event happens (for example a major transaction or capital raising) that in the opinion of the Committee, causes the annual targets or measures to no longer be appropriate or such adjustment to be reasonable. The Committee also has the discretion to reduce the vesting level of any award if it deems that the outcome is not consistent with performance delivered. The annual bonus may be delivered partly in cash and partly deferred into cash, shares or other instruments. The mechanism for making the bonus deferral is the Deferred Bonus Share Plan (DBSP). Deferral levels are set at the time of award and in line with regulatory requirements. At present this means that at least 60% of total variable pay is deferred, at least 50% of variable pay is paid in shares or other instruments, and vested shares (post taxation) are subject to a retention period. The deferral and holding periods may be amended to take into account any regulatory changes over the life of the policy. The Remuneration Committee may adjust awards or amend the terms of the awards in accordance with the DBSP rules. At the time of the shares being released and as long as this remains permissible under the regulatory rules, Executive Directors may receive an amount (in cash or in shares) equal to the dividends paid or payable between the date of grant and the vesting of the award on the number of shares which have vested. All awards will be subject to malus and clawback provisions
Maximum potential	The normal maximum bonus for Executive Directors is 100% of fixed pay. Under the DBSP rules, there is scope to award a bonus up to 300% of total fixed remuneration in exceptional circumstances, normally linked with recruitment. Any such Award would however remain subject to the overall regulatory rules.
Performance measures	Performance measures are determined by the Remuneration Committee each year. At least 50% of the annual bonus opportunity is based on performance against key financial measures determined at the beginning of each financial year. The remainder of the annual bonus is based on performance against non-financial measures, which will normally include a scorecard of brand, culture, control measures and personal strategic objectives.

Directors' Remuneration Report

Long Term Incentive Plan (LTIP)

Purpose and link to strategy	The plan is designed to reward delivery of the Group's strategy and growth in shareholder value over a multi-year period and aligns senior colleagues' interests with those of shareholders.
Operation	Awards are granted in the form of nil cost options or conditional shares, subject to performance conditions aligned to long term strategy. The Committee has discretion, in exceptional circumstances, to amend targets, measures, or number of shares under award if an event happens (for example a major transaction or capital raising) that in the opinion of the Committee, causes the targets or measures to no longer be appropriate or such adjustment to be reasonable. The Committee also has the discretion to reduce the vesting level of any award if it deems that the outcome is not consistent with performance delivered. Performance conditions will normally be tested over a period of three financial years. Deferral terms are set at the time of award and in line with regulatory requirements. Vested shares (post taxation) will be subject to a holding period. The performance, vesting and holding periods may be amended to take into account any regulatory changes over the life of the policy. At the time of the shares being released and as long as this remains permissible under regulatory rules, Executive Directors may receive an amount (in cash or in shares) equal to the dividends paid or payable between the date of grant and the vesting of the award on the number of shares which have vested. All awards will be subject to malus and clawback provisions.
Maximum potential	The normal maximum award for Executive Directors is 100% of fixed pay. There is scope to increase Awards up to 300% of total fixed remuneration in exceptional circumstances, normally linked with recruitment. Any such award would remain subject to the overall regulatory rules.
Performance measures	Performance measures are determined by the Remuneration Committee each year.

All-colleague plans

Purpose and link to strategy	If operated in the future, Executive Directors will be eligible to participate in HMRC approved all-colleague schemes which encourage share ownership, as approved by shareholders.
Operation	Executive Directors may participate in these plans if operated in the future in line with the prevailing HMRC guidelines (where relevant), on the same basis as other eligible employees.
Maximum potential	Participation levels will be in line with HMRC limits as amended from time to time.
Performance measures	N/A

Legacy awards and restrictions on payments

The Remuneration Committee reserves the right to honour any remuneration payments or awards and any payments or awards for loss of office, notwithstanding that they are not in line with the policy set out above where the terms of the payment or award were agreed before the policy came into effect (as set out in the 2014 Directors' Remuneration Policy or the Listing Prospectus where relevant). Such payments or awards are set out in the Implementation Report for the relevant year. This includes payments in relation to legacy deferred bonus awards and long-term incentive awards and share options (including exceptional awards vesting on the listing of the Company) granted prior to listing of the Company.

Service Agreements

The notice period and date of the current Executive Director's service agreement is shown below:

	Notice period	Date of service agreement
Jayne-Anne Gadhia	12 months	18 November 2014

The Company policy is that the Chairman will normally have a six month notice period, to be served by either party.

Colleague remuneration and engagement

When reviewing and setting Executive Director remuneration, the Remuneration Committee takes into account the pay and employment conditions of all colleagues. Specifically, the level of any Group-wide pay review is a key determinant when setting the level of any increase to Executive Directors' salaries. Discussion on the Group's approach to remuneration and relevant colleague reward matters takes place with union representatives during the annual pay review cycle.

There is no colleague representative on the Remuneration Committee. Instead, time is taken to meet and listen to the views of many colleagues. One of the duties of the People Director is to brief the Board on colleague views and, as a regular invitee to Remuneration Committee meetings, he ensures that decisions are made with appropriate insight to colleagues' views.

Colleague engagement is a measure within the scorecards for both the annual bonus and the LTIP. The structure of the Executive Director's remuneration packages cascades down to other colleagues. Particular points to note are:

> LTIP awards are granted to the wider Virgin Money Executive Team;

> all colleagues are eligible to participate in an annual bonus arrangement, with no product-focused sales incentives. Instead, all bonuses are subject to a balanced scorecard of measures with particular emphasis on customer experience; and

> colleagues in certain roles may receive a fixed allowance where this is considered appropriate taking into account pre-determined criteria.

Directors' Remuneration Report

Chairman and Non-Executive Director Fees

Purpose and link to strategy	To ensure the Group is able to engage and retain highly skilled and experienced individuals who can provide a valuable contribution, having a significant range and depth of expertise.
Operation	Fees payable to the Chairman are determined by the Remuneration Committee, whilst the fees paid to the Non-Executive Directors are set by the Board. The Board undertakes periodic reviews, at least annually, of Non-Executive Director fees and this may lead to fee increases. The fees are set at a rate that reflects the individuals' experience, value to the Group and the expected time commitment of them. The regulatory regime and the practical aspects of running a complex financial services company are important inputs to remuneration decisions. For the Non-Executive Directors, there is a base fee which is then supplemented by additional fees in respect of chairing and being a member of Board committees. Incremental fees will be paid for additional duties and time commitment, such as those of the Senior Independent Director. The current fees are set out on page 116. From time to time, new Board Committees may be established and/or responsibilities distributed between Committees, at which point fees for Committee membership and Chairmanship may be reviewed. The Chairman and Non-Executive Directors are reimbursed for expenses (grossed-up where taxable) incurred in performing their duties. For individuals based outside of the UK this will include travel to and from the UK. The Chairman has access to a vehicle for personal use, which is a taxable benefit, and may be offered access to private medical insurance.
Maximum limit	The maximum aggregate value of fees payable to the Chairman and the Non-Executive Directors is capped at £2 million under the Articles of Association.
Performance metrics	No remuneration payable to the Chairman and the Non-Executive Directors has performance conditions.

Implementation Report

Purpose and membership of the Remuneration Committee

The role of the Remuneration Committee is to determine and recommend to the Board a fair and responsive remuneration framework to ensure that the Group's most senior Executives are appropriately rewarded and incentivised for their contribution to the Group's performance. The Remuneration Committee's primary purpose is to formulate policies that ensure a clear link between reward and performance and are compliant with regulatory requirements.

The Committee reports to the Board on its activities and makes recommendations, where required, all of which have been accepted during the year.

Full details of the Committee's responsibilities are set out in the Committee terms of reference which can be found on our website at virginmoney.com/virgin/investor-relations.

During the year, the Committee met its objectives and carried out its responsibilities effectively, as confirmed by the annual effectiveness review.

Remuneration Committee membership in 2016

Marilyn Spearing	Independent member	Joined 29 January 2014 (and Chair from 1 January 2016)
Norman McLuskie	Independent member	Joined 27 January 2010
Geeta Gopalan	Independent member	Joined 25 June 2015

Other attendees (by invitation from time to time) included: the Chairman, the Virgin NED, the Chief Executive, the People Director, and the Reward Director. To manage potential conflicts of interest, those five individuals did not attend at times when their own remuneration outcome was discussed and approved. Deloitte (the Committee's independent consultants in relation to Directors' remuneration following the 2016 AGM) and PwC (consultants prior to the 2016 AGM) also attended meetings where invited. The Company Secretary attended meetings to record minutes.

The Company manages the link between risk and remuneration carefully and members of the Remuneration Committee are also members of the Board Risk Committee. In addition, representatives from Risk may attend meetings where appropriate. In advance of a share award vesting or a bonus being awarded, the Chief Risk Officer provides the Remuneration Committee with a detailed risk assessment. This is also considered separately by the Board Risk Committee.

Remuneration Committee activity in 2016

There were 6 meetings of the Remuneration Committee during 2016. The key matters were as follows:

Date	Pay / bonus	Policy / Governance
Q1	– FY15 pay and bonus outcomes – Performance conditions for the FY16 Annual Bonus and LTIP – Release of deferred bonus awards – Terms for the incoming Chief Financial Officer	– Directors' Remuneration Policy for FY16 – FY15 Directors' Remuneration Report and Pillar 3 – FY15 PRA Remuneration Policy Statement
Q2	– Terms for the retirement of the Chief Banking Officer	– Material Risk Taker population for 2016 – Review of EBA consultation on sound remuneration practices
Q3	– Release of shares vesting under Buy-out Awards	
Q4	– Release of Executive awards vesting under the IPO Share Award and IPO Incentive scheme	– Review of performance measures for the FY17 Annual Bonus and LTIP – Review of PRA's application of the EBA's guidelines on sound remuneration practices

Directors’ Remuneration Report

Advisors to the Remuneration Committee

From the 2016 AGM, the Remuneration Committee took external advice from Deloitte, the Committee’s independent consultants in relation to Directors’ remuneration. PwC, the Committee’s previous advisers, also provided advice to the Committee until the 2016 AGM, at which point they were approved as the Group Auditor. After this event PwC provided no further advice to the Remuneration Committee.

Deloitte and PwC’s respective appointments as consultants were made by the Remuneration Committee. Both Deloitte and PwC are members of the Remuneration Consultants Group and comply with the professional body’s code of conduct. This supports the Remuneration Committee’s view that the advice received was objective and independent.

Deloitte’s fees since they were appointed Remuneration Committee advisors at the AGM amounted to £71,250. During the year, Deloitte also provided co-sourced internal audit services and advisory services in relation to data analytics, regulatory advice, quantitative risk measurement and security systems.

PwC fees for work carried out prior to the 2016 AGM were £20,450. During 2016, in addition to their work as the Group’s Auditor following the AGM, they also provided assurance services in relation to Treasury and IFRS 9.

Statement of voting at Annual General Meeting

The proposals in relation to the Group’s remuneration policy and the remuneration offered to the Executive Directors in 2016 were detailed within the Directors’ Remuneration Report for 2015 and were voted on at the 2016 AGM. The shareholder votes submitted at the meeting, either directly, by mail or by proxy, were as follows:

	Votes in favour		Votes against		Votes withheld
	Number of shares	Percentage of votes cast	Number of shares	Percentage of votes cast	Number of shares
Remuneration Policy	349,102,101	91.79%	31,219,817	8.21%	83,374
Remuneration Implementation Report	373,747,604	98.77%	4,636,406	1.23%	2,021,282

Implementation of the policy in 2017

The following sets out how the Directors' Remuneration Policy will be applied in 2017:

Fixed Pay

Base salary	Jayne-Anne Gadhia (Chief Executive): £780,000
Fixed Allowance	Jayne-Anne Gadhia (Chief Executive): £100,000
Pension and other benefits	No change from the stated policy.

Annual Bonus

Opportunity	Maximum annual bonus opportunity is 100% of fixed pay.
Deferral terms	For 2017: – up to 32% of any bonus will be paid in cash following the publication of the financial statements for the previous year; – up to 32% of any annual bonus will be converted into an award of equivalent value under the Deferred Bonus Share Plan, vesting immediately on award and the resultant number of shares (post taxation) will be subject to a twelve month retention period; – up to 36% of any bonus will be converted to an award of equivalent value under the Deferred Bonus Share Plan, vesting equally from the third anniversary to the seventh anniversary and the resultant number of shares (post taxation) will be subject to a twelve month retention period; Dividend equivalents will not be paid on the number of shares which vest.
Performance measures and targets	The Remuneration Committee has determined that for 2017 the annual bonus will be based on: – financial measures (underlying profit before tax) – 50% weighting – non-financial measures (personal strategic objectives and a series of risk, brand, culture and control measures) – 50% weighting The Board considers the targets that apply to these measures to be commercially sensitive at this time but will provide information on the targets alongside the level of payout relative to the performance achieved in next year's Implementation Report. The Remuneration Committee has determined that 60% vesting is justified for target performance and 0% is justified for threshold performance. All awards will be subject to malus and clawback provisions.

Long Term Incentive Plan

Opportunity	LTIP awards in 2017 will be granted over shares worth 100% of fixed pay.
Vesting terms	The performance period will be the three years commencing on 1 January 2017. An assessment of performance in the financial year preceding the date of grant will be taken into account before awards are made. The intended date of grant is March 2017. To the extent that the performance measures are satisfied, awards will vest equally from the fourth anniversary of the date of grant to the eighth such anniversary. At each vesting date the resultant number of shares (post taxation) will be subject to a twelve month retention period. Dividend equivalents will not be paid on the number of shares which vest.
Performance measures and targets	The Remuneration Committee has chosen performance measures that are based on delivering the Company's strategic objectives, and the continued creation of shareholder value. This choice and the calibration of the targets is consistent with the strategic plan. The Remuneration Committee has determined that 80% vesting is justified for target performance and 20% is justified for threshold performance. Performance against the targets will be subject to a risk assessment review. The following table outlines the weightings and measures for the 2017 awards. All awards will be subject to malus and clawback provisions.

Directors' Remuneration Report

FY17 LTIP Performance Measures

Measure	Target	Weighting
Underlying basic earnings per share	Threshold: 5% p.a. Maximum: 10% p.a.	35%
Return on tangible equity	Threshold: 11% Maximum: 14%	35%
Scorecard of measures relative to external comparators and internal scores	a) Customers (Advocacy) b) Customers (Complaints) c) Colleagues (Engagement)	30%

Outcomes will be disclosed on a retrospective basis after the end of the three year performance period.

Chairman and Non-Executive Director fees in 2017

The annual fees for the Chairman and Non-Executive Directors are unchanged to that specified in the 2015 Annual Report. A review of the Chairman fee was carried out in 2016 and a review of the Non-Executive Director fees was carried out in early 2017.

2017 fee policy	2017	2016
Chairman fee[1]	**£350,000**	£350,000
Non-Executive Director basic fee	**£80,000**	£80,000
Senior Independent Directorship	**£20,000**	£20,000
Audit Committee Chairmanship	**£25,000**	£25,000
Remuneration Committee Chairmanship	**£25,000**	£25,000
Board Risk Committee Chairmanship	**£25,000**	£25,000
Nomination Committee Chairmanship	**£–**	£–
Audit Committee Membership	**£10,000**	£10,000
Remuneration Committee Membership	**£10,000**	£10,000
Board Risk Committee Membership	**£10,000**	£10,000
Nomination Committee Membership	**£–**	£–

1 The Chairman has access to a vehicle for personal use, which is a taxable benefit and is offered access to the Group's private medical insurance scheme which he has accepted and chosen to personally fund.

Non-Executive Directors may receive more than one of the above fees.

Remuneration outcome for 2016

Executive Directors (audited)

The following table summarises the total remuneration awarded in relation to Executive Director's services during 2016.

	Jayne-Anne Gadhia	
	2016 £'000	2015 £'000
Salary	**750**	725
Fixed Allowance[1]	**100**	–
Taxable benefits[2]	**1**	8
Pension allowance	**225**	218
Total fixed	**1,076**	**951**
Bonus	**1,000**	666
Total remuneration	**2,076**	**1,617**

1 The Chief Executive received a fixed allowance in 2016. There is no year on year comparison for this allowance.

2 Taxable benefits comprise of a car allowance (2015 only) and private medical insurance.

Directors' Remuneration Report

Variable Awards

Annual Bonus

For 2016 the Chief Executive had a maximum annual bonus opportunity of 100% of fixed pay.

The Chief Executive's 2016 annual bonus determination was based on performance against:

> financial measures (60% of overall award): underlying profit before tax, cost of risk, return on tangible equity;

> brand, culture, control objectives (20% of overall award): based on performance against objectives from the Group's corporate scorecard; and

> personal strategic objectives (20% of overall award): based on performance against pre-determined personal strategic objectives.

Actual performance against the 2016 bonus targets was as follows (audited):

					Chief Executive	
Performance measure	Threshold (0%)	Target (60%)	Maximum (100%)	Actual performance	Weighting at maximum	Bonus score
Underlying profit before tax	£180.7m	£190.7m	£220.8m	£213.3m	20%	18.0%
Cost of risk	20bps	19bps	16bps	13bps	20%	20.0%
Return on tangible equity	10.6%	11.2%	13.0%	12.4%	20%	17.3%
Brand, culture, control scorecard				as explained below	20%	17.5%
Personal strategic objectives				as explained below	20%	20.0%
Total bonus					100%	93%

Brand, Culture, Control Scorecard (20% weighting)

> Delivered superior customer satisfaction and advocacy, with an increase in overall Net Promoter Score to +29.

> Colleague engagement exceeded target at 81%, benchmarking strongly against competitors.

> Increased the number of women in senior leadership roles across the company, supporting progress to achieving the aim of 50%/50% gender balance by 2020.

> Virgin Money Giving continues to grow with £92m of donations made to charities demonstrating continued support to the communities we serve.

> A continued focus and drive to ensure our customers have been treated fairly.

2016 Final outcome: 17.5% out of a maximum 20%

Personal strategic objectives (20% weighting)

> Long-term strategic planning was completed and approved by the Board for implementation.

> Development of the Virgin Money Digital Bank proposition and a partnership with 10X has been agreed and has commenced.

> Progress has been made towards an improved gender balance within the Company through enhancing leadership capability to identify and counter unconscious bias, encouraging a flexible working culture and utilising technology to enable this.

> Progress in relation to company succession planning, including the successful induction and transitional handovers for Peter Bole (Chief Financial Officer) and Hugh Chater (Chief Commercial Officer), has been achieved.

> Enhancing the company reputation and brand, for example through delivery of the HM Treasury sponsored 'Women in Finance' Review.

2016 Final outcome: 20% out of a maximum 20%

FY16 Variable Pay

Overall 69% of the Chief Executive's FY16 variable pay is deferred from 2020 through 2024 (via a combination of deferred bonus and LTIP awards).

Annual Bonus

The bonus awarded to the Chief Executive is summarised in the table below:

Name	Jayne-Anne Gadhia
Maximum opportunity (% of fixed pay)	100%
% of fixed pay awarded for 2016	93%
Bonus awarded for 2016	£1,000,000

For the 2016 annual bonus, 32% of the annual bonus will be paid in cash in March 2017, 32% will be paid in shares with a six-month holding period. The remaining 36% will be deferred with one-fifth vesting in March 2020, one-fifth vesting in March 2021, one-fifth vesting in March 2022, one-fifth vesting in March 2023 and the final one-fifth vesting in March 2024 (each with a six month holding period). Once vested, the awards remain subject to clawback provisions, in line with the Group policy.

LTIP

The Chief Executive received an FY16 LTIP award in March 2016 (100% of fixed pay). The award will be assessed against performance at 31 December 2018 based on the performance conditions set out in detail in the 2015 Directors' Remuneration Report. One-fifth of the award will vest after four years in March 2020, one-fifth after five years in March 2021, one-fifth after six years in March 2022, one-fifth after seven years in March 2023, and the final one-fifth after eight years in March 2024 (each with a six month holding period). Once vested, the awards remain subject to clawback provisions, in line with the Group policy.

Chief Executive remuneration compared with the wider employee population

The table below compares the percentage change in remuneration of the Chief Executive with all colleagues. Figures for 'All Colleagues' are calculated using salary figures excluding the Chief Executive, which is considered to be the most appropriate approach for these purposes.

	% change in base salary (2015-2016)[1]	% change in annual bonus (2015-2016)[2]	% change in taxable benefits (2015-2016)[3]
Chief Executive	3%	50%	(87.5%)
All Colleagues	4%	43%	0%

Note the percentages for "All Colleagues" included in the table above represent the year-end position as at 31 December 2016 compared with the year-end position as at 31 December 2015. The percentages are adjusted for movements in colleague numbers and other impacts to ensure a like for like comparison.

1 The percentage change for the Chief Executive's salary represents the difference between the 2016 salary included in the single figure table on page 117 (£750,000) with the corresponding figure in 2015 (£725,000).

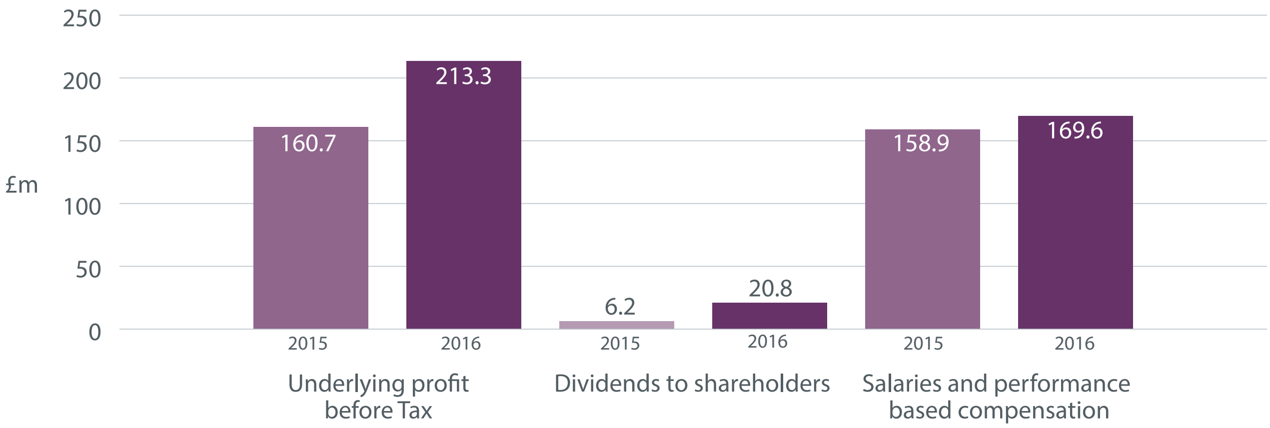
2 This figure represents the percentage change in the FY16 Annual Bonus when compared with the FY15 Annual Bonus.

3 In 2016 the CEO's car allowance benefit of £7,000 ceased.

Directors' Remuneration Report

Relative spend on pay

A year on year comparison of the relative spend on pay is shown below. Underlying profit before tax has been used for comparison on the basis that it reflects performance, excluding one-off events. Total spend on salaries and performance based compensation in 2016 increased by 7% against an increase in underlying profit before tax of 33%. Dividend distributions in 2016 were £14.6m higher compared with 2015.



To note, the distribution in 2015 constituted payment of the interim dividend for the financial year 2015; the distribution in 2016 constituted the final dividend for financial year 2015 in addition to the interim dividend for financial year 2016.

Total Pension Entitlements

The Chief Executive does not have a prospective right to a defined benefit pension in respect of qualifying service.

External Appointments

The Chief Executive undertakes a number of external appointments (as set out on page 76). The Chief Executive does not receive any earnings in respect of these appointments.

Payments within the reporting year to past Directors (audited)

As part of arrangements on leaving the Company:

> an FY12 deferred bonus was released to Finlay Williamson of £278,611;

> the final tranches of (i) an IPO Incentive Award of £134,556 and (ii) a Recruitment Award of £405,352 were released to Lee Rochford.

Loss of office payments (audited)

There were no payments for the loss of office made to former Directors during 2016.

Chairman and Non-Executive Directors' fees (audited)

	Fees paid in 2016 (£000s)	Fees paid in 2015 (£000s)
Glen Moreno[1]	**350**	253
Colin Keogh	**114**	111
Norman McLuskie	**142**	125
Marilyn Spearing	**124**	106
Patrick McCall	**80**	80
Gordon McCallum	**80**	80
Geeta Gopalan (from 25/6/15)	**109**	53

1 Glen Moreno has access to a vehicle for personal use, which is a taxable benefit (£5,618). A similar benefit was provided in 2015.

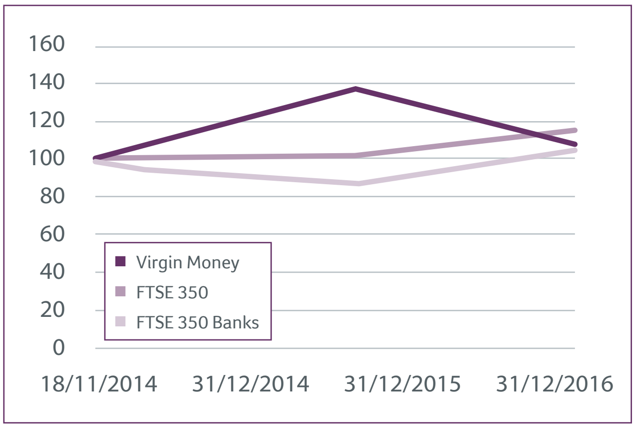
Breakdown of Non-Executive Directors' fees

Non-Executive Directors receive specific committee fees, as set out in the table on page 116. There were no changes to fees during 2016.

Historical TSR performance and Chief Executive pay

The graph opposite shows the total shareholder return (TSR) of the Company for the period from the date when shares were listed on the London Stock Exchange (18 November 2014) to the end of the 2016 financial year, and the performance of the FTSE 350 Index over the same time period. As a recently listed company, a five year TSR graph cannot be included. The FTSE 350 Index has been chosen as the comparative broad equity index because the Company is a member of that index. For further context and comparison to some competitors, the graph also shows the Company's TSR performance against the FTSE 350 Banks Index over the same period.

Virgin Money TSR v FTSE 350



Chief Executive remuneration outcome – historic (since Initial Public Offering)

Financial year ending	**31/12/2016**	31/12/2015	31/12/2014
Chief Executive	**Jayne-Anne Gadhia**	Jayne-Anne Gadhia	Jayne-Anne Gadhia
Total remuneration single figure (£000)	**2,076**	1,617	3,647
Annual bonus awarded (% of maximum opportunity)	**93%**	88%	95%
Long term Incentive Award vesting	**–**	–	–

Directors' Remuneration Report

Outstanding share awards (audited)

Directors' interests

The table below summarises shareholdings and share interests as at 31 December 2016.

Jayne-Anne Gadhia	Owned outright	Number of shares[1,2] Unvested (not subject to performance conditions)	Unvested (subject to performance conditions)	Total
Ordinary shares	2,438,275			
Breakdown of unvested shares:				
(A) Phantom Share Awards (pre-IPO)		446,000		
(B) Deferred Bonus Share Plan Awards		274,535		
(C) Long Term Incentive Plan Awards			563,643	
				3,722,453

1 The Chief Executive does not hold any vested or unvested options.

2 All unvested awards above will be subject to tax upon vesting.

Breakdown of share interests

Further details in respect of the unvested shares included in the Directors' interest table above are provided in the following tables. The details are in relation to the current Executive Director and no other Directors have rights to shares. The share numbers referred to in this section are adjusted for the effect of the re-organisation of the Company share capital on listing in 2014.

(A) FY12 and FY13 Phantom Share Awards

Awards were granted prior to IPO under a deferred bonus plan known as the 'Phantom Incentive Plan'. No further phantom share awards have been granted since listing. No further performance conditions apply, although the awards remain subject to malus and clawback. Holding periods of six months apply to each deferred tranche.

	At 1 Jan 2016	Awarded during the year	Vested during the year	Lapsed during the year	Unvested as at 31 Dec 2016[2]	Date of grant	Market value at grant[1]	Notes
Jayne-Anne Gadhia FY12 deferred bonus	485,160	–	242,580	–	242,580	18 July 2013	n/a	Vests March 2017
Jayne-Anne Gadhia FY13 deferred bonus	203,420	–	–		203,420	27 February 2015	n/a	Vests March 2017 and 2018
Total					**446,000**			

1 The Company was in private ownership at the date of grant and therefore no market value was available at that time.

2 All unvested awards above will be subject to tax upon vesting.

(B) Annual Bonus – Deferred Bonus Share Plan (DBSP)

A Conditional Share Award was granted under the Deferred Bonus Share Plan in March 2016 in respect of FY15. The portion of the annual bonus converted into shares had a face value of £433,225. No further performance conditions apply, although awards remain subject to malus and clawback provisions. Holding periods of six months apply to each deferred tranche. Details of this award are included in the table below alongside the award made in respect of FY14.

	At 1 Jan 2016	Awarded during the year	Vested during the year	Lapsed during the year	Unvested as at 31 Dec 2016[2]	Date of grant	Market value at grant[1]	Notes
Jayne-Anne Gadhia FY14 deferred bonus	221,570	–	–	–	221,570	26 March 2015	409p per share	Vests 26 March 2018 and 2019
Jayne-Anne Gadhia FY15 deferred bonus	–	114,759	61,794	–	52,965	15 March 2016	377.5p per share	Vests 15 March 2017, 2018 and 2019
Total					**274,535**			

1 Awards are made based on the market value of ordinary shares determined on the dealing day preceding the date of grant.

2 All unvested awards above will be subject to tax upon vesting.

(C) Long Term Incentive Plan

A Conditional Share Award was granted under the FY16 Long Term Incentive Plan on 15 March 2016. The Award is subject to performance conditions (as described in last year's report) that will apply from 1 January 2016 to 31 December 2018, with threshold performance resulting in 20% of the award vesting.

The face value of the award was £1,075,000. This value was converted into the number of shares shown using the share price on the day immediately preceding grant. One-fifth of the award will vest after four years in March 2020, one-fifth after five years in March 2021, one-fifth after six years in March 2022, one-fifth after seven years in March 2023, and the final one-fifth after eight years in March 2024 (each with a six month holding period). All awards are subject to malus and clawback provisions. Details of this award are included in the table below alongside the award made in respect of FY15.

	At 1 Jan 2016	Awarded during the year	Vested during the year	Lapsed during the year	Unvested as at 31 Dec 2016[2]	Date of grant	Market value at grant[1]	Notes
Jayne-Anne Gadhia FY15 LTIP	278,875	–	–	–	278,875	26 March 2015	409p per share	Vests 26 March 2018, 2019 and 2020
Jayne-Anne Gadhia FY16 LTIP	–	284,768	–	–	284,768	15 March 2016	377.5p per share	Vests 15 March 2020, 2021, 2022, 2023 and 2024
Total					**563,643**			

1 Awards are made based on the market value of ordinary shares determined on the dealing day preceding the date of grant.

2 All unvested awards above will be subject to tax upon vesting.

Directors' Remuneration Report

Additional disclosures

IPO Incentive Scheme

The IPO Incentive Scheme is not included in the unvested shares reported in the Directors' interests table above since all shares awarded under this scheme have now vested. Awards were granted under the IPO Incentive Scheme on 19 December 2013. These were included in the Chief Executives total remuneration for 2014 when the performance conditions were assessed. The final 20% of the award vested in December 2016 with a holding period of six months applied. Awards are subject to malus and clawback provisions.

	At 1 Jan 2016	Awarded during the year	Vested during the year	Lapsed during the year	Unvested as at 31 Dec 2016[2]	Date of grant	Market value at grant[1]	Notes
Jayne-Anne Gadhia	66,643	–	66,643	–	–	19 December 2013	n/a	–

1 The Company was in private ownership at the date of grant and therefore no market value was available at that time.

2 The vested shares from the above awards are included in the owned outright total (page 122).

Shareholding guidelines

Executive Directors are expected to hold 200% of salary in shares of Virgin Money built up over five years from listing or recruitment, whichever is the later.

As a result of the shareholdings in the table on page 125, the position for the Executive Director in 2016 is as follows:

		Shareholding requirement		Current shareholding		
Executive Directors	**Base salary**	**% of base salary**	**Number of shares (at 31.12.16 closing price of £3.03)**	**% of base salary (at 31.12.16 closing price of £3.03)**	**Value of shares held (at 31.12.16 closing price of £3.03)**	**Requirement met Yes/No**
Jayne-Anne Gadhia	£750,000	200%	495,540	984%	£7,380,658	Yes

Directors' interest – summary of awards vested and purchases and sales made by directors in 2016 (audited)

	Holding at 1 January 2016 (or appointment date)	Transactions during year	Number of shares	Notes	Holding at 31 December 2016
Jayne-Anne Gadhia	**2,242,251**	15 March 2016	160,814	Number of shares from vesting of deferred bonus shares (FY12 Phantom Incentive and FY15 DBSP) after tax	**2,438,275**
		19 December 2016	35,210	Number of shares from vesting of fourth tranche of IPO Incentive after tax	
Glen Moreno	**25,000**	28 June 2016	46,164	Purchase of shares	**71,164**
Geeta Gopalan	**–**	–	–	–	**–**
Colin Keogh	**137,260**	27 June 2016	20,000	Purchase of shares	**157,260**
Patrick McCall	**–**	–	–	–	**–**
Gordon McCallum	**18,983**	–	–	–	**18,983**
Norman McLuskie	**90,080**	–	–	–	**90,080**
Marilyn Spearing	**–**	–	–	–	**–**

On 10 January 2017 Gordon McCallum disposed of 18,983 shares for nil consideration, by way of donation to charity.

There have been no other changes to the above interests between 31 December 2016 and 28 February 2017.

Marilyn Spearing
Chair, Remuneration Committee
27 February 2017

Directors' Report

Corporate governance report

The Corporate Governance Report found on pages 79 to 104, together with this report of which it forms part, fulfils the requirements of the Corporate Governance Statement for the purpose of the Disclosure Guidance and Transparency Rules (DTR).

Results

The consolidated income statement shows a profit before tax for the year ended 31 December 2016 of £194.4m.

Dividends

Following the approval of the 2015 final dividend by shareholders at the 2016 Annual General Meeting (AGM), a final dividend of 3.1 pence per ordinary share was paid on 25 May 2016 to those shareholders registered at the close of business on 15 April 2016.

On 26 July 2016, the Board announced that it had declared and approved an interim dividend of 1.6 pence per ordinary share which was paid on 23 September 2016 to those shareholders registered at the close of business on 12 August 2016.

On 27 February 2017, the Board recommended a final dividend of 3.5 pence per ordinary share in respect of the financial year ended 31 December 2016 which will, subject to approval by shareholders at the 2017 AGM, be payable on 10 May 2017. Further information on dividends is shown in note 11 of the Financial Statements and is incorporated into this report by reference.

Post balance sheet events

There have been no material post balance sheet events.

Going concern

The going concern basis of the Company and the Group is dependent on successfully funding the balance sheet and maintaining adequate levels of capital. In order to satisfy themselves that the Company and the Group have adequate resources to continue to operate for a period of at least twelve months from the date of approval of this report, the Directors have considered a number of key dependencies which are set out in the Risk Overview and Risk Management Report sections under Principal Risks on pages 48 to 51 and 138, Funding and Liquidity on page 50 and pages 177 to 187 and Capital Position on pages 187 to 192, and additionally have considered projections for the Company and the Group's capital and funding position.

Having considered these and made appropriate enquiries, the Directors consider that the Company and Group have adequate resources to continue in business for a period of at least twelve months from the date of approval of this report. As a result, it is appropriate to continue to adopt the going concern basis in preparing the accounts.

Viability statement

In accordance with the 2014 UK Corporate Governance Code requirement, the Directors have assessed the viability of the Group, taking into account its current position, the Board's assessment of the Group's prospects and the potential impact of the principal risks and uncertainties the Group faces, which are set out on pages 48 to 51. The Directors have determined that a three year period to 31 December 2019 constitutes an appropriate period over which to perform this assessment in line with the Board's strategic planning horizon. We believe this presents a reasonable degree of confidence, while providing a longer term perspective.

In making this statement, the Board has considered the principal and emerging risks facing the Group, including those that could threaten the Group's business model, future performance, solvency or liquidity, such as changes in the macro-economic environment and the macro-structural landscape. The Group's capital and liquidity ratios, including the CET1, total capital and leverage ratios, have been assessed in comparison to risk appetite, early warning indicators and regulatory minima.

As described in the Corporate Governance Report on pages 79 to 104 and the Risk Management Report on pages 132 to 192, the Board monitored the effectiveness of the Group's risk management and internal control systems over the course of the year. The monitoring and review covered all material controls, including financial, operational and compliance controls.

The Board considers at least annually, and monitors on an ongoing basis its strategic plan. This plan is stress tested and includes a review of the sensitivity of the Group to business as usual risks and other, severe but plausible events. The Board also considers the ability of the Group to raise finance and deploy capital. These results take account of the availability and likely effectiveness of the mitigating actions that could be taken to avoid or reduce the impact or occurrence of the underlying risk.

As part of the Group's stress testing work, which includes the Internal Capital Adequacy Assessment (ICAAP) and Internal Liquidity Adequacy Assessment (ILAAP), the Group performs a wide range of severe macro-economic, idiosyncratic and income stress tests, the most material of which relate to rising unemployment, increased base rate and a reduction in HPI. The results of this stress testing show that sufficient capital is held to cover the stress scenarios and liquidity, both in amount and quality. Supporting capital and funding plans are developed to survive the impact of the stress scenarios over the planning horizon.

Information relevant to the Board's assessment of viability can be found on the following pages:

> the Group's principal activities, business model and strategy are described in the Strategic Report on pages 32 and 33;

> the Group's emerging risks are disclosed on pages 136 and 137;

> the Group's principal risks, including mitigating actions, key risk indicators and areas of future focus, are described on pages 48 to 51; and

> the Group's approach to stress testing and reverse stress testing, including both regulatory and internal stresses, is described on page 135.

On the basis of this assessment, the Directors confirm they have reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due in the period to 31 December 2019.

Directors

The names and biographical details of the current Directors, who, other than Eva Eisenschimmel, all served throughout the year, are shown on pages 75 and 76. Particulars of their emoluments and interests in shares in the Company are given on pages 108 to 125 of the Directors' Remuneration Report.

Changes to the composition of the Board since 1 January 2016, and up to the date of this report, are shown in the table below. Further details of Board changes can be found on page 84 of the Corporate Governance Report.

Name	Role	Date of appointment
Eva Eisenschimmel	Independent Non-Executive Director	25 January 2017

Appointment and retirement of Directors

The appointment, retirement and/or replacement of Directors is governed by the Articles of Association of the Company (Articles), the 2014 Edition of the UK Corporate Governance Code (Code) and the Companies Act 2006 (Act). The Articles may be amended only by a special resolution of the shareholders in a general meeting.

All Directors appointed to the Board since the 2016 AGM will stand for election by shareholders at the 2017 AGM. In the interests of good governance, all of the other Directors will also retire and those wishing to serve again will submit themselves for re-election at the 2017 AGM.

Directors' indemnities

The Directors have entered into individual deeds of indemnity with the Group which constitute 'qualifying third party indemnity provisions' for the purposes of the Act. The deeds indemnify the Directors to the maximum extent permitted by law and remain in force for the duration of a Director's period of office and for a six-year period thereafter. The deeds were in force during the whole of the financial year. Deeds for existing Directors are available for inspection at the Company's registered office. In addition, the Group had appropriate Directors' and Officers' liability insurance cover in place throughout 2016.

Directors' Report

Internal control and financial risk management

Information about internal controls and financial risk management systems in relation to financial reporting, as well as the Board's review of these, can be found on pages 98 to 100 of the Audit Committee Report.

Information about financial risk management objectives and policies in relation to the use of financial instruments can be found in the Risk Management Report beginning on page 132.

Both of these sections of the Annual Report and Accounts are incorporated into this report by reference.

Information included in the Strategic Report

The following information that would otherwise be required to be disclosed in this report, and which is incorporated into this report by reference, can be found on the following pages of the Strategic Report:

Subject matter	Page reference
Future developments	32 to 43
Employment of disabled persons	36
Colleague engagement	36 and 37
Emissions reporting	42 and 43

Disclosure of information under Listing Rule (LR) 9.8.4R

Additional information required to be disclosed by LR 9.8.4R, where applicable to the Group, can be found on the following pages of this report:

Subject matter	Page reference
Relationship agreement	90
Publication of unaudited financial information	139
Dividend waivers	Note 11 and Pg 232
Allotment of equity securities	Note 28 and Pg 244
Allotment of other equity securities (ATI issuance)	Note 29 and Pg 245
Significant contracts	Note 36 and Pg 253

Share capital, control and Directors' powers

Information about share capital, restrictions on the transfer of shares or voting rights, and special rights with regard to control of the Company is shown in note 28 to the Financial Statements and is incorporated into this report by reference.

The Company operates an employee benefit trust (EBT), which holds ordinary shares on trust for the benefit of employees and former employees of the Group, and their dependents, and which is used in conjunction with the Group's employee share schemes. Whilst ordinary shares are held in the EBT, the voting rights in respect of these ordinary shares are exercised by the trustees of the EBT.

The powers of the Directors, including in relation to the issue or buy back of the Company's shares, are set out in the Act and in the Articles. The Directors were granted authorities to issue and allot shares and to buy back shares at the 2016 AGM.

Shareholders will be asked to renew these authorities taking into account the latest institutional shareholder guidelines at the 2017 AGM.

The Company did not repurchase any of the issued ordinary shares during 2016 and up to the date of this report or in 2015.

Substantial shareholders

Information provided to the Company by substantial shareholders pursuant to the DTR is published via a Regulatory Information Service. As at 31 December 2016, the Company has been notified under DTR Rule 5 of the interests in its issued share capital as set out below. All such share capital has the right to vote in all circumstances at general meetings.

As at 31 December 2016 Shareholder	Ordinary shares held	% of voting rights	Direct/ indirect interest
Virgin Group Holdings Limited	155,120,454	34.86%	Direct
Kames Capital LLC	22,404,747	5.04%	Direct/Indirect
York Capital Management Global Advisors, LLC	18,482,971	4.15%	Indirect
Standard Life Investments (Holdings) Limited	28,777,913	6.47%	Indirect
Prudential plc	14,003,154	3.15%	Indirect

In the period from 31 December 2016 to the date of this report, the Company has received notifications from Standard Life Investments (Holdings) Limited and the Prudential plc group of companies. As at the date of this report, those notifications indicate that Standard Life Investments (Holdings) Limited shareholding is 44,666,748 Ordinary Shares representing 10.04% of the total voting rights attached to issued share capital and the Prudential plc group of companies shareholding is 16,018,229 representing 3.60% of the total voting rights attached to issued share capital.

Change of control

The Company is not a party to any significant contracts that are subject to change of control provisions in the event of a takeover bid, other than the Virgin Money Trademark Licence Agreement. This is the agreement under which Virgin Enterprises Limited (VEL) grants a perpetual licence to Virgin Money providing the right to use the 'Virgin' and 'Virgin Money' trademarks. VEL has the right to terminate the agreement in the event of a change of control, other than a change of control pre-approved by VEL. VEL shall be entitled to withhold consent only in the event of a takeover by a third party who, in VEL's reasonable opinion, is a direct competitor of VEL or any Virgin entity in the UK, or whose reputation or financial standing is reasonably likely to damage materially the value or reputation of the Virgin brand.

There are no agreements between Virgin Money and its Directors or employees which provide compensation for loss of office or loss of employment that occurs because of a takeover bid.

In the event of a takeover or other change of control (excluding an internal reorganisation), outstanding awards under the Group's share plans vest to the extent any applicable performance conditions have been met, and subject to applicable time pro-rating, in accordance with the rules of the plans.

Research and development activities

Virgin Money does not undertake formal research and development activities although it does invest in the development of platforms and products.

Directors' Report

Statement of Directors' responsibilities

The Directors are responsible for preparing the Annual Report and the Group and parent company financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare Group and parent company financial statements for each financial year. Under that law, they are required to prepare the Group financial statements in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU and applicable law and have elected to prepare the parent company financial statements on the same basis.

Under company law, the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and parent company, and of the profit or loss for that period. In preparing each of the Group and parent company financial statements, the Directors are required to:

> select suitable accounting policies and then apply them consistently;

> make judgements and estimates that are reasonable and prudent;

> state whether they have been prepared in accordance with IFRS as adopted by the EU; and

> prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group and the parent company will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the parent company's transactions and disclose with reasonable accuracy, at any time, the financial position of the parent company and enable them to ensure that its financial statements comply with the Act. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

Under applicable law and regulations, the Directors are also responsible for preparing a Strategic Report, Directors' Report, Directors' Remuneration Report and Corporate Governance Statement that comply with that law and those regulations.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Group's website, virginmoney.com. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Responsibility statement of the Directors in respect of the Annual Financial Report

Each of the current Directors, who is in office at the date of this report and whose name is listed on pages 75 and 76, confirms that to the best of his or her 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.

The Directors consider that the Annual Report and Accounts, taken as a whole, are fair, balanced and understandable and provide the information necessary for shareholders to assess the Group's position and performance, business model and strategy.

Independent auditors and audit information

Each of the current Directors, who is in office at the date of this report and whose name is listed on pages 75 and 76, confirms that, so far as the Director is aware, there is no relevant audit information of which the Company's auditors, PricewaterhouseCoopers LLP, is unaware and that they have taken all the steps that they ought to have taken as a Director to make themselves aware of any relevant audit information and to establish that the Company's auditors are aware of that information. This confirmation is given and should be interpreted in accordance with the provisions of the Act.

Resolutions concerning the re-appointment of PricewaterhouseCoopers LLP as auditors and authorising the Audit Committee to set the auditors' remuneration will be proposed at the 2017 AGM.

On behalf of the Board:

KJ Marshall

Katie Marshall
Company Secretary
27 February 2017

Virgin Money Holdings (UK) plc
Registered No. 03087587

Risk Management Report

Virgin Money Lounge, Edinburgh

The Group's approach to risk management

Risk management is at the heart of the Group's strategy to deliver sustainable growth, quality and returns. This is achieved through a prudent risk appetite and informed risk decision-making, supported by a consistent risk-focused culture across the Group.

Risk culture and values

The Group has a customer-focused business model built on a prudent risk culture. The risk culture is aligned to the Group's EBO philosophy and reinforces accountability. The Group's risk values, outlined below, describe how it expects all colleagues, suppliers and partners to operate.

Do the right thing

Challenge the status quo

Understand your responsibilities

Risk appetite

Risk appetite is the amount and type of risk that the Group is prepared to seek, accept or tolerate. It is reflected in frameworks and policies that either limit or, where appropriate, prohibit activities that could be detrimental to the Group. The Group's strategy is developed in conjunction with risk appetite. A Risk Appetite Statement is approved by the Board with each strategic planning cycle.

Governance and control

Delegation of authority from the Board to Executive Committees and management establishes governance and control. Issues are escalated promptly and remediation plans are initiated where required.

The key responsibilities of the Board and senior management include setting risk appetite, agreeing the risk management framework, and approving policies and practices.

Accountability

The Group uses a 'Three Lines of Defence' model which defines clear responsibilities and accountabilities ensuring effective independent assurance activities over key business activities.

> line management (first line) have primary responsibility for risk decisions; measuring, monitoring and controlling risks within their areas of accountability. They are required to establish effective controls in line with policy, to maintain appropriate risk management skills, practices and tools, and to act within Board-approved risk appetite parameters. All Executives certify a monthly control effectiveness review and a quarterly risk and control attestation;

> the Risk function (second line) provides proactive advice and constructive challenge on the effectiveness of risk decisions taken by management. It is responsible for the design and development of the risk management framework and for promoting the implementation of a strategic approach to risk management. It provides a view of the Group's risk profile while proposing and reporting against risk appetite to the Board. It also oversees the Group's internal stress testing framework and maintains a good working relationship with regulators; and

> Internal Audit (third line) provides independent, objective assurance to improve operations. It helps the Group achieve its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.

Risk Management Report

The Group's approach to risk management

Board
Chairman: Glen Moreno

Board Committees[1]

Risk Committee	Audit Committee	Remuneration Committee
Chairman: Colin Keogh (Non-Executive Director)	Chairman: Norman McLuskie (Non-Executive Director)	Chairman: Marilyn Spearing (Non-Executive Director)

Executive Committees

Risk Management Committee	Asset and Liability Committee
Chairman: Chief Risk Officer Identifies and recommends risk appetite, manages risk within agreed limits, monitors key risk exposures in relation to risk strategy and recommends the approach to managing all types of risk.	Chairman: Chief Financial Officer Responsible for management and monitoring of liquidity, funding, capital and asset and liability management within agreed risk appetite and policy.

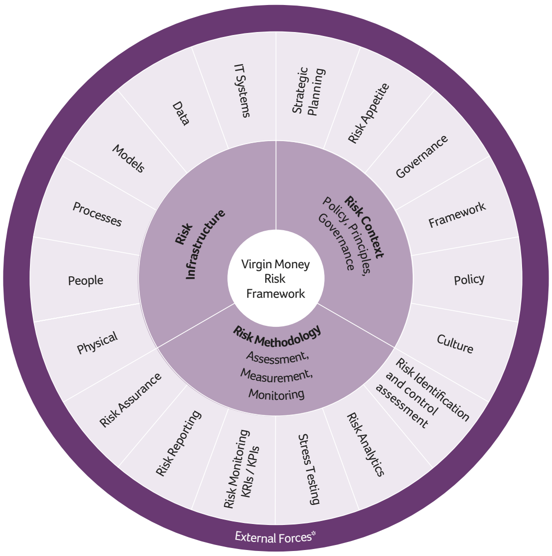
Management Committees

Operational Risk, Conduct Risk and Compliance Committee	Credit Risk Committee	Treasury Risk Committee

1 In addition, there is a Board Nomination Committee.

Risk management framework

The Group's risk management framework is the foundation for the delivery of effective risk management and is structured around the components below:



* **External forces**

Legal	Customer	Political
Regulatory	Competitor	Technological
Economic	Supplier/Partner	

Risk identification and control assessment

The process to identify, measure and control risk is integrated into the overall risk governance framework. Risk identification processes are forward-looking to ensure emerging risks are identified. Risks are captured in comprehensive risk logs and measured using consistent methodologies. Risk measurement includes the application of sound stress testing and scenario analysis, and considers whether relevant controls are in place.

Risk decision-making and reporting

A current and forecast view of the Group's overall risk profile, key exposures, management actions, and performance is reported to the Risk Management Committee, the Board Risk Committee and the Board. Rigorous stress testing exercises are carried out to assess the impact of a range of adverse scenarios and enable the Group to make appropriate contingency plans. The Chief Risk Officer has direct access to the Chairman of the Board Risk Committee.

Stress testing

Stress testing is an essential risk management tool which examines the sensitivities of the strategic plan and business model and supports the development of management actions and contingency plans. It is overseen by the Board Risk Committee.

Sensitivity analysis and scenario stress testing is used to:

> ensure the Group operates within a prudent risk appetite and can meet any unexpected demands on financial resources without threatening the viability of the business;

> inform decision-making, ranging from underwriting decisions to ensuring the sufficiency of capital and liquidity over the planning horizon. This involves the use of a variety of macro-economic, operational, liquidity and financial market disruption scenarios;

> support the Internal Capital Adequacy Assessment Process (ICAAP), the Individual Liquidity Adequacy Assessment Process (ILAAP) and inform the setting of regulatory guidance; and

> develop the Recovery Plan for the business including the identification of material recovery options.

Reverse stress testing is used to explore the vulnerabilities of the Group's strategies and plans to extreme adverse events with the aim of improving contingency planning.

The Senior Managers and Certification Regime outlines stress testing as a prescribed responsibility, with clear accountabilities and responsibilities assigned to senior management and the Risk and Finance functions. The Chief Risk Officer is the Executive accountable for stress testing with collective engagement from the wider Executive and Board.

Risk Management Report

Emerging risks

The Group considers the following to be risks that have the potential to increase in significance and affect the performance of the Group.

Macro-economic environment

The UK's decision to leave the EU has introduced a significant degree of uncertainty for the economy. While there has been no evidence of material changes in customer behaviour to date, adverse developments in the macro-economic environment may affect the Group's earnings and profitability as they are exposed to risks relating to credit conditions and the housing and savings markets.

The Bank of England (BoE) reduced the Bank Base Rate in August 2016. Lower for longer interest rates will put pressure on banking sector net interest margins and may impact the financial performance of the Group.

Key mitigating actions

> the Group regularly reviews earnings in light of economic forecasts and tests its readiness to respond to future changes in the economy;

> the BoE's Term Funding Scheme (TFS) is designed to mitigate the impact of the reduction in interest rates;

> the Group ensures there is an appropriate balance between profitability and customer outcomes; and

> the Group monitors its credit and liquidity positions operational capability and risk of disruption to payment and other systems.

Macro-structural landscape

There is a wide range of incoming regulatory changes which will impact the Group.

Changes to capital requirements include an increase to the countercyclical buffer, implementation of the ring-fencing regime and the introduction of Minimum Requirements for Own Funds and Eligible Liabilities (MREL). Further information regarding these changes can be found on page 188.

The outcome of the EU referendum brings uncertainty in relation to regulation derived from EU legislation. 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 and competition authorities continue to review key banking markets. Market inefficiencies and consolidation within the banking sector could change the competitive landscape and possibly impact market structures and margins.

Key mitigating actions

> the Board is focused on responding effectively and efficiently to changes in the regulatory environment;

> the business planning process incorporates the Group's view of emerging capital requirements;

> stress and scenario testing forms an integral part of the Group's strategic and capital planning; and

> the Group actively participates in a range of regulatory developments, engaging with HM Treasury, the PRA, the FCA and the BoE on the evolving UK regulatory framework and the impact of EU directives.

Balance sheet risk

Credit

The UK has been experiencing strong credit conditions and historically low arrears emergence. However, should there be a rise in interest rates, unemployment, or an economic slow-down, there is the risk that retail consumers' disposable income will come under pressure. This could lead to further increases in defaults and impairments. Additionally, the implementation of IFRS 9 in 2018 will change the basis of provisioning to a view of expected loss. More details relating to IFRS 9 can be found in note 38 to the financial statements, on page 255.

Key mitigating actions

> the Group remains resilient to this risk as a result of its strong asset quality;

> the Group has tightened credit scores for new card applications following the EU referendum to protect the credit quality of new card lending; and

> the Group has a fully mobilised IFRS 9 programme and has adjusted plans for the estimated impact.

Cyber-crime

The external threat of cyber attack continues with reports of data and security breaches increasing in frequency and severity across all industries. Cyber-crime continues to be cited as a material risk by the FPC.

Key mitigating actions

> the Group has a Cyber Security Strategy to enhance IT resilience and information security capability, taking account of both the external threat environment and the changing risk profile of the business;

> the Group monitors the changing external threat landscape, invests to enhance its control environment and improve resilience; and

> increased focus on digital capability and IT resilience.

Supplier partnerships

The Group manages outsourced relationships with third parties who support the credit card, investment and insurance business lines. The Group has strategic suppliers for key components of its infrastructure. Reliance on key corporate partners and strategic suppliers gives rise to the potential risk of disruption.

Key mitigating actions

> the Group develops its supplier partnership and oversight capability to minimise the risk of service disruption caused by the failure of a third party;

> the Group engages specialist third parties to undertake targeted reviews of supplier performance as required; and

> the Group outsources the administration of its unit trust and pension business to IFDS. During 2016, IFDS initiated a significant programme of remediation relating to compliance with client asset regulations which will continue into 2017. The Group continues to strengthen its oversight of IFDS.

Risk Management Report

Exposure to risk by business activity

The table below provides a high-level illustration of how the Group's business activities are reflected in risk-weighted assets.

Virgin Money Group

Total risk-weighted assets £7,695m

Mortgages and savings

Current accounts
Residential mortgages
Buy-to-let mortgages
Customer deposits

Risk-weighted assets	£m
Credit risk	4,765
Operational risk	440

Credit cards

Credit cards

Risk-weighted assets	£m
Credit risk	1,847
Operational risk	165

Financial services

Pensions
Insurance
Investments

Risk-weighted assets	£m
Operational risk	50

Central functions

Shared support functions
Interest Rate Risk in the Banking Book (IRRBB)[1]

Risk-weighted assets	£m
Credit risk	405
Credit value adjustments	23

1 Virgin Money does not have a trading book and, as such, does not have material exposure to market risk. Interest Rate Risk in the Banking Book is captured as part of Pillar 2 capital and therefore does not give rise to risk-weighted assets.

Principal risks

The Board have carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency or liquidity. The Group's principal risks are shown in the Risk overview on pages 48 to 51.

The Group's emerging risks are shown on pages 136 and 137. Full analysis of the group's risk classes is shown on pages 140 to 192.

Risk classes

The Group's risk framework covers all types of risk which affect the Group and could impact on the achievement of strategic objectives. A detailed description of each category is provided on pages 140 to 192.

All disclosures in the Risk Management Report are unaudited, unless otherwise stated. Additional information can be found in the Pillar 3 disclosures on the Group's website.

Credit Risk Page 140
- Retail
  - Mortgage
  - Personal Current Accounts
  - Credit Cards
  - Collections & Recoveries
  - Responsible Lending
- Wholesale
  - Wholesale Credit Risk
  - Large Exposures

Market Risk Page 164
- Foreign Exchange Risk

Operational Risk Page 169
- Operational Risk Framework
- Corporate Risks
- Operational Risk Losses

Other Operational Risk Page 169
- Fund Management
- People
- Legal Risk
- Process
- Business Disruption
- Systems
- Information Security
- Payment & Settlement Risk
- Information Management
- Physical Security & Safe Environment
- Financial Crime
- Non-financial Counterparty Risk

Conduct Risk and Compliance Page 170
- Conduct
  - Product Design and Governance
  - Unfair Contract Terms
  - Sales Practices, Advice & Culture
  - Sales Incentives and Reward
  - Quality and Competence
  - Post sale Administration & Transaction Handling
  - Partner Conduct
  - Vulnerable Customers & Treating Customers Fairly
- Compliance
  - Upstream Regulation
  - Regulatory Reporting
  - Critical and Important Outsourcing
  - Senior Persons Regime
  - Privacy and Data Protection
  - Sourcebooks CASS COLL MCOB BCOB BIPRU COB CCA REMCODE
  - Markets Compliance

Strategic and Business Risk Page 44
- Macro-economic Risk
- Transformation Risk
- Change Risk Management
- Reputation Risk Management
- Competitive Environment

Financial Risk Page 171
- Interest Rate Risk in the Banking Book
- Retail Concentration Risk
- Secured Wholesale Debt
- Pricing
- Model Risk
- Wholesale Credit Concentration Risk
- Under-estimation of Credit Risk

Liquidity Page 177
- Retail Funding Risk
- Off-Balance Sheet Liquidity Risk
- Marketable Asset Risk
- Non-Marketable Asset Risk
- Franchise Viability Risk
- Wholesale Funding Risk
- Funding Concentration Risk
- Intra-Day Liquidity Risk

Capital Page 187
- Capital Sufficiency
- Capital Efficiency

Risk Management Report

Full analysis of risk classes

Credit risk

Definition

Credit risk is defined as the risk that a borrower or counterparty fails to pay the interest or the capital due on a loan or other financial instrument (both on and off-balance sheet).

Risk appetite

The Group has appetite for high-quality credit exposures including affordable retail lending and liquid wholesale investments.

Exposures

The principal credit risks arise from loans and advances to customers, debt securities and derivatives. The credit risk exposures of the Group are set out on page 143. Credit risk exposures are categorised as retail (secured and unsecured) and wholesale.

In terms of loans and advances, credit risk arises both from amounts lent and commitments to extend credit to a customer. This applies to the secured and unsecured portfolios.

Loans and advances expose the Group to customer re-mortgage risk, for example, in the interest only retail mortgage portfolio. Re-mortgage risk is the possibility that an outstanding exposure cannot be repaid at its contractual maturity date. Interest only mortgage management strategies are detailed on page 159.

Growth in buy-to-let lending has been undertaken in a controlled manner, with Board oversight against risk appetite. The buy-to-let lending policy is targeted towards retail customers rather than professional landlords, with specific restrictions in place on total exposures by loan amount and number of properties.

The Group's unsecured portfolio has grown in line with expectation and within strict underwriting criteria.

Credit risk in the wholesale portfolio arises from debt securities, derivatives and foreign exchange activities. The Group's wholesale credit risk exposure is reflected on page 161.

Measurement

The Group uses statistical models, supported by both internal and external data, to measure retail credit risk exposures.

The models reflect three components: (i) the 'probability of default' (PD) by the borrowers on their contractual obligations, (ii) current exposures to the borrowers and their likely future development, from which the Group derives the 'exposure at default', and (iii) the likely loss ratio on the defaulted obligations (the 'loss given default'). These parameters are used in order to derive an expected loss.

Portfolios are assessed by using segmentation for measurement and reporting purposes. Details of the classifications used for asset quality can be found on page 144.

The Group uses Advanced Internal Ratings Based (AIRB) models in measuring the credit risk of secured loans and advances to customers. All retail unsecured and wholesale exposures are measured under the Standardised Approach for regulatory capital.

The Group's credit portfolios are subject to regular stress testing, with stress scenario assessments run at various levels of the organisation from Group-led to individual portfolio exercises. Further information on the stress testing process, methodology and governance can be found on page 135.

Page 147 provides details of the Group's approach to the impairment of financial assets. Refer to note 1 to the financial statements.

Mitigation

The Group uses a range of approaches to mitigate credit risk.

Credit policy

The Risk function uses risk appetite to set the credit policy for each type of credit risk. These policies are supported by lending manuals which define the responsibilities of underwriters and provide a rule set for credit decisions. The risk appetite, target market and risk acceptance criteria are reviewed at least annually. Risk oversight teams monitor early warning indicators, credit performance trends, and key risk indicators, and review and challenge exceptions to planned outcomes. They test the adequacy of the credit risk infrastructure and governance processes throughout the Group. Counterparty exposures are regularly reviewed and appropriate interventions are made where necessary. Risk Assurance perform independent risk-based reviews, and provide an assessment of the effectiveness of internal controls and risk management practices. Oversight and review is also undertaken by Internal Audit.

Controls over AIRB rating systems

The Group has an established Independent Model Validation team that sets common minimum standards. The standards are designed to ensure risk models and associated AIRB rating systems are developed consistently, and are of sufficient quality to support business decisions and meet regulatory requirements[1].

Credit underwriting

The Group uses a variety of lending criteria when assessing applications for secured and unsecured lending. The general approval process uses credit acceptance scorecards and involves a review of an applicant's previous credit history using information held by credit reference agencies.

The Group assesses the affordability of the borrower under stressed scenarios including increased interest rates. In addition, the Group has in place limits on permitted indebtedness.

The Group rejects any application for a product where a customer is registered as bankrupt or insolvent, or has a County Court Judgement registered at a credit reference agency used by the Group. In addition, the Group's approach to underwriting applications takes into account the total unsecured debt held by a customer and their affordability.

For residential mortgages, the Group's policy is to accept only standard applications with a loan-to-value (LTV) of less than 95%. All originations in the year to 31 December 2016 which were between 90% and 95% LTV were only permitted under the Help to Buy loan guarantee scheme. The Group has maximum % LTV limits which depend upon the loan size. Residential mortgage limits are:

Loan size from	To	Maximum LTV
£1	£500,000	95% (purchase) 90% (re-mortgage)
£500,001	£1,000,000	80%

1 The Risk function reviews model effectiveness, while new models and model changes are referred to the appropriate model governance committee for approval.

Buy-to-let is limited to a maximum of 75% LTV and residential interest only is limited to a maximum of 70% LTV, regardless of loan size.

The Group's approach to underwriting applications for unsecured products takes into account the total unsecured debt held by a customer and their affordability.

The Group uses statistically based decisioning techniques (primarily credit scoring models) for its retail portfolios.

Collateral for secured retail and wholesale exposures

The sole collateral type for secured loans and advances to customers is residential real estate. Property offered as collateral must be of acceptable construction and located in England, Wales, Scotland or Northern Ireland. Title to the property must be good, marketable and free from onerous restrictions and conditions. The Group requires first legal charge over the property offered as collateral and does not accept charges over part of the collateral. The Group does not lend where the collateral is land only.

Collateral held as security for financial assets other than loans and advances is determined by the nature of the instrument. Debt securities, treasury and other bills are generally unsecured, with the exception of asset-backed securities and similar instruments such as covered bonds, which are secured by portfolios of financial assets. Collateral is generally not held against loans and advances to financial institutions, except where a collateral agreement has been entered into under a master netting agreement.

In addition, derivative transactions with wholesale counterparties are collateralised under a Credit Support Annex in conjunction with the ISDA Master Agreement to further mitigate credit risk. The Group will receive additional collateral from certain counterparties in the event their external credit rating falls below contractually set triggers as agreed in the Credit Support Annex.

It is the Group's policy that, at the time of borrowing, collateral should always be realistically valued by an appropriately qualified source, independent of both the credit decision process and the customer. Collateral valuation is reviewed on a regular basis.

Monitoring

The Group produces regular portfolio monitoring reports for review by senior management. The Risk function in turn produces a review of credit risk throughout the Group, including reports on significant credit exposures, which are

Risk Management Report

Full analysis of risk classes

presented to the Risk Management Committee and the Board Risk Committee.

The performance of all rating models is monitored on a regular basis to ensure that:

> appropriate risk differentiation capability is provided;

> generated ratings remain as accurate and robust as practical; and

> appropriate risk estimates are assigned to grades and pools of accounts.

In the event that the monitoring identifies material exceptions or deviations from expected outcomes, these are escalated for resolution.

Debt management for customers in financial difficulty

The Group's aim in offering forbearance and other assistance to retail customers in financial distress is to benefit both the customer and the Group by discharging the Group's regulatory and social responsibilities to support customers and act in their best long-term interests. This allows customer facilities to be brought back into a sustainable position which, for residential mortgages, may also mean keeping customers in their homes. The Group offers a range of tools and assistance to support customers who are encountering financial difficulties. Cases are managed on an individual basis, with the circumstances of each customer considered separately and the action taken judged as being affordable and sustainable for the customer.

Customers are assisted through the Debt Management Function where tailored repayment programmes can be agreed. Customers are actively supported and referred to free money advice agencies where they have multiple credit facilities, including those at other lenders, which require restructuring.

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

Specific tools are available to assist customers which vary by product and the customer's status. Further details can be found on page 159.

Income and expenditure assessments are undertaken for all customers entering into a long-term repayment plan. This ensures that customers are provided with a sustainable and affordable solution that allows them a realistic opportunity to repay their debt in the short to medium term. In addition, the Group will advise customers to contact debt management companies such as Citizens Advice Bureau, Stepchange and Payplan. These companies do not charge any fees and will offer advice to customers as well as work with creditors to agree affordable repayment plans. Understanding what has changed and establishing the customers' current and future financial situation is imperative to ensuring that the right level of support is offered and that customers receive the appropriate solution to help them manage their debt when in financial difficulty.

Forbearance and provisioning

The Group's approach is to ensure that provisioning models, supported by management judgement, appropriately reflect the incurred loss risk of exposures. The Group uses behavioural scoring to assess customers' credit risk and the models take a range of potential indicators of customer financial distress into account.

The performance of provision models is monitored and challenged on an ongoing basis in line with the Retail Credit Provisioning Policy. Regular detailed analysis of modelled provision outputs is undertaken to demonstrate that the risk of forbearance or other similar activities is recognised, that the outcome period adequately captures the risk and that the underlying risk is appropriately reflected.

Further details on forbearance can be found on page 159.

Credit risk portfolio as at 31 December 2016

Overview

The tables below show the total credit risk exposures for the Group's retail and wholesale portfolios.

	Secured		Unsecured		Wholesale		
2016 (audited)	**Residential mortgage loans £m**	**Residential buy-to-let mortgage loans £m**	**Credit cards £m**	**Overdrafts £m**	**Treasury assets £m**	**Derivative exposures £m**	**Total £m**
Total gross loans and advances to customers	**24,283.0**	**5,468.4**	**2,486.5**	**0.1**	**–**	**–**	**32,238.0**
Loans and advances to banks	**–**	**–**	**–**	**–**	**635.6**	**–**	**635.6**
Cash and balances at central banks	**–**	**–**	**–**	**–**	**786.3**	**–**	**786.3**
Debt securities classified as loans and receivables	**–**	**–**	**–**	**–**	**0.7**	**–**	**0.7**
Available-for-sale financial assets	**–**	**–**	**–**	**–**	**858.8**	**–**	**858.8**
Gross positive fair value of derivative assets	**–**	**–**	**–**	**–**	**–**	**104.2**	**104.2**
Total	**24,283.0**	**5,468.4**	**2,486.5**	**0.1**	**2,281.4**	**104.2**	**34,623.6**

	Secured		Unsecured		Wholesale		
2015 (audited)	Residential mortgage loans £m	Residential buy-to-let mortgage loans £m	Credit cards £m	Overdrafts £m	Treasury assets £m	Derivative exposures £m	Total £m
Total gross loans and advances to customers	21,060.3	4,401.9	1,609.8	0.2	–	–	27,072.2
Loans and advances to banks	–	–	–	–	614.5		614.5
Cash and balances at central banks	–	–	–	–	888.6	–	888.6
Debt securities classified as loans and receivables	–	–	–	–	1.1	–	1.1
Available-for-sale financial assets	–	–	–	–	1,296.9	–	1,296.9
Gross positive fair value of derivative assets	–	–	–	–	–	82.3	82.3
Total	**21,060.3**	**4,401.9**	**1,609.8**	**0.2**	**2,801.1**	**82.3**	**29,955.6**

Risk Management Report

Full analysis of risk classes

Credit quality of assets

Loans and receivables

The Group defines three classifications of credit quality (low risk, medium risk and higher risk) for all credit exposures. These are based on the following criteria.

Secured credit exposures are segmented according to the credit quality classification and a point-in-time PD. The point-in-time PD is an internal parameter used within the Group's AIRB capital models which aims to estimate the probability of default over the next 12 months based on account characteristics and customer behavioural data. Default occurs where the borrower has missed six months of mortgage repayments or the borrower is deemed to be unlikely to repay their loan. Exposures are categorised as:

> higher risk where assets are past due or have a point in time PD greater than 2%;

> medium risk where assets are not past due and have a PD greater than 0.8% and less than or equal to 2%; and

> low risk where assets are not past due and have a PD less than or equal to 0.8%.

Unsecured exposures are categorised as:

> higher risk where assets are past due;

> medium risk where assets are currently not past due and benefiting from a forbearance solution; and

> low risk where assets are neither past due nor in forbearance.

Wholesale credit exposures are assessed by reference to credit rating. The Group's wholesale exposures are investment grade and therefore classified as low risk.

No wholesale credit exposures were past due or impaired as at 31 December 2016 and 31 December 2015.

Further asset quality categorisation is disclosed on page 147, which reflects the impairment status of assets.

Maximum credit exposure

The maximum credit risk exposure of the Group in the event of other parties failing to perform their obligations is detailed below. No account is taken of any collateral held, other credit enhancements or provisions for impairment.

The maximum credit risk exposure for off-balance sheet items relates to applications that have been approved and have not yet been drawn by the customer and undrawn loan commitments. These commitments represent agreements to lend in the future and may be decreased or removed by the Group, subject to product notice requirements.

2016 (audited)	Low risk £m	Medium risk £m	Higher risk £m	Total exposures £m	Low risk %	Medium risk %	Higher risk %
On-balance sheet							
Wholesale							
Cash and balances at central banks	786.3	–	–	786.3	100.0	–	–
Debt securities classified as loans and receivables	0.7	–	–	0.7	100.0	–	–
Available-for-sale financial assets	858.8	–	–	858.8	100.0	–	–
Loan and advances to banks	635.6	–	–	635.6	100.0	–	–
Derivative financial instruments	104.2	–	–	104.2	100.0	–	–
Retail							
Gross loans and advances to customers – secured	26,822.3	1,871.6	1,057.5	29,751.4	90.1	6.3	3.6
Gross loans and advances to customers – unsecured	2,451.3	2.9	32.4	2,486.6	98.6	0.1	1.3
Total on-balance sheet	31,659.2	1,874.5	1,089.9	34,623.6	91.5	5.4	3.1
Off-balance sheet							
Loan commitments (pipeline and undrawn commitments)	5,289.1	–	–	5,289.1	100.0	–	–

Risk Management Report

Full analysis of risk classes

2015 (audited)	Low risk £m	Medium risk £m	Higher risk £m	Total exposures £m	Low risk %	Medium risk %	Higher risk %
On-balance sheet							
Wholesale							
Cash and balances at central banks	888.6	–	–	888.6	100.0	–	–
Debt securities classified as loans and receivables	1.1	–	–	1.1	100.0	–	–
Available-for-sale financial assets	1,296.9	–	–	1,296.9	100.0	–	–
Loan and advances to banks	614.5	–	–	614.5	100.0	–	–
Derivative financial instruments	82.3	–	–	82.3	100.0	–	–
Retail							
Gross loans and advances to customers – secured	22,916.7	1,652.7	892.8	25,462.2	90.0	6.5	3.5
Gross loans and advances to customers – unsecured	1,579.7	2.9	27.4	1,610.0	98.1	0.2	1.7
Total on-balance sheet	**27,379.8**	**1,655.6**	**920.2**	**29,955.6**	**91.4**	**5.5**	**3.1**
Off-balance sheet							
Loan commitments (pipeline and undrawn commitments)	4,479.8	–	–	4,479.8	100.0	–	–

Loans and advances to customers comprise:

(audited)	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
Total advances secured on residential property	**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
Impairment allowance-secured	**(10.6)**	(8.7)
Loans and advances-secured	**29,740.8**	25,453.5
Credit cards	**2,486.5**	1,609.8
Overdrafts	**0.1**	0.2
Unsecured receivables not subject to securitisation	**2,486.6**	1,610.0
Impairment allowance – unsecured	**(39.5)**	(31.2)
Loans and advances – unsecured	**2,447.1**	1,578.8
Total loans and advances to customers excluding portfolio hedging	**32,187.9**	27,032.3

The mortgage portfolio has grown by 16.8% (£4.3 billion) during 2016. Buy-to-let loans grew by 24.2% (£1.1 billion) to £5.5 billion, accounting for 18.4% of total secured loans (2015: 17.3%). This increase is in line with growth in the private rental sector, with the proportion of buy-to-let mortgage lending in line with the market. In particular, the market experienced an increase in buy-to-let lending during the first three months of 2016, ahead of the stamp duty changes which came into effect on 1 April 2016. Growth in buy-to-let lending has been undertaken in a controlled manner, with the intention of keeping the portfolio mix broadly in line with the market average position.

The credit card portfolio has grown by 54.5% (£876.7 million) during 2016, in line with the target of £3 billion of receivables by the end of 2017. This growth has not been at the expense of credit quality, as shown by the reduction in the proportion of impaired balances to total book of 0.4% in the year.

Credit risk categorisation	Description
Neither past due nor impaired	Loans that are not in arrears and which do not meet the impaired asset definition. This segment can include assets subject to forbearance solutions.
Neither past due nor impaired and in forbearance	Loans that are categorised as neither past due nor impaired, and are currently subject to one of the defined forbearance solutions.
Past due and not impaired	Loans that are in arrears or where there is objective evidence of impairment and the asset does not meet the definition of impaired assets, as the expected recoverable amount exceeds the carrying amount. This category is not applicable for unsecured lending.
Arrears	For secured lending, where the customer's payment shortfall exceeds 1% of the current monthly contractual payment amount. For unsecured lending, customers are classified as in arrears at one day past due.
Impaired assets	Loans that are in arrears or where there is objective evidence of impairment, including changes in customer behaviour or circumstances, and where the carrying amount of the loan exceeds the expected recoverable amount. Unsecured lending assets are treated as impaired at one day past due. All fraud and operational risk loans are categorised as impaired irrespective of the expected recoverable amount.

Risk Management Report

Full analysis of risk classes

The credit quality of retail assets is detailed in the tables below.

	Secured				Unsecured				Total	
	Residential mortgage loans		Residential buy-to-let mortgage loans		Credit cards		Overdrafts			
2016 (audited)	£m	%	£m	%	£m	%	£m	%	£m	%
Neither past due nor impaired	**24,047.8**	**99.1**	**5,441.8**	**99.5**	**2,454.1**	**98.7**	**0.1**	**100.0**	**31,943.8**	**99.1**
– of which in receipt of forbearance[1]	*231.5*	*1.0*	*25.7*	*0.5*	*2.9*	*0.1*	–	–	*260.1*	*0.8*
Past due and not impaired	**151.3**	**0.6**	**17.6**	**0.3**	–	–	–	–	**168.9**	**0.5**
Impaired	**83.9**	**0.3**	**9.0**	**0.2**	**32.4**	**1.3**	–	–	**125.3**	**0.4**
Total	**24,283.0**	**100.0**	**5,468.4**	**100.0**	**2,486.5**	**100.0**	**0.1**	**100.0**	**32,238.0**	**100.0**

1 This category reflects accounts which are neither past due nor impaired and subject to forbearance solutions. Accounts in this category are also included in the neither past due nor impaired categorisation. Full forbearance disclosures can be found on page 160.

	Secured				Unsecured				Total	
	Residential mortgage loans		Residential buy-to-let mortgage loans		Credit cards		Overdrafts			
2015 (audited)	£m	%	£m	%	£m	%	£m	%	£m	%
Neither past due nor impaired	20,837.5	98.9	4,379.9	99.5	1,582.4	98.3	0.2	100.0	26,800.0	99.0
– of which in receipt of forbearance[1]	*238.6*	*1.1*	*8.8*	*0.2*	*2.9*	*0.2*	-	-	*250.3*	*0.9*
Past due and not impaired	145.2	0.7	15.0	0.3	-	-	-	-	160.2	0.6
Impaired	77.6	0.4	7.0	0.2	27.4	1.7	-	-	112.0	0.4
Total	**21,060.3**	**100.0**	**4,401.9**	**100.0**	**1,609.8**	**100.0**	**0.2**	**100.0**	**27,072.2**	**100.0**

1 This category reflects accounts which are neither past due nor impaired and subject to forbearance solutions. Accounts in this category are also included in the neither past due nor impaired categorisation. Full forbearance disclosures can be found on page 160.

The criteria the Group uses to determine that there is objective evidence of impairment are disclosed on page 147. All loans, where specific circumstances indicate that a loss is likely to be incurred (for example, mortgage accounts which have entered possession or loans where fraud has been confirmed), are individually assessed for impairment by reviewing expected future cash flows including those that could arise from the realisation of security.

Loans and advances which are neither past due nor impaired

Loans which are neither past due nor impaired have improved marginally by 0.1% in the year to 31 December 2016. This has been driven primarily by a reduction in secured and unsecured arrears rates. Additionally, new lending during the period, although having a diluting effect, has shown strong arrears performance.

The segmentation for 'low', 'medium' and 'higher' risk categories for the unsecured portfolio can be found on page 145.

The tables below show the details of the credit quality for neither past due nor impaired loans.

	Residential mortgage loans		Residential buy-to-let mortgage loans		Total	
2016 (audited)	**£m**	**%**	**£m**	**%**	**£m**	**%**
PD by internal ratings						
Low risk	**21,565.5**	**89.7**	**5,256.8**	**96.6**	**26,822.3**	**90.9**
Medium risk	**1,699.5**	**7.1**	**172.1**	**3.2**	**1,871.6**	**6.3**
Higher risk	**782.8**	**3.2**	**12.9**	**0.2**	**795.7**	**2.8**
Total neither past due nor impaired	**24,047.8**	**100.0**	**5,441.8**	**100.0**	**29,489.6**	**100.0**

	Residential mortgage loans		Residential buy-to-let mortgage loans		Total	
2015 (audited)	£m	%	£m	%	£m	%
PD by internal ratings						
Low risk	18,681.1	89.6	4,235.6	96.7	22,916.7	90.8
Medium risk	1,519.0	7.3	133.7	3.1	1,652.7	6.6
Higher risk	637.4	3.1	10.6	0.2	648.0	2.6
Total neither past due nor impaired	**20,837.5**	**100.0**	**4,379.9**	**100.0**	**25,217.4**	**100.0**

Risk Management Report

Full analysis of risk classes

Loans and advances which are past due and not impaired

The balance of mortgages which are past due and not impaired totalled £168.9 million at 31 December 2016, representing a 5.4% (£8.7 million) increase from 31 December 2015. Past due and not impaired balances as a proportion of the overall book have remained stable, constituting 0.6% of secured loans (2015: 0.6%). All unsecured assets which are past due are treated as impaired.

	Residential mortgage loans		Residential buy-to-let mortgage loans		Total	
2016 (audited)	£m	%	£m	%	£m	%
Up to one month	**57.1**	**37.8**	**4.3**	**24.4**	**61.4**	**36.4**
One to three months	**63.9**	**42.2**	**10.8**	**61.4**	**74.7**	**44.2**
Three to six months	**21.4**	**14.1**	**2.1**	**11.9**	**23.5**	**13.9**
Over six months	**8.9**	**5.9**	**0.4**	**2.3**	**9.3**	**5.5**
Total past due and not impaired	**151.3**	**100.0**	**17.6**	**100.0**	**168.9**	**100.0**

	Residential mortgage loans		Residential buy-to-let mortgage loans		Total	
2015 (audited)	£m	%	£m	%	£m	%
Up to one month	44.4	30.6	4.3	28.7	48.7	30.4
One to three months	63.5	43.7	8.3	55.3	71.8	44.8
Three to six months	24.1	16.6	1.3	8.7	25.4	15.9
Over six months	13.2	9.1	1.1	7.3	14.3	8.9
Total past due and not impaired	**145.2**	**100.0**	**15.0**	**100.0**	**160.2**	**100.0**

Impaired assets

The tables below show the movement of impaired loan balances during 2016 and 2015.

	Secured		Unsecured		Wholesale		
2016 (audited)	**Residential mortgage loans £m**	**Residential buy-to-let mortgage loans £m**	**Credit cards £m**	**Overdrafts £m**	**Treasury assets £m**	**Derivative exposures £m**	**Total £m**
As at 1 January 2016	**77.6**	**7.0**	**27.4**	**–**	**–**	**–**	**112.0**
Classified as impaired during the year	**132.3**	**20.4**	**85.0**	**–**	**–**	**–**	**237.7**
Transferred from impaired to unimpaired	**(112.9)**	**(17.7)**	**(38.3)**	**–**	**–**	**–**	**(168.9)**
Amounts written off	**(0.6)**	**(0.2)**	**(32.3)**	**–**	**–**	**–**	**(33.1)**
Repayments	**(12.5)**	**(0.5)**	**(9.4)**	**–**	**–**	**–**	**(22.4)**
As at 31 December 2016	**83.9**	**9.0**	**32.4**	**–**	**–**	**–**	**125.3**

	Secured		Unsecured		Wholesale		
2015 (audited)	Residential mortgage loans £m	Residential buy-to-let mortgage loans £m	Credit cards £m	Overdrafts £m	Treasury assets £m	Derivative exposures £m	Total £m
As at 1 January 2015	68.9	7.6	27.4	–	–	–	103.9
Classified as impaired during the year	174.9	22.2	81.9	–	–	–	279.0
Transferred from impaired to unimpaired	(151.2)	(21.6)	(42.7)	–	–	–	(215.5)
Amounts written off	(1.7)	(0.2)	(26.0)	–	–	–	(27.9)
Repayments	(13.3)	(1.0)	(13.2)	–	–	–	(27.5)
As at 31 December 2015	**77.6**	**7.0**	**27.4**	**–**	**–**	**–**	**112.0**

Total impaired assets increased by £13.3 million in the year to 31 December 2016. This increase reflects growth in the book, despite improved arrears performance. Further details can be found on page 154.

Risk Management Report

Full analysis of risk classes

An analysis of impaired assets by overdue term and assets where the borrower's property is in possession is provided in the tables below.

	Residential mortgage loans		Residential buy-to-let mortgage loans		Credit cards		Overdrafts		Total	
2016 (audited)	**£m**	**%**	**£m**	**%**	**£m**	**%**	**£m**	**%**	**£m**	**%**
Up to one month	**55.7**	**66.4**	**6.2**	**69.0**	**13.1**	**40.5**	**–**	**–**	**75.0**	**59.8**
One to three months	**19.9**	**23.7**	**2.2**	**24.4**	**9.3**	**28.7**	**–**	**–**	**31.4**	**25.1**
Three to six months	**4.1**	**4.9**	**0.3**	**3.3**	**9.7**	**29.9**	**–**	**–**	**14.1**	**11.3**
Over six months	**3.9**	**4.6**	**0.2**	**2.2**	**0.3**	**0.9**	**–**	**–**	**4.4**	**3.5**
Possession	**0.3**	**0.4**	**0.1**	**1.1**	**–**	**–**	**–**	**–**	**0.4**	**0.3**
Total impaired assets	**83.9**	**100.0**	**9.0**	**100.0**	**32.4**	**100.0**	**–**	**–**	**125.3**	**100.0**

	Residential mortgage loans		Residential buy-to-let mortgage loans		Credit cards		Overdrafts		Total	
2015 (audited)	£m	%	£m	%	£m	%	£m	%	£m	%
Up to one month	50.6	65.1	4.5	64.3	11.8	43.1	–	–	66.9	59.7
One to three months	13.7	17.7	1.4	20.0	7.6	27.7	–	–	22.7	20.3
Three to six months	5.2	6.7	0.3	4.3	7.7	28.1	–	–	13.2	11.8
Over six months	7.2	9.3	0.7	10.0	0.3	1.1	–	–	8.2	7.3
Possession	0.9	1.2	0.1	1.4	–	–	–	–	1.0	0.9
Total impaired assets	77.6	100.0	7.0	100.0	27.4	100.0	–	–	112.0	100.0

The tables below show impaired assets and impairment provisions.

2016 (audited)	**Gross balances £m**	**Impaired balances £m**	**Impaired balances as a % of gross balances %**	**Impairment provisions £m**	**Impairment provisions as a % of impaired balances %**
Residential mortgage loans	**24,283.0**	**83.9**	**0.3**	**9.4**	**11.2**
Residential buy-to-let mortgage loans	**5,468.4**	**9.0**	**0.2**	**1.2**	**13.3**
Total secured	**29,751.4**	**92.9**	**0.3**	**10.6**	**11.4**
Credit cards	**2,486.5**	**32.4**	**1.3**	**39.4**	**121.6**
Overdrafts	**0.1**	**–**	**–**	**0.1**	**–**
Total unsecured	**2,486.6**	**32.4**	**1.3**	**39.5**	**121.9**
Wholesale treasury assets	**2,281.4**	**–**	**–**	**–**	**–**
Wholesale derivative exposures	**104.2**	**–**	**–**	**–**	**–**
Total wholesale	**2,385.6**	**–**	**–**	**–**	**–**
Total	**34,623.6**	**125.3**	**0.4**	**50.1**	**40.0**

2015 (audited)	Gross balances £m	Impaired balances £m	Impaired balances as a % of gross balances %	Impairment provisions £m	Impairment provisions as a % of impaired balances %
Residential mortgage loans	21,060.3	77.6	0.4	7.7	9.9
Residential buy-to-let mortgage loans	4,401.9	7.0	0.2	1.0	14.3
Total secured	25,462.2	84.6	0.3	8.7	10.3
Credit cards	1,609.8	27.4	1.7	31.1	113.5
Overdrafts	0.2	–	–	0.1	–
Total unsecured	1,610.0	27.4	1.7	31.2	113.9
Wholesale treasury assets	2,801.1	–	–	–	–
Wholesale derivative exposures	82.3	–	–	–	–
Total wholesale	2,883.4	–	–	–	–
Total	**29,955.6**	**112.0**	**0.4**	**39.9**	**35.6**

Risk Management Report

Full analysis of risk classes

Secured impaired balances increased by 9.8% during the year to 31 December 2016 and remained stable as a proportion of gross balances. Impairment provisions on the secured book have increased by £1.9 million; representing 0.04% and 0.03% as a proportion of gross balances as at 31 December 2016 and 31 December 2015 respectively. This increase reflects book growth and the use of management judgement to maintain appropriate coverage in the current uncertain economic environment.

Unsecured impaired assets have increased by £5.0 million during the year, reducing as a proportion of gross balances from 1.7% to 1.3% at 31 December 2015 and 31 December 2016 respectively. This reflects improved arrears performance and the diluting effect of new lending which is yet to mature. Impairment provisions have increased by £8.3 million during the period and have reduced as a percentage of gross balances from 1.9% at 31 December 2015 to 1.6% at 31 December 2016. The impairment provisions as a proportion of impaired balances have increased however, from 113.9% to 121.9% at 31 December 2015 and 31 December 2016 respectively. Impairment provisions have remained consistent on older tranches of debt while increasing on newer tranches to take into account the maturing of the book.

The table below shows the movement of impairment provisions during the year.

	Secured		Unsecured		Wholesale		
(audited)	On advances secured on residential property £m	On advances secured on residential buy-to-let property £m	Credit cards £m	Overdrafts £m	Treasury assets £m	Derivative exposures £m	Total £m
As at 1 January 2015	6.2	1.4	22.9	0.1	–	–	30.6
Advances written off	(1.7)	(0.2)	(26.0)	–	–	–	(27.9)
Gross charge to the income statements	3.2	(0.2)	34.2	–	–	–	37.2
As at 1 January 2016	**7.7**	**1.0**	**31.1**	**0.1**	**–**	**–**	**39.9**
Advances written off	**(0.6)**	**(0.2)**	**(32.3)**	**–**	**–**	**–**	**(33.1)**
Gross charge to the income statement	**2.3**	**0.4**	**40.6**	**–**	**–**	**–**	**43.3**
As at 31 December 2016	**9.4**	**1.2**	**39.4**	**0.1**	**–**	**–**	**50.1**

The net impairment charge to the income statement in 2016 was £37.6 million (2015: £30.3 million) with the gross charge of £43.3 million (2015: £37.2 million), and advances written off of £33.1 million (2015: £27.9 million), representing the movement between opening and closing provision balances as shown above. The difference between the gross and net charge represents sales of credit card receivables which had previously been written off resulting in net recoveries of £5.7 million (2015: £6.9 million). Refer to note 8 in the financial statements for more details.

Collateral held as security for loans and receivables to customers

A general description of collateral held as security in respect of financial instruments is provided on page 141. The Group holds collateral against loans and receivables in the mortgage portfolio. Quantitative and, where appropriate, qualitative information is provided in respect of this collateral on page 156.

The Group holds collateral in respect of loans and advances to customers as set out on page 141. The Group does not hold collateral against debt securities, comprising asset-backed securities and corporate and other debt securities, which are classified as loans and receivables.

The tables below show retail secured loan-to-value (LTV) %.

	Residential mortgage loans		Residential buy-to-let mortgage loans		Total	
2016 (audited)	£m	%	£m	%	£m	%
<50%	**9,476.6**	**39.1**	**1,922.8**	**35.2**	**11,399.4**	**38.3**
50%-<60%	**4,958.1**	**20.4**	**1,454.8**	**26.6**	**6,412.9**	**21.6**
60%-<70%	**3,918.9**	**16.1**	**1,271.8**	**23.3**	**5,190.7**	**17.4**
70%-<80%	**3,162.8**	**13.0**	**796.4**	**14.6**	**3,959.2**	**13.3**
80%-<90%	**2,307.7**	**9.5**	**19.0**	**0.3**	**2,326.7**	**7.8**
90%-<100%	**445.1**	**1.8**	**2.2**	**–**	**447.3**	**1.5**
>100%	**13.8**	**0.1**	**1.4**	**–**	**15.2**	**0.1**
Total	**24,283.0**	**100.0**	**5,468.4**	**100.0**	**29,751.4**	**100.0**
Average LTV[1] of stock – indexed		**55.6%**		**54.8%**		**55.4%**
Average LTV of new business		**69.8%**		**60.5%**		**68.0%**

1 The average LTV of stock and new business is balance weighted.

	Residential mortgage loans		Residential buy-to-let mortgage loans		Total	
2015 (audited)	£m	%	£m	%	£m	%
<50%	8,125.8	38.6	1,443.5	32.8	9,569.3	37.6
50%-<60%	4,680.7	22.2	1,202.9	27.3	5,883.6	23.1
60%-<70%	4,026.2	19.1	1,069.7	24.3	5,095.9	20.0
70%-<80%	2,247.7	10.7	680.5	15.5	2,928.2	11.5
80%-<90%	1,720.1	8.2	3.4	0.1	1,723.5	6.8
90%-<100%	250.4	1.2	1.4	–	251.8	1.0
>100%	9.4	–	0.5	–	9.9	–
Total	**21,060.3**	**100.0**	**4,401.9**	**100.0**	**25,462.2**	**100.0**
Average LTV[1] of stock – indexed		54.9%		55.4%		55.0%
Average LTV of new business		69.8%		62.7%		68.0%

1 The average LTV of stock and new business is balance weighted.

The average indexed LTVs of the overall mortgage portfolio have increased by 0.4% as at 31 December 2016. This reflects the overall book growth, with an increased proportion of residential new lending. The value of loans with a LTV greater than 100% increased from £9.9 million as at 31 December 2015 to £15.2 million as at 31 December 2016. This increase is due to a small number of cases in Northern Ireland which experienced a 7.1% decrease in the indexed value for properties during the period.

The average LTV for new business has remained at 68.0% as at 31 December 2016, despite a reduction in the proportion of buy-to-let new business. Buy-to-let mortgages have lower LTV's due to the 75% cap enforced at origination, therefore, this reduction is not sufficiently material to change the overall new business LTV.

Risk Management Report

Full analysis of risk classes

Collateral held in relation to secured loans is capped at the amount outstanding on an individual loan basis. The percentages in the tables below represent the value of collateral, capped at loan amount, divided by the total loan amount in each category.

	Residential mortgage loans		**Residential buy-to-let mortgage loans**		**Total**	
2016[1] (audited)	**£m**	**%**	**£m**	**%**	**£m**	**%**
Neither past due nor impaired	**24,046.6**	**100.0**	**5,441.7**	**100.0**	**29,488.3**	**100.0**
– of which in receipt of forbearance	*231.5*	*100.0*	*25.7*	*100.0*	*257.2*	*100.0*
Past due and not impaired	**151.3**	**100.0**	**17.6**	**100.0**	**168.9**	**100.0**
Impaired	**83.7**	**99.8**	**9.0**	**100.0**	**92.7**	**99.8**
– of which in possession	*0.3*	*100.0*	*0.1*	*100.0*	*0.4*	*100.0*
Total	**24,281.6**	**100.0**	**5,468.3**	**100.0**	**29,749.9**	**100.0**

1 Some segments may appear fully collateralised due to immaterial balances in negative equity. Due to rounding these do not change the overall collateralised percentage shown.

	Residential mortgage loans		Residential buy-to-let mortgage loans		Total	
2015[1] (audited)	£m	%	£m	%	£m	%
Neither past due nor impaired	20,836.9	100.0	4,379.8	100.0	25,216.7	100.0
– of which in receipt of forbearance	*238.6*	*100.0*	*8.8*	*100.0*	*247.4*	*100.0*
Past due and not impaired	145.2	100.0	15.0	100.0	160.2	100.0
Impaired	77.3	99.6	7.0	100.0	84.3	99.6
– of which in possession	*0.9*	*100.0*	*0.1*	*100.0*	*1.0*	*100.0*
Total	**21,059.4**	**100.0**	**4,401.8**	**100.0**	**25,461.2**	**100.0**

1 Some segments may appear fully collateralised due to immaterial balances in negative equity. Due to rounding these do not change the overall collateralised percentage shown.

The tables below show the excess between the mortgage balance and collateral held, on secured balances with a LTV of greater than 100%.

For these loans, the exposure was £1.5 million greater than the collateral held as at 31 December 2016. This has increased from £1.0 million as at 31 December 2015 reflecting a small number of cases in Northern Ireland where negative house price movements were observed during the year. The recoverable amount used for impairment provision purposes reflects this level of collateral.

2016 (audited)	**Residential mortgage loans £m**	**Residential buy-to-let mortgage loans £m**	**Total £m**
Neither past due nor impaired	**1.2**	**0.1**	**1.3**
– of which in receipt of forbearance	**–**	**–**	**–**
Past due and not impaired	**–**	**–**	**–**
Impaired	**0.2**	**–**	**0.2**
– of which in possession	**0.1**	**–**	**0.1**
Total	**1.4**	**0.1**	**1.5**

2015 (audited)	Residential mortgage loans £m	Residential buy-to-let mortgage loans £m	Total £m
Neither past due nor impaired	0.6	0.1	0.7
– of which in receipt of forbearance	–	–	–
Past due and not impaired	–	–	–
Impaired	0.3	–	0.3
– of which in possession	–	–	–
Total	**0.9**	**0.1**	**1.0**

Repossessions

The Group works with customers who have difficulty paying their mortgages, and will only repossess a property when all other possibilities have been exhausted. Where accounts have been repossessed, the Group will obtain the best price that might reasonably be paid, taking into account factors such as property and market conditions.

The Group uses external asset management specialists to realise the value as soon as practicable to settle indebtedness. Any surplus funds are returned to the borrower or are otherwise dealt with in accordance with appropriate insolvency regulations.

The Group had six repossessed properties as at 31 December 2016, compared to twelve as at 31 December 2015.

Risk Management Report

Full analysis of risk classes

Interest only mortgages

The Group provides interest only mortgages to customers, whereby payments made by the customer comprise interest for the term of the mortgage, with the customer responsible for repaying the principal outstanding at the end of the loan term. The Group's interest only exposure for customers on both interest only and part-and-part for the year to 31 December 2016 has reduced, accounting for 29.9% of total secured balances, compared to 33.1% at 31 December 2015.

The tables below provide details of balances which are on an interest only basis, analysed by maturity. This includes the interest only balances for loans on a part-and-part repayment basis.

2016 (audited)	**Residential mortgage loans £m**	**Residential buy-to-let mortgage loans £m**	**Total £m**
Term expired (still open)	**30.1**	**1.9**	**32.0**
Due within 2 years	**167.5**	**16.4**	**183.9**
Due after 2 years and before 5 years	**405.2**	**77.8**	**483.0**
Due after 5 years and before 10 years	**1,012.9**	**591.8**	**1,604.7**
Due after more than 10 years	**2,726.0**	**3,852.6**	**6,578.6**
Total	**4,341.7**	**4,540.5**	**8,882.2**
– of which are impaired	**8.6**	**47.8**	**56.4**
% of total secured loans and advances to customers	**17.9**	**83.0**	**29.9**
Average LTV (%)	**42.1**	**55.8**	**49.6**

2015 (audited)	Residential mortgage loans £m	Residential buy-to-let mortgage loans £m	Total £m
Term expired (still open)	19.1	0.7	19.8
Due within 2 years	172.4	15.7	188.1
Due after 2 years and before 5 years	411.6	57.6	469.2
Due after 5 years and before 10 years	1,017.7	488.1	1,505.8
Due after more than 10 years	3,173.2	3,068.6	6,241.8
Total	**4,794.0**	**3,630.7**	**8,424.7**
– of which are impaired	6.7	41.6	48.3
% of total secured loans and advances to customers	**22.8**	**82.5**	**33.1**
Average LTV (%)	**44.9**	**56.4**	**50.3**

The Group has been following a process whereby contact is made with customers who have an interest only mortgage scheduled to mature within the next ten years. These customers are contacted throughout their mortgage term to confirm if their strategy to repay the mortgage loan in full at the end of the agreed term remains on track. If not, the Group will discuss a range of options with them which may include a review of the product to ensure it remains the best product for their needs, or a forbearance treatment if required.

Interest only balances due to mature in the next two years represent 2.1% of total interest only balances, totalling £183.9 million at 31 December 2016. Treatment strategies exist to help customers who may not be able to repay the full amount of principal balance at maturity. Of residential interest only mortgages which have missed the payment of principal at the end of term, £32.0 million remain at 31 December 2016 (2015: £19.8 million).

All expired term balances are categorised as impaired loans, regardless of loss expectation. The provisioning methodology for expired term mortgage loans reflects the latest performance on these accounts. Approximately 0.1% of the secured portfolio relates to expired term loan balances. The average balance of expired term loans which are more than six months past their maturity date is around £60,000 with an average LTV of 24%.

The Group offers interest only loans to applicants who have credible means to repay the mortgage loan at maturity other than sale of main residence. The flow of new interest only residential business has remained low during 2016, representing 2.5% of residential completions. As a result, the proportion of residential interest only mortgages (excluding part-and-part) in the portfolio continues to reduce, moving from 19.1% to 15.0% during 2016.

The Group regularly reviews the effectiveness of the interest only policy and contact strategies to ensure the delivery of fair customer outcomes.

Forbearance

The Group operates a number of treatments to assist borrowers who are experiencing financial distress. In defining these treatments, the Group distinguishes between the following categories for secured assets:

- payment arrangements: a temporary arrangement for customers in financial distress where arrears accrue at the contractual payment, for example, short-term arrangements to pay less than the contractual payment;
- transfers to interest only: an account change to assist customers through periods of financial difficulty where arrears do not accrue at the original contractual payment. Any arrears existing at the commencement of the arrangement are retained;
- term extensions: a permanent account change for customers in financial distress where the overall term of the mortgage is extended, resulting in a lower contractual monthly payment; and
- discretionary payment holidays: a temporary account change to assist customers through periods of financial difficulty where arrears do not accrue at the original contractual payment.

The value of forbearance stock totalled £278.8 million at 31 December 2016, representing a 3.2% (£8.6 million) increase since 31 December 2015. This increase is reflective of book growth, as forbearance as a percentage of total loans and advance has reduced for both secured and unsecured lending.

Risk Management Report

Full analysis of risk classes

2016 (audited)	Neither past due nor impaired		Past due not impaired		Impaired		Total	
	£m	%	£m	%	£m	%	£m	%
Secured								
Payment arrangement	0.1	–	0.6	9.7	–	–	0.7	0.3
Transfer to interest only	20.9	8.1	1.8	29.0	0.6	22.2	23.3	8.8
Term extension	177.0	68.9	2.3	37.1	1.4	51.9	180.7	67.8
Payment holiday	59.2	23.0	1.5	24.2	0.7	25.9	61.4	23.1
Total secured forbearance	**257.2**	**100.0**	**6.2**	**100.0**	**2.7**	**100.0**	**266.1**	**100.0**
Unsecured								
Accounts where the customer has been approved on a repayment plan	2.9	100.0	–	–	9.8	100.0	12.7	100.0
Total forbearance	**260.1**	**100.0**	**6.2**	**100.0**	**12.5**	**100.0**	**278.8**	**100.0**

2015 (audited)	Neither past due nor impaired		Past due not impaired		Impaired		Total	
	£m	%	£m	%	£m	%	£m	%
Secured								
Payment arrangement	3.0	1.2	0.3	3.2	0.3	12.5	3.6	1.4
Transfer to interest only	17.5	7.1	3.3	34.0	0.8	33.3	21.6	8.3
Term extension	171.9	69.5	5.3	54.6	0.7	29.2	177.9	68.6
Payment holiday	55.0	22.2	0.8	8.2	0.6	25.0	56.4	21.7
Total secured forbearance	**247.4**	**100.0**	**9.7**	**100.0**	**2.4**	**100.0**	**259.5**	**100.0**
Unsecured								
Accounts where the customer has been approved on a repayment plan	2.9	100.0	–	–	7.8	100.0	10.7	100.0
Total forbearance	**250.3**	**100.0**	**9.7**	**100.0**	**10.2**	**100.0**	**270.2**	**100.0**

£266.1 million of retail secured loans and advances were subject to forbearance as at 31 December 2016 (31 December 2015: £259.5 million). Loans which are forborne are grouped with other assets portraying similar risk characteristics and assessed collectively for impairment, for example, all customers with a payment arrangement are grouped together and assessed on a collective basis. The loans are not considered to be impaired unless they meet the Group's definition of an impaired asset.

Retail unsecured loans and advances subject to forbearance totalled £12.7 million (31 December 2015: £10.7 million). Credit risk provisioning for the retail unsecured portfolio is undertaken on a collective basis, except for fraud cases, which are provided for in full, on an individual basis. The approach used is based on PD's for various behavioural and arrears status segments, measuring the likelihood of default and the probability of charge-off given default.

Wholesale credit risk

(audited)	2016 £m	2015 £m
Loans and advances to banks excluding Bank of England	**635.6**	614.5
Bank of England	**786.3**	888.6
Debt securities classified as loans and receivables	**0.7**	1.1
Debt securities classified as available-for-sale financial assets	**850.9**	1,292.3
Gross positive fair value of derivative contracts	**104.2**	82.3
Total	**2,377.7**	2,878.8

The Group's wholesale credit risk exposures reduced by £501.1 million during 2016 due to a reduction of debt securities held and cash deposited at the BoE. Full disclosure of the Group's liquid asset portfolio can be found on page 183.

At 31 December 2016 the single largest exposure to any single counterparty, which is not a sovereign or a supranational, was £115.9 million (2015: £130.8 million). This exposure was to a large UK bank. The table below shows the credit ratings of loans and advances to banks excluding the BoE.

(audited)	2016 £m	2015 £m
AA+	**56.8**	16.8
AA-	**115.9**	130.8
A+	**208.4**	205.5
A	**187.4**	174.3
A-	**35.2**	42.1
BBB+	**31.9**	45.0
Total	**635.6**	614.5

Risk Management Report

Full analysis of risk classes

The table below shows debt securities classified as loans and receivables and debt securities classified as available-for-sale financial assets.

(audited)	**2016** Debt securities classified as loans and receivables £m	**2016** Debt securities classified as available-for-sale financial assets £m	2015 Debt securities classified as loans and receivables £m	2015 Debt securities classified as available-for-sale financial assets £m
UK sovereign exposures	**–**	**317.3**	–	409.5
Non-domestic sovereign exposures	**–**	**–**	–	–
Supranational	**–**	**129.3**	–	203.7
Residential mortgage-backed securities	**0.7**	**52.2**	1.1	59.4
Covered bonds	**–**	**327.1**	–	535.3
Debt securities issued by banks	**–**	**25.0**	–	84.4
Total	**0.7**	**850.9**	1.1	1,292.3

The table below shows the credit rating of debt securities classified as loans and receivables and debt securities classified as available-for-sale financial assets.

(audited)	**2016 £m**	2015 £m
AAA	**508.6**	798.4
AA+	**–**	434.9
AA	**317.3**	–
AA-	**25.0**	30.0
A+	**–**	29.0
A	**0.7**	1.1
Total	**851.6**	1,293.4

The credit rating of the debt securities remains high, with 97% rated AA or higher compared to 95% at 31 December 2015. The movement of exposures from AA+ to AA is due to the downgrading of the UK's credit rating, following the outcome of the EU referendum.

Derivative financial instruments

The Group reduces exposure to credit risk through central clearing for eligible derivatives and daily posting of cash collateral on such transactions, as detailed in note 34 to the financial statements. For over-the-counter (OTC) transactions, exposure is reduced by the use of master netting agreements and by obtaining collateral in the form of cash or highly liquid securities. In respect of the Group's maximum credit risk relating to derivative assets of £104.2 million (2015: £82.3 million), collateral of £86.4 million (2015: £10.6 million) was held.

The Group measures exposure in OTC derivatives using the gross positive fair value of contracts outstanding with a counterparty, increased by potential future rises in fair value and reduced by gross negative fair value of contracts and collateral received.

While exposures are managed on a net basis, they are represented on the balance sheet on a gross basis unless the IAS 32 offsettings rules are met. Contracts with positive fair value are disclosed as assets in the balance sheet under 'derivative financial instruments'; those with negative fair value are disclosed as stated on the liabilities side under the same title.

Cash collateral received is shown as deposits from banks, with cash collateral posted shown as loans and advances to banks. The notes to the financial statements provide further information on collateral. The table below details OTC derivative exposures.

(audited)	**2016 £m**	2015 £m
Gross positive fair value of derivative contracts	**104.2**	82.3
Netting with gross negative fair value of derivative contracts[1]	**(25.4)**	(70.4)
Potential future incremental exposure	**61.2**	49.9
Collateral received	**(86.4)**	(10.6)
Net OTC derivative exposures	**53.6**	51.2

1 The use of netting allows positions on all bilateral transactions with any given counterparty to be offset.

The table below provides a summary of net OTC liabilities.

(audited)	**2016 £m**	2015 £m
Gross negative fair value of derivative contracts	**(222.3)**	(151.0)
Netting with gross positive fair value of derivative contracts[1]	**25.4**	70.4
Collateral pledged (loans and advances to banks)[2]	**168.1**	72.5
Net OTC derivative liability	**(28.8)**	(8.1)

1 The use of netting allows positions on all bilateral transactions with any given counterparty to be offset.

2 The December 2015 collateral pledged has been restated to exclude the impact of over-collateralisation.

The only netting agreements in place are in relation to derivative financial instruments and repurchase transactions. In respect of repurchase transactions, only the haircut between the asset pledged and deposit received is classed as an exposure given the balance sheet maintains the exposure to the underlying obligor.

The table below provides credit quality analysis of the gross OTC derivative exposures by credit rating of the counterparties.

	31 December 2016		31 December 2015	
(audited)	**£m**	**%**	£m	%
AA-	**5.6**	**5.4**	22.1	26.9
A+	**0.6**	**0.6**	6.8	8.3
A	**84.5**	**81.1**	42.0	51.0
A-	**12.7**	**12.2**	6.4	7.7
BBB+	**0.8**	**0.7**	5.0	6.1
Total	**104.2**	**100.0**	82.3	100.0

Risk Management Report

Full analysis of risk classes

Market risk

Definition

Market risk is defined as the risk that the value of, or net income arising from, assets and liabilities changes as a result of interest rate or exchange rate movements. Market risk for the Group arises only as a natural consequence of carrying out and supporting core business activities. The Group does not trade or make markets. As a result, interest rate risk is the only material market risk for the Group.

Risk appetite

The Group has limited risk appetite for exposures to IRRBB, in terms of both potential changes to economic value, and changes to expected net interest income or earnings.

Exposures

The Group's banking activities expose it to the risk of adverse movements in interest rates and exchange rates.

Interest rate mismatch risk in the Group's portfolio and in the Group's capital and funding activities arises from the different re-pricing characteristics of the Group's assets, liabilities and off-balance sheet positions. Interest rate risk arises predominantly from the mismatch between interest rate sensitive assets and liabilities, the variation in volume of business written in response to changes in interest rate, optionality in customers' ability to complete or redeem their products, the investment term of capital and reserves, and the need to stabilise earnings in order to minimise income volatility.

Basis risk arises from possible changes in spreads, between different reference rates, for example, where assets and liabilities reprice at the same time and the scale of rate movement differs. The primary rates that the Group is exposed to are the Bank Base Rate and LIBOR. If the spread between these rates moves adversely, the Group may experience a reduction in income on unhedged exposures.

Pipeline risk arises where new business volumes are higher or lower than forecast, requiring the business to unwind or execute additional hedging at rates which may differ to what was expected.

Product option/optionality risk arises as customer balances amortise more quickly or slowly than anticipated due to economic conditions or customers' response to changes in economic conditions.

Foreign currency risk arises as a result of having assets, liabilities and derivative items denominated in currencies other than Sterling as a result of banking activities. This includes maintaining liquid assets and wholesale funding. The Group has minimal appetite for foreign currency risk.

Measurement

The Group uses stress scenarios to quantify the impact to economic value and earnings arising from a shift to interest rates. These include interest rate re-pricing gaps, earnings sensitivity analysis and open foreign exchange positions.

During April 2016, the Basel Committee on Banking Supervision (BCBS) published standards relating to the management of IRRBB. The Group maintains IRRBB management practices in line with regulatory expectations.

Interest rate risk exposure is measured as follows:

> Capital at Risk (CaR) is considered for assets and liabilities in all interest rate risk re-pricing periods. This is expressed as the present value of the negative impact of a sensitivity test on the Group's capital position.

> Earnings at Risk (EaR) is considered for assets and liabilities on the forecast balance sheet over a 12 month period, measuring the adverse change to net interest income from a movement in interest rates.

IRRBB is measured considering both positive and negative instantaneous shocks to interest rates. The measurement is enhanced with non-parallel stress scenarios (basis risk) and behavioural volume stresses (pipeline and optionality risk). Both EaR and CaR are controlled by a defined risk appetite limit and supporting metrics.

The disclosures on the following page show CaR and EaR measurements based on a 2% parallel stress for interest rate mismatch risk, subject to a contractual rate floor at 0%, with complementary stress scenarios in other risk categories. The use of this standardised parallel stress is intended to provide comparability in reporting, consistent with the objectives of the regulatory bodies. The magnitude of stress used within the Group's internal risk appetite differs from the standardised regulatory stress, based on observed rate movements and internally defined exposure holding periods.

The Group has an integrated Asset and Liability Management system which allows it to measure and manage interest rate re-pricing profiles (including behavioural assumptions), perform stress testing and produce forecasts.

Mitigation

As defined within the scope of the Group's IRRBB Policy, the Interest Rate Risk Transfer Pricing framework is used for all hedgeable interest rate risk arising from commercial product lines. Treasury is responsible for managing risk and does this through natural offsets of matching assets and liabilities where possible.

Appropriate hedging activity of residual exposures is undertaken, subject to the authorisation and mandate of the Asset and Liability Committee, within the Board-approved risk appetite. Certain residual interest rate risks may remain due to differences in basis and profile mismatches arising from customer behaviour. The impact of this is detailed in the table on page 167.

The TFS could increase the Group's basis mismatch exposure as funding is linked to the BBR. In the absence of the TFS, the Group would use more retail and market-based wholesale funding. While the TFS offers cost-effective funding, it brings additional concentration in relation to basis risk. The Group mitigates basis risk through product strategy; creating natural offsets where possible. When required, the Group uses basis derivatives to maintain the residual exposure within risk appetite.

Monitoring

The Board Risk Committee regularly reviews market risk exposure as part of the wider risk management framework.

Capital at Risk

The forecast interest rate environment reduced during 2016, following the UK's vote to leave the EU and the BoE's 25 basis point reduction to Bank Base Rate. The lower rate environment reduced the severity of the negative rate shock assuming contractual rates do not go below 0%. CaR as at 31 December 2016, decreased to £14.1 million from £20.1 million at 31 December 2015 in a negative rate shock scenario. CaR at December 2016 under a positive rate shock scenario is comparable with December 2015 across all sources of IRRBB risk.

	2016		2015	
	Positive rate shock £m	**Negative rate shock[1] £m**	Positive rate shock £m	Negative rate shock[1] £m
Interest rate mismatch risk	**(1.6)**	**(0.7)**	(3.8)	3.1
Pipeline risk	**5.7**	**7.1**	8.9	4.7
Optionality risk	**30.1**	**7.7**	27.1	12.3
Total interest rate risk – Capital at Risk	**34.2**	**14.1**	32.2	20.1

1 Market rate (BBR, LIBOR and swaps) stresses are subject to a contractual rate floor of 0%.

Risk Management Report

Full analysis of risk classes

Earnings at Risk

EaR has increased year-on-year by £7.8 million in a positive rate shock scenario and by £16.1 million in a negative rate shock scenario due to changes made in the way the Group measures the exposure to basis risk. The scenarios used have been updated to better capture basis risk in the current low rate environment. The Group's underlying IRRBB risk exposure, after removing the impact of changes to basis risk stress scenarios, is materially unchanged.

	2016		2015	
(unaudited)	**Positive rate shock £m**	**Negative rate shock[1] £m**	Positive rate shock £m	Negative rate shock[1] £m
Interest rate mismatch risk	**1.7**	**1.4**	4.0	2.9
Basis risk	**10.4**	**17.6**	(0.2)	0.1
Pipeline risk	**3.0**	**2.3**	3.8	1.7
Optionality risk	**8.6**	**0.3**	8.3	0.8
Total interest rate risk – Earnings at Risk	**23.7**	**21.6**	15.9	5.5

1 Market rate (BBR, LIBOR and swaps) stresses are subject to a contractual rate floor of 0%.

The volume of balance sheet items denominated in foreign currencies has increased since 31 December 2015 due to the issuance of debt securities in US Dollars and Euros as part of the Gosforth Residential Mortgage Backed Securities (RMBS) programmes. The Group raised £803.0 million during January 2016 and a further issuance in May 2016 raised £474.2 million. Exposures to adverse changes in exchange rates have been reduced by using cross-currency swaps, resulting in a minimal net exposure. The table below shows assets and liabilities in foreign currency at sterling carrying values.

	2016		2015	
(audited)	**US$ in £m**	**€ in £m**	US$ in £m	€ in £m
Assets				
Loans and advances to banks	**0.7**	**0.9**	–	–
Available-for-sale financial assets	**1.5**	**–**	–	3.3
Other assets	**0.1**	**0.5**	0.1	0.1
Total assets	**2.3**	**1.4**	0.1	3.4
Liabilities				
Debt securities in issue	**175.7**	**412.4**	–	–
Other liabilities	**0.4**	**0.5**	0.1	0.1
Total liabilities	**176.1**	**412.9**	0.1	0.1
Notional value of derivatives affecting currency exposures	**(174.1)**	**(412.4)**	–	–
Net position	**0.3**	**0.9**	**–**	3.3

Interest rate re-pricing of assets and liabilities

The following tables provide an analysis of the contractual re-pricing periods of assets and liabilities on the balance sheet. Mismatches in the re-pricing timing of assets, liabilities, and off-balance sheet positions create interest rate risk quantified in CaR and EaR.

2016[1] (audited)	Within 3 months £m	After 3 months and within 6 months £m	After 6 months and within 1 year £m	After 1 year and within 5 years £m	After 5 years £m	Non-interest bearing instruments £m	Total £m
Assets							
Cash and balances at central banks	**732.0**	**–**	**–**	**–**	**–**	**54.3**	**786.3**
Loans and receivables:							
Loans and advances to banks	**630.1**	**–**	**–**	**–**	**–**	**5.5**	**635.6**
Loans and advances to customers	**8,074.2**	**1,871.1**	**3,425.2**	**18,365.1**	**298.5**	**333.0**	**32,367.1**
Debt securities	**0.7**	**–**	**–**	**–**	**–**	**–**	**0.7**
Available-for-sale financial assets	**212.9**	**–**	**–**	**154.5**	**426.0**	**65.4**	**858.8**
Other assets	**54.0**	**–**	**–**	**–**	**–**	**353.1**	**407.1**
Total assets	**9,703.9**	**1,871.1**	**3,425.2**	**18,519.6**	**724.5**	**811.3**	**35,055.6**
Liabilities							
Deposits from banks	**2,132.5**	**–**	**–**	**–**	**–**	**–**	**2,132.5**
Customer deposits	**18,027.5**	**1,157.1**	**4,081.4**	**4,810.2**	**–**	**30.1**	**28,106.3**
Debt securities in issue	**2,299.9**	**–**	**–**	**300.0**	**–**	**0.1**	**2,600.0**
Other liabilities	**–**	**–**	**–**	**–**	**–**	**546.3**	**546.3**
Equity	**–**	**–**	**–**	**390.0**	**–**	**1,280.5**	**1,670.5**
Total liabilities and equity	**22,459.9**	**1,157.1**	**4,081.4**	**5,500.2**	**–**	**1,857.0**	**35,055.6**
Notional values of derivatives affecting interest rate sensitivity	**10,864.0**	**(548.2)**	**1,388.0**	**(10,395.4)**	**(1,240.7)**	**(67.7)**	**–**
Total interest rate sensitivity gap	**(1,892.0)**	**165.8**	**731.8**	**2,624.0**	**(516.2)**	**(1,113.4)**	**–**
Cumulative interest rate sensitivity gap	**(1,892.0)**	**(1,726.2)**	**(994.4)**	**1,629.6**	**1,113.4**	**–**	**–**

1 Items are allocated to time bands in the table above by reference to the earlier of the next contractual interest rate re-pricing date and the residual maturity date.

Risk Management Report

Full analysis of risk classes

2015[1] (audited)	Within 3 months £m	After 3 months and within 6 months £m	After 6 months and within 1 year £m	After 1 year and within 5 years £m	After 5 years £m	Non-interest bearing instruments £m	Total £m
Assets							
Cash and balances at central banks	835.5	–	–	–	–	53.1	888.6
Loans and receivables:							
Loans and advances to banks	610.0	–	–	–	–	4.5	614.5
Loans and advances to customers	7,201.3	1,710.6	3,132.4	14,407.5	516.9	140.3	27,109.0
Debt securities	1.2	–	–	–	–	(0.1)	1.1
Available-for-sale financial assets	373.2	4.7	59.0	177.9	612.7	69.4	1,296.9
Other assets	–	–	–	–	–	318.9	318.9
Total assets	**9,021.2**	**1,715.3**	**3,191.4**	**14,585.4**	**1,129.6**	**586.1**	**30,229.0**
Liabilities							
Deposits from banks	1,298.7	–	–	–	–	–	1,298.7
Customer deposits	14,679.4	1,661.6	3,443.6	5,348.6	–	11.7	25,144.9
Debt securities in issue	1,745.9	–	–	300.0	–	(6.5)	2,039.4
Other liabilities	–	–	–	–	–	405.7	405.7
Equity	–	–	–	160.0	–	1,180.3	1,340.3
Total liabilities and equity	**17,724.0**	**1,661.6**	**3,443.6**	**5,808.6**	–	**1,591.2**	**30,229.0**
Notional values of derivatives affecting interest rate sensitivity	7,698.6	199.8	591.2	(7,103.3)	(1,386.3)	–	–
Total interest rate sensitivity gap	**(1,004.2)**	**253.5**	**339.0**	**1,673.5**	**(256.7)**	**(1,005.1)**	**–**
Cumulative interest rate sensitivity gap	(1,004.2)	(750.7)	(411.7)	1,261.8	1,005.1	–	–

The interest rate re-pricing tables shown above reflect the re-pricing of assets and liabilities without adjustments to the re-pricing profile that reflect future pricing assumptions or taking into account expected future business that the Group hedges ahead of becoming contractually bound. The Group manages interest rate risk taking these factors into account. Therefore, the increased gap profile shown above does not directly translate to the CaR and EaR term mismatch quantification.

Operational risk

Definition

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. It also includes legal risk.

Risk appetite

The Group's operational risk appetite is designed to safeguard the interests of customers, internal and external stakeholders, and shareholders.

Exposures

The principal operational risks to the Group are:

> IT systems and resilience risk arising from failure to develop, deliver and maintain effective IT solutions;

> information security risk arising from information leakage, loss or theft;

> external fraud arising from an act of deception or omission;

> cyber risk arising from malicious attacks on the Group via technology, networks and systems;

> service disruption;

> failure of a third party corporate partner or strategic supplier; and

> normal business operational risk including transaction processing, information capture and implementation of change.

Measurement

A variety of measures is used such as scoring of potential risks, considering impact and likelihood, assessing the effectiveness of controls, monitoring of events and losses by size, functional area and internal risk categories. The Group maintains a formal approach to operational risk event escalation. Material events are identified, captured and escalated. The root causes of events are determined and action plans put in place to ensure an optimum level of control. This ensures the Group keeps customers and the business safe, reduces costs, and improves efficiency.

Mitigation

The Group's control environment is regularly reviewed and reporting on material risks is discussed monthly by senior management. Risks are managed through a range of strategies such as mitigation, transfer (including insurance), and acceptance. Contingency plans are maintained for a range of potential scenarios with regular disaster recovery exercises.

Mitigating actions for the principal risks include:

> investment in IT to ensure continued availability, security and resilience of infrastructure;

> investment in information security capability to protect customers and the Group;

> investment in the protection of customer information, including access to key systems and the security, durability and accessibility of critical records;

> a risk-based approach to mitigate the financial crime risks the Group faces, reflecting the current and emerging financial crime risks within the market. The Group has developed a comprehensive financial crime operating model. The Group's fraud awareness programme is a key component of the financial crime control environment; and

> operational resilience measures and recovery planning to ensure an appropriate and consistent approach to the management of continuity risks, including potential interruptions from a range of internal and external incidents or threats.

Monitoring

Monitoring and reporting of operational risk is undertaken at Board and Executive Committees. A combination of systems, monthly reports, oversight and challenge from the Risk function, Internal Audit and assurance teams ensures that key risks are regularly presented and debated by Executive Management.

Key operational risks are appropriately insured, where possible. The insurance programme is monitored and reviewed regularly, with recommendations made to Executive management prior to each renewal.

Risk Management Report

Full analysis of risk classes

Conduct risk and compliance

Definition

Conduct risk and compliance is defined as the risk that the Group's operating model, culture or actions result in unfair outcomes for customers, and the risk of regulatory sanction, material financial loss or reputational damage if the Group fails to design and implement operational processes, systems and controls and maintain compliance with all applicable regulatory requirements.

Risk appetite

The Group has no appetite for failure to remediate regulatory breaches and no tolerance for failing to deliver fair customer outcomes, whether through product design, sales or after sales processes.

Exposures

Conduct risk could affect all aspects of the Group's operations, all types of customers and the Group's stakeholders. The Group faces limited conduct risk in relation to products and services, sales processes and complaint handling.

A series of change programmes drives new legislation and regulation into day-to-day operational and business practices across the Group.

The Group is unburdened with legacy conduct risk issues such as PPI, investments or derivatives mis-selling, LIBOR manipulation and distressed asset portfolios.

Measurement

Risk assessments are regularly reviewed and include assessments of control and material regulatory rule breaches, complaints and whistleblowing.

Mitigation

The Group takes a range of mitigating actions with respect to conduct risk and compliance. They include:

> policies, processes and standards which provide a framework for the business to operate in accordance with the relevant laws and regulations;

> putting the customer at the heart of business planning and strategy;

> using a risk assessment framework that ensures product design and sales processes offer customers value for money, meet the needs of the target market, and deliver fair outcomes to customers, including vulnerable customers;

> focusing on recruitment and training and how the Group manages colleagues' performance in relation to fair customer outcomes;

> regulatory horizon scanning; and

> using oversight and assurance themed reviews to assess compliance with rules, regulations and policies.

Monitoring

A robust assurance and quality monitoring regime is in place to test the performance of customer critical activities. Customer metrics are proactively used when reviewing business performance and feedback loops have been established to learn from issues identified.

The Risk function reports on conduct risk and compliance exposure. The report forms the basis of challenge to the business at the monthly Operational Risk, Conduct Risk and Compliance Committee.

Concentration risk[1]

Definition

Concentration risk is defined as the exposure of the Group to credit concentrations in relation to retail and wholesale portfolios, products and counterparty levels.

Risk appetite

The Group has limited appetite for concentrated exposures by country, region, loan size and type.

Exposures

The principal source of concentration risk is from loans and advances to customers in relation to geography, loan size and loan type concentrations in the mortgage portfolio.

In addition, concentration risk arises from cash, debt securities and derivatives in relation to individual counterparty and country of exposure.

The Group has no significant concentrations of risk in the credit card portfolio.

Measurement

Credit concentration risk is measured through the application of limits relating to each concentration category.

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Mitigation

Credit risk management includes portfolio controls on product lines and risk segments to reflect risk appetite and individual limit guidelines. Credit policy is aligned to the Group's risk appetite and restricts exposure to more vulnerable sectors and segments.

Monitoring

Monthly reporting on concentration risk exposures is made to the Board.

Secured credit

The Group's large exposures are reported in accordance with regulatory reporting requirements. There has been significant focus on house price inflation since the end of 2013 with London and the South East experiencing higher levels of house price growth than the rest of the UK. Whilst demand for London property may be influenced by the international market, concerns over an asset bubble forming in these two regions are based on the rate of growth relative to other regions, a potential divergence in supply and demand for property, and customer affordability being stretched. The Group's policy restricts LTV for higher value loans, resulting in the lower average new lending LTVs observed in London (58%) and the South East (65%) compared to other regions (72%). The Group made changes to its lending policy in March 2016 in response to this risk through an income multiple cap.

1 All risk class components of financial risk are outlined on page 139. Concentration risk is the most significant component of financial risk and therefore has been disclosed in detail

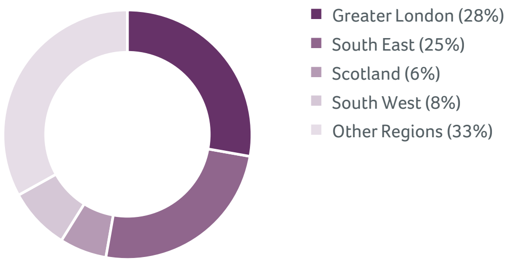
Risk Management Report

Full analysis of risk classes

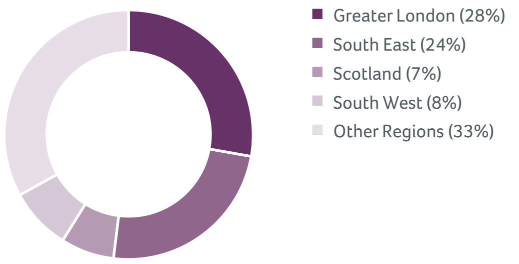
The table below shows the geographical concentration of the mortgage portfolio.

	2016		2015	
(audited)	£m	%	£m	%
East Anglia	**726.0**	**2.6**	605.9	2.5
East Midlands	**1,556.4**	**5.2**	1,287.8	5.1
North	**1,025.3**	**3.4**	957.0	3.8
Yorkshire & Humberside	**1,640.3**	**5.5**	1,413.0	5.5
North West	**2,209.3**	**7.4**	1,890.7	7.4
West Midlands	**1,560.9**	**5.2**	1,302.3	5.1
South West	**2,320.6**	**7.8**	1,936.2	7.6
South East	**7,365.7**	**24.8**	6,139.4	24.1
Greater London	**8,365.9**	**28.1**	7,230.0	28.4
Wales	**673.9**	**2.3**	597.4	2.3
Scotland	**1,828.0**	**6.1**	1,685.5	6.6
Northern Ireland	**478.3**	**1.6**	416.5	1.6
Other	**0.8**	**–**	0.5	–
Total	**29,751.4**	**100.0**	25,462.2	100.0

2016



2015

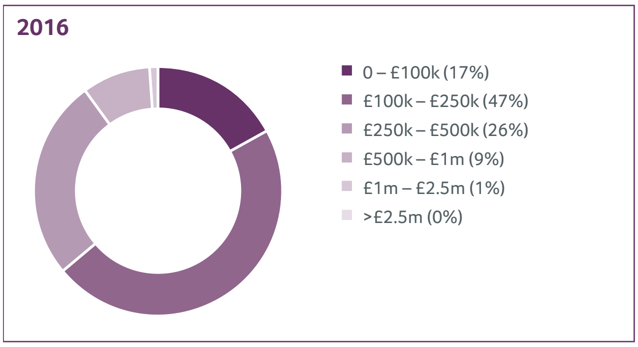


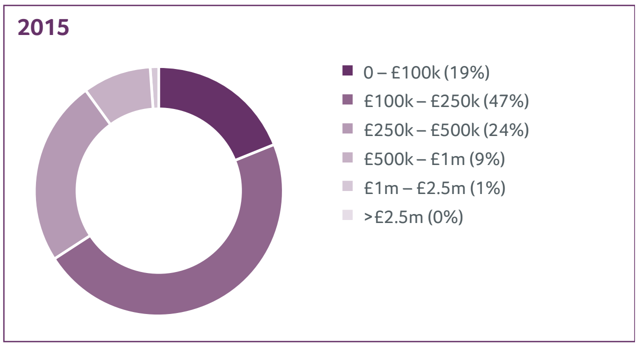
The geographical split of the portfolio remains broadly stable.

The table below shows retail secured credit concentrations by loan size.

	2016		2015	
(audited)	**£m**	**%**	£m	%
0-£100k	**5,169.9**	**17.4**	4,941.5	19.4
£100k-£250k	**13,989.5**	**47.1**	11,878.2	46.6
£250k-£500k	**7,835.2**	**26.3**	6,078.0	23.9
£500k-£1m	**2,536.2**	**8.5**	2,334.3	9.2
£1m-£2.5m	**207.4**	**0.7**	211.3	0.8
>£2.5m	**13.2**	**0.0**	18.9	0.1
Total	**29,751.4**	**100.0**	25,462.2	100.0

As at 31 December 2016, 0.7% (2015: 0.9%) of mortgage balances consisted of loans in excess of £1 million.





The value of loans with balances of up to £250,000 increased by £2,339.7 million during 2016. This represents 55% of the total secured loans portfolio growth of £4,289.2 million.

Risk Management Report

Full analysis of risk classes

The table below shows retail secured credit average LTV by loan size.

2016 (audited)	**Residential mortgage loans %**	**Residential buy-to-let mortgage loans %**	**Total**
0-£100k	**42.6**	**58.2**	**48.4**
£100k-£250k	**58.9**	**55.2**	**58.2**
£250k-£500k	**57.9**	**49.0**	**57.1**
£500k-£1m	**51.0**	**42.7**	**50.3**
£1m-£2.5m	**43.7**	**34.9**	**42.2**
>£2.5m	**35.8**	**–**	**35.8**
Total	**55.6**	**54.8**	**55.4**

2015 (audited)	Residential mortgage loans %	Residential buy-to-let mortgage loans %	Total
0-£100k	42.9	57.9	47.9
£100k-£250k	58.9	56.5	58.5
£250k-£500k	56.5	49.5	55.9
£500k-£1m	51.6	43.9	51.0
£1m-£2.5m	46.5	35.9	44.9
>£2.5m	43.8	–	43.8
Total	**54.9**	**55.4**	**55.0**

The Group's policy broadly restricts LTV for higher value loans. The average LTV for each loan band demonstrates that, excluding loans under £100,000, higher value loans have lower LTVs. The average indexed LTV across the loan size bands has increased reflecting portfolio growth, with an increased proportion of residential new lending.

Loan type

The residential mortgage loan portfolio comprises three principal loan repayment types:

> capital repayment loans amortise monthly through customer repayments which comprise an interest payment and contribution to the principal loan balance;

> part-and-part loans provide customers with the flexibility to choose to pay a proportion of the loan on a capital repayment basis and a proportion on interest only, with the interest only element repaid from an acceptable repayment vehicle; and

> interest only loans allow borrowers to pay only the interest on the loan each month, with the capital to be repaid in full at the end of the loan period from an acceptable repayment vehicle.

For residential mortgage customers, the Group continues to apply strict affordability criteria and restricts applicant LTV. For buy-to-let customers, interest only mortgages continue to be the predominant repayment method, with the majority of customers looking to the sale of the mortgaged property as the ultimate loan repayment vehicle. These loans are also subject to stringent lending standards.

The tables below show retail secured credit concentrations by loan type.

	Residential mortgage loans		**Residential buy-to-let mortgage loans**		**Total**	
2016 (audited)	**£m**	**%**	**£m**	**%**	**£m**	**%**
Capital repayment	**19,521.7**	**80.4**	**913.0**	**16.7**	**20,434.7**	**68.7**
Part-and-part	**1,115.6**	**4.6**	**37.3**	**0.7**	**1,152.9**	**3.9**
Interest only	**3,645.7**	**15.0**	**4,518.1**	**82.6**	**8,163.8**	**27.4**
Total	**24,283.0**	**100.0**	**5,468.4**	**100.0**	**29,751.4**	**100.0**

	Residential mortgage loans		Residential buy-to-let mortgage loans		Total	
2015 (audited)	£m	%	£m	%	£m	%
Capital repayment	15,800.7	75.0	761.0	17.3	16,561.7	65.0
Part-and-part	1,235.4	5.9	26.5	0.6	1,261.9	5.0
Interest only	4,024.2	19.1	3,614.4	82.1	7,638.6	30.0
Total	**21,060.3**	**100.0**	**4,401.9**	**100.0**	**25,462.2**	**100.0**

Risk Management Report

Full analysis of risk classes

Wholesale

Concentration risk is managed for both individual counterparties and for country of exposure. The Group does not set a limit on exposures to the BoE and the UK Sovereign. The table below shows exposures by country.

(audited)	**2016 £m**	2015 £m
Australia	**19.3**	63.2
Canada	**169.0**	108.9
France	**105.3**	67.7
UK	**1,747.5**	2,234.9
Germany	**–**	10.9
Netherlands	**102.7**	73.8
Norway	**–**	24.0
Sweden	**–**	20.0
USA	**104.6**	71.7
Supranational	**129.3**	203.7
Total	**2,377.7**	2,878.8

The Group's wholesale credit risk exposure outside the UK remains well-diversified.

Funding and liquidity risk

Definition

Funding risk is defined as the inability to raise and maintain sufficient funding in quality and quantity to support the delivery of the business plan. Sound funding risk management reduces the likelihood of liquidity risks occurring through minimising refinancing concentration.

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

Risk appetite

The Group funds before it lends. The Group operates an investment strategy for treasury assets which prioritises liquidity and ensures that the Group holds a liquid asset buffer in excess of internal analysis.

Exposures

Liquidity exposure represents the amount of potential stressed outflows in any future period less expected inflows.

The Group's primary liquidity risk exposure arises through the redemption of retail deposits where customers are permitted to withdraw funds with limited or no notice. Additional exposures exist in relation to pipeline mortgage business, undrawn card balances and wholesale funding.

The Group is exposed to refinancing risk at the point of contractual maturity. The risk arises from both wholesale and retail funding sources.

Measurement

A series of measures is used across the Group to monitor both short and long-term liquidity requirements including ratios, cash outflow triggers, wholesale and retail funding maturity profile, early warning indicators and stress test survival periods. Liquidity risk appetite covers a range of metrics considered key to maintaining a strong liquidity and funding position. Strict criteria and limits are in place to ensure highly liquid marketable securities are available as part of the portfolio of liquid assets.

The measurement framework has two other important components:

> the volume and quality of the Group's liquid asset portfolio is defined through a series of stress tests across a range of time horizons and stress conditions. The Group ensures a liquidity surplus is held during normal market conditions above liquidity stress outflow requirements. Stress cash outflow assumptions have been established for individual liquidity risk drivers across idiosyncratic and market wide stresses.

Internal and regulatory liquidity requirements are quantified on a daily basis, with holdings assessed against a full suite of liquidity stresses weekly.

As at 31 December 2016, the results of stress testing of liquidity outflows were £3,688.1 million (2015: £3,069.1 million) based on the Group's internal 90 day liquidity stress scenario. The primary driver for the increased liquidity outflows is growth in deposit redemption risk arising from customer deposits which permit access. Risk drivers of this liquidity stress outflow are detailed, in the following table. As the Group is predominantly retail funded, the largest potential source of liquidity stress is the unexpected outflow of retail customer deposits.

The key risk driver assumptions applied to the scenarios are:

Liquidity risk driver	Modelling assumption
Retail funding	Severe unexpected withdrawal of retail deposits arising from redemption or refinancing risk. No additional deposit inflows are assumed.
Wholesale funding	Limited opportunity to refinance wholesale contractual maturities. Full outflow of secured and unsecured funding during the refinancing period, with no reinvestment of funding.
Off-balance sheet	Cash outflows during the period of stress as a result of off-balance sheet commitments such as mortgage pipeline, undrawn credit card facilities and collateral commitments.
Franchise viability risk	Lending outflows over and above those relating to contractual obligations, as the Group undertakes actions in order to preserve ongoing franchise viability.
Marketable asset risk	Assets held for liquidity purposes experience deterioration in market availability.

Risk Management Report

Full analysis of risk classes

The scenarios and the assumptions are reviewed to ensure that they continue to be relevant to the nature of the business. The Group's liquidity risk appetite is calibrated against a number of stressed metrics. The funding plan is also stressed against a range of macro-economic scenarios; and

> the Group maintains a Contingency Funding Plan which is designed to provide an early warning indicator for liquidity concerns and a list of potential actions to address a liquidity shortfall. As a result, mitigating actions can be taken to avoid a more serious situation developing.

Mitigation

The most material component of the Group's funding and liquidity position is the customer deposit base, which is supplemented by wholesale funding providing a source of stable funding for balance sheet growth. Exposures to the UK Sovereign are described on page 183. The concentration of exposure to other counterparties is not considered significant for the Group. Where concentrations do exist for example, refinancing at maturity, these are managed within the appropriate internal risk appetite, to control the size of the exposure. Refinancing exposures are planned in advance of maturity with liquidity held to mitigate the potential exposure. Longer term funding is used to manage the Group's strategic liquidity profile in line with limits.

The Group operates a Funds Transfer Pricing (FTP) mechanism which supports customer pricing and the overall Group balance sheet strategy.

FTP makes use of behavioural maturity profiles, taking account of expected customer loan prepayments and the stability of customer deposits. Such behavioural maturity assumptions are subject to formal governance and reviewed periodically.

The ability to deploy assets quickly, either through the repo market or through outright sale, is also an important source of liquidity for the Group. In addition to central bank reserves, the Group holds sizeable balances of high-quality marketable debt securities which can be sold to provide, or used to secure, additional cash inflows should the need arise from either market counterparties or central bank facilities (BoE).

Monitoring

Liquidity is actively monitored by the Group. Reporting is conducted through the Asset and Liability Committee and the Board Risk Committee. In a stress situation the level of monitoring and reporting is increased commensurate with the nature of the stress event.

Daily monitoring and control processes are in place to address internal and regulatory liquidity requirements. The Group monitors a range of market and internal early warning indicators on a daily basis for early signs of liquidity risk in the market or specific to the Group. These are a mixture of quantitative and qualitative measures including daily variation of customer balances, cash outflows, changes in primary liquidity portfolio, credit default swap spreads and changing funding costs.

Funding and liquidity management in 2016

During 2016 the Group has maintained a strong funding and liquidity position in excess of risk appetite and the regulatory short-term liquidity stress metric, the Liquidity Coverage Ratio (LCR). As at 31 December 2016, the Group had a LCR of 153.7% based on the PRA's guidance for calculation. The Net Stable Funding Ratio (NSFR) is due to become a minimum standard from January 2018. The Group expects to meet the minimum requirements once fully implemented into liquidity regulation.

Wholesale funding is used to support balance sheet growth, lengthen the contractual tenor of funding and diversify sources of funding. During January and May 2016, the Group raised wholesale funding in two separate issuances from the well-established Gosforth RMBS programme and through additional drawings from the FLS facility. The RMBS issuance further diversified the Group's investor base and sources of wholesale funding, through issuing in non-sterling denominations. The Group has made use of the TFS during the final quarter of the year, drawing £1,268.0 million of funding. The scheme provides the Group with a cost effective source of funding.

Group funding sources

The Group is funded predominantly through customer deposits. Throughout 2016, the Group maintained a strong presence in the retail savings market, increasing total customer deposits by £3.0 billion, representing 81.5% of the Group's funding. The primary driver of retail funding growth was the Defined Access product, which offers a higher rate of interest than other instant access products, whilst retaining depositors' access to funds on demand. The balance of these defined access products increased by £3,580.2 million since December 2015 to £6,993.4 million at 31 December 2016.

The Group's loan-to-deposit ratio increased to 114.5% as at 31 December 2016 (31 December 2015: 107.5%), as a result of participation in the TFS. The Group expects the overall loan-to-deposit ratio to increase beyond this for the period in which the scheme is used. The following table shows the Group's funding position.

(audited)	2016 £m	2015 £m
Loans and advances to customers	**32,367.1**	27,109.0
Loans and advances to banks	**635.6**	614.5
Debt securities classified as loans and receivables	**0.7**	1.1
Available-for-sale financial assets (encumbered)	**10.6**	–
Cash and balances at central banks (encumbered)	**168.1**	160.5
Funded assets	**33,182.1**	27,885.1
Other assets	**407.1**	318.9
Total assets (excluding liquid assets)	**33,589.2**	28,204.0
On balance sheet primary liquidity assets		
Cash and balances at central banks – primary	**618.2**	728.1
Available-for-sale financial assets (unencumbered)	**848.2**	1,296.9
Total assets	**35,055.6**	30,229.0
Less: Other liabilities	**(560.8)**	(429.5)
Funding requirement	**34,494.8**	29,799.5
Funded by		
Customer deposits	**28,106.3**	25,144.9
Wholesale funding	**4,718.0**	3,314.3
Total equity	**1,670.5**	1,340.3
Total funding	**34,494.8**	29,799.5

Risk Management Report

Full analysis of risk classes

The table below shows the sources of wholesale funding.

(audited)	**2016 £m**	2015 £m
Debt securities in issue	**2,600.0**	2,039.4
Liabilities in respect of securities sold under repurchase agreements	**850.0**	1,274.9
Secured loans	**1,268.0**	–
Total on-balance sheet sources of funds	**4,718.0**	3,314.3
Treasury bills raised through FLS	**2,683.7**	2,960.0
Total	**7,401.7**	6,274.3

The tables below show residual maturity of the wholesale funding book.

2016 (audited)	**Within 3 months £m**	**3-12 months £m**	**1-5 years £m**	**After 5 years £m**	**Total £m**
Debt securities in issue	**–**	**–**	**305.8**	**2,294.2**	**2,600.0**
Liabilities in respect of securities sold under repurchase agreements	**500.0**	**75.0**	**275.0**	**–**	**850.0**
Secured loans	**–**	**–**	**1,268.0**	**–**	**1,268.0**
Total on-balance sheet sources of funds	**500.0**	**75.0**	**1,848.8**	**2,294.2**	**4,718.0**
Treasury bills raised through FLS	**–**	**649.2**	**2,034.5**	**–**	**2,683.7**
Total	**500.0**	**724.2**	**3,883.3**	**2,294.2**	**7,401.7**

2015 (audited)	Within 3 months £m	3-12 months £m	1-5 years £m	After 5 years £m	Total £m
Debt securities in issue	–	–	297.5	1,741.9	2,039.4
Liabilities in respect of securities sold under repurchase agreements	749.9	525.0	–	–	1,274.9
Total on-balance sheet sources of funds	749.9	525.0	297.5	1,741.9	3,314.3
Treasury bills raised through FLS	–	510.0	2,450.0	–	2,960.0
Total	**749.9**	**1,035.0**	**2,747.5**	**1,741.9**	**6,274.3**

The increase in average tenor of wholesale funding during 2016 is driven by the drawings from the TFS and additional RMBS issuances, which are categorised as '1-5 years' and 'After 5 years' maturities.

The Group manages the average tenor of wholesale funding within a defined Board risk appetite based on cash flow maturity as shown on page 185.

Encumbered assets

The Group's assets can be used to support funding collateral requirements for central bank operations or third party re-purchase transactions. Assets that have been set aside for such purposes are classified as 'encumbered and pledged assets' and cannot be used for other purposes. The following tables show asset encumbrance.

	Encumbered assets		Unencumbered assets		
2016 (audited)	Pledged as collateral[2] £m	Other[3] £m	Available as collateral[4] £m	Other[5] £m	Total £m
Cash and balances at central banks	–	168.1	–	618.2	786.3
Debt securities classified as loans and receivables	–	–	0.7	–	0.7
Available-for-sale financial assets	10.6	–	840.3	7.9	858.8
Derivative financial assets	–	–	–	104.2	104.2
Loans and advances to banks	181.1	354.4	–	100.1	635.6
Loans and advances to customers	9,425.6	–	2,932.9	20,008.6	32,367.1
Other assets	53.9	–	–	249.0	302.9
Total assets	**9,671.2**	**522.5**	**3,773.9**	**21,088.0**	**35,055.6**
Treasury bills raised through FLS held off balance sheet[6]	–	–	2,683.7	–	2,683.7
Total assets plus off-balance sheet Treasury bills raised through FLS	**9,671.2**	**522.5**	**6,457.6**	**21,088.0**	**37,739.3**

Risk Management Report

Full analysis of risk classes

2015 (audited)[1]	Encumbered assets		Unencumbered assets		
	Pledged as collateral[2] £m	Other[3] £m	Available as collateral[4] £m	Other[5] £m	Total £m
Cash and balances at central banks	–	160.5	–	728.1	888.6
Debt securities classified as loans and receivables	–	–	1.1	–	1.1
Available-for-sale financial assets	–	–	1,292.3	4.6	1,296.9
Derivative financial assets	–	–	–	82.3	82.3
Loans and advances to banks	94.3	384.3	–	135.9	614.5
Loans and advances to customers	7,524.1	–	3,153.5	16,431.4	27,109.0
Other assets	0.3	–	–	236.3	236.6
Total assets	**7,618.7**	**544.8**	**4,446.9**	**17,618.6**	**30,229.0**
Treasury bills raised through FLS held off balance sheet[6]	786.0	–	2,174.0	–	2,960.0
Total assets plus off-balance sheet Treasury bills raised through FLS	**8,404.7**	**544.8**	**6,620.9**	**17,618.6**	**33,189.0**

1 The 2015 table has been restated to reclassify certain encumbered assets between the 'Pledged as collateral and 'Other' categories to better reflect the underlying nature of the Group's collateral arrangements. This restatement has not impacted the Group's total encumbrance ratio as at 31 December 2015.

2 Encumbered loans and advances to customers of £9,425.6 million (2015: £7,524.1 million) consists of securitised mortgages and other loan pools positioned with the Bank of England that have been pledged as collateral for funding and liquidity transactions. At 31 December 2016, £2,302.3 million (2015: £755.0 million) of loan pools have been pledged as collateral in respect of secured loans and repo agreements (refer note 17 to the financial statements).

3 Other encumbered assets are assets that cannot be used for secured funding due to legal or other reasons. These comprise the mandatory reserve and the minimum requirement for the BACS payment system of £168.1 million (2015: £160.5 million) and cash reserves supporting secured funding structures of £354.4 million (2015: £384.3 million).

4 Unencumbered asserts which are classified as 'Available for collateral' are readily available to secure funding or to meet collateral requirements. Loans and advances to customers are classified as 'Available for collateral' only if they are already in such a form that they can be used immediately to raise funding.

5 Other unencumbered assets are assets which are not subject to any restrictions and are not readily available for use.

6 These amounts represent Treasury Bills received by the Group through FLS, which are not recognised on the balance sheet. The Group is permitted to re-pledge these securities to generate on-balance sheet financial assets, such as cash, or to fund lending. These items are classified as encumbered where the Group has used them in repurchase transactions or unencumbered where it has not.

The Group's total level of asset encumbrance remained at 27.0% at 31 December 2016. Encumbered assets increased by £1,244.2 million year-on-year, in line with balance growth, due to wholesale funding to support increased lending. Encumbrance of assets predominantly arises from the use of the BoE funding and liquidity facilities and from the Gosforth RMBS programme. The Group manages the volume of available unencumbered collateral to meet requirements arising from current and future secured funding transactions. Available collateral provides a source of contingent funding for use in stress conditions, as identified within the Contingency Funding Plan.

The Group maintains a portfolio of liquid assets in accordance with risk appetite. Liquid assets are held predominantly in high-quality unencumbered securities issued by the UK Government or supranationals and deposits with central banks. The portfolio mix is aligned to the liquidity coverage requirement defined in European liquidity regulatory standards. Other liquidity resources represent additional unencumbered liquid assets held over and above high-quality liquid assets. These are intended to covermore extreme stress events and provide flexibility for liquidity management. The table opposite shows the composition of the liquidity portfolio.

Level 1	2016 £m	2016 Average £m	2015 £m	2015 Average £m
Cash and balances at central banks	737.2	819.6	846.3	796.4
UK Government securities	306.7	339.3	409.5	392.6
Other HQLA level 1 eligible	–	33.8	25.4	15.8
Supranational securities	129.3	222.0	203.7	294.6
Treasury bills raised through FLS	2,683.7	2,528.2	2,174.0	2,150.6
Covered bonds (Level 1 eligible)	304.9	434.4	498.2	248.2
Total level 1	4,161.8	4,377.3	4,157.1	3,898.2
Level 2a				
Covered bonds (Level 2a eligible)	22.2	22.4	22.1	133.5
Total level 2a	22.2	22.4	22.1	133.5
Level 2b				
Eligible RMBS	38.6	49.1	59.4	44.7
Total level 2b	38.6	49.1	59.4	44.7
High quality liquid assets (Level 1 + 2a + 2b)	4,222.6	4,448.8	4,238.6	4,076.4
Other liquidity resources				
Covered bonds	–	1.2	15.0	2.3
Non-eligible RMBS	13.6	11.6	–	3.0
Certificates of deposit	–	44.5	59.0	4.5
Floating rate notes	25.0	9.6	–	–
Fixed rate bonds	–	–	–	17.0
Money market loans	26.0	38.8	54.0	30.9
Total other liquidity resources	64.6	105.7	128.0	57.7
Self-issued RMBS	1,306.4	550.8	326.7	197.6
Total liquidity	5,593.6	5,105.3	4,693.3	4,331.7

The Group holds sufficient liquidity to meet all internal and regulatory liquidity requirements.

The tables overleaf analyse assets and liabilities of the Group into relevant maturity groupings based on the remaining contractual period at the balance sheet date. The Group's assets and liabilities may be repaid or otherwise mature earlier or later than implied by their contractual terms, and readers are therefore advised to use caution when using this data to evaluate the Group's liquidity position.

In particular, amounts in respect of customer deposits are usually contractually payable on demand or at short notice. In practice, these deposits are not usually withdrawn on their contractual maturity. Amounts in respect of RMBS in issue have a maximum contractual maturity consistent with underlying mortgage assets (in excess of five years); the cashflow profile below reflects that securitisation documents will require repayment of the securities in line with repayments of the underlying mortgages, which may be in advance of the legal maturity date.

Risk Management Report

Full analysis of risk classes

2016 (audited) **Assets**	**Within 3 months £m**	**3-12 months £m**	**1-5 years £m**	**After 5 years £m**	**Total £m**
Cash and balances at central banks	**737.2**	**–**	**–**	**49.1**	**786.3**
Derivative financial instruments	**1.4**	**1.5**	**99.8**	**1.5**	**104.2**
Loans and receivables:					
Loans and advances to banks	**635.6**	**–**	**–**	**–**	**635.6**
Loans and advances to customers	**2,700.3**	**720.1**	**3,910.6**	**25,036.1**	**32,367.1**
Debt securities	**–**	**–**	**–**	**0.7**	**0.7**
Available-for-sale financial assets	**–**	**25.0**	**283.2**	**550.6**	**858.8**
Other assets	**99.2**	**25.3**	**10.8**	**167.6**	**302.9**
Total assets	**4,173.7**	**771.9**	**4,304.4**	**25,805.6**	**35,055.6**
Liabilities					
Deposits from banks	**514.5**	**75.0**	**1,543.0**	**–**	**2,132.5**
Customer deposits	**24,540.2**	**1,883.6**	**1,682.5**	**–**	**28,106.3**
Derivative financial instruments	**8.2**	**8.6**	**185.6**	**27.3**	**229.7**
Debt securities in issue	**–**	**–**	**305.8**	**2,294.2**	**2,600.0**
Other liabilities	**240.7**	**67.0**	**5.0**	**3.9**	**316.6**
Total liabilities	**25,303.6**	**2,034.2**	**3,721.9**	**2,325.4**	**33,385.1**
Net liquidity (gap) / surplus	**(21,129.9)**	**(1,262.3)**	**582.5**	**23,480.2**	**1,670.5**

2015 (audited) **Assets**	Within 3 months £m	3-12 months £m	1-5 years £m	After 5 years £m	Total £m
Cash and balances at central banks	846.9	–	–	41.7	888.6
Derivative financial instruments	16.1	13.3	47.4	5.5	82.3
Loans and receivables:					
Loans and advances to banks	614.5	–	–	–	614.5
Loans and advances to customers	1,778.0	572.5	3,334.6	21,423.9	27,109.0
Debt securities	–	–	–	1.1	1.1
Available-for-sale financial assets	47.5	4.7	424.4	820.3	1,296.9
Other assets	47.5	20.2	14.8	154.1	236.6
Total assets	**3,350.5**	**610.7**	**3,821.2**	**22,446.6**	**30,229.0**
Liabilities					
Deposits from banks	773.7	525.0	–	–	1,298.7
Customer deposits	20,776.5	2,630.2	1,738.2	–	25,144.9
Derivative financial instruments	5.9	12.1	103.2	34.8	156.0
Debt securities in issue	–	–	297.5	1,741.9	2,039.4
Other liabilities	158.8	46.9	39.5	4.5	249.7
Total liabilities	**21,714.9**	**3,214.2**	**2,178.4**	**1,781.2**	**28,888.7**
Net liquidity (gap) / surplus	(18,364.4)	(2,603.5)	1,642.8	20,665.4	1,340.3

Cashflow profile

The tables below allocate the Group's non-derivative cash outflows into relevant maturity groupings based on the remaining period between the balance sheet date and the contractual maturity date. The amounts disclosed are the contractual undiscounted cash flows. These differ from balance sheet values due to the effects of discounting on certain balance sheet items and due to the inclusion of contractual future interest flows.

2016 (audited)	**Within 3 months £m**	**3-6 months £m**	**6-12 months £m**	**1-5 years £m**	**Over 5 years £m**	**Total £m**
Deposits from banks	**514.1**	**76.7**	**3.1**	**1,556.8**	**–**	**2,150.7**
Customer deposits	**24,638.0**	**703.8**	**1,393.7**	**1,835.9**	**–**	**28,571.4**
Debt securities in issue	**158.7**	**154.4**	**304.1**	**2,056.5**	**–**	**2,673.7**
Total	**25,310.8**	**934.9**	**1,700.9**	**5,449.2**	**–**	**33,395.8**

2015 (audited)	Within 3 months £m	3-6 months £m	6-12 months £m	1-5 years £m	Over 5 years £m	Total £m
Deposits from banks	775.8	526.3	–	–	–	1,302.1
Customer deposits	21,228.6	895.0	1,604.4	1,962.0	–	25,690.0
Debt securities in issue	152.3	236.7	208.3	1,550.4	–	2,147.7
Total	**22,156.7**	**1,658.0**	**1,812.7**	**3,512.4**	**–**	**29,139.8**

Growth in customer deposits has primarily been achieved through the Defined Access product, providing on-demand access to depositors, shown in the 'Within 3 months' column. As a result, the Group's contractual cashflow profile of customer deposits has shortened. The reduced retail funding tenor has been partially offset by a lengthening of the wholesale funding profile.

The following tables allocate the undiscounted derivative cash outflows into relevant maturity groupings based on the remaining period between the balance sheet date and the contractual maturity date. Cash flows for the floating legs of derivative transactions are calculated based on market indications of future interest rates. As a result, totals in these tables are not intended to be identical to tables on OTC derivatives or the notes to the financial statements by definition.

2016 (audited)	**Within 3 months £m**	**3-6 months £m**	**6-12 months £m**	**1-5 years £m**	**Over 5 years £m**	**Total £m**
Settled on a net basis						
Derivatives in economic and not accounting hedges	**(1.8)**	**(0.5)**	**(4.5)**	**(12.2)**	**(0.3)**	**(19.3)**
Derivatives in accounting hedge relationships	**(26.1)**	**(21.2)**	**(37.6)**	**(110.0)**	**(6.2)**	**(201.1)**
	(27.9)	**(21.7)**	**(42.1)**	**(122.2)**	**(6.5)**	**(220.4)**
Settled on a gross basis						
Outflows	**1.4**	**2.6**	**2.5**	**23.3**	**–**	**29.8**
Inflows	**(1.5)**	**(3.0)**	**(2.8)**	**(26.6)**	**–**	**(33.9)**
Total	**(28.0)**	**(22.1)**	**(42.4)**	**(125.5)**	**(6.5)**	**(224.5)**

Risk Management Report

Full analysis of risk classes

2015 (audited)	Within 3 months £m	3-6 months £m	6-12 months £m	1-5 years £m	Over 5 years £m	Total £m
Settled on a net basis						
Derivatives in economic and not accounting hedges	(1.1)	0.2	(0.6)	(13.5)	(0.9)	(15.9)
Derivatives in accounting hedge relationships	(30.9)	(25.1)	(35.8)	(41.6)	(3.2)	(136.6)
	(32.0)	(24.9)	(36.4)	(55.1)	(4.1)	(152.5)
Settled on a gross basis						
Outflows	–	–	–	–	–	–
Inflows	–	–	–	–	–	–
Total	**(32.0)**	**(24.9)**	**(36.4)**	**(55.1)**	**(4.1)**	**(152.5)**

External credit ratings

Virgin Money Holdings (UK) plc does not have an external credit rating. Disclosures below relate to its subsidiary, Virgin Money plc. Virgin Money plc's short and long-term credit ratings as at 31 December 2016 are as follows.

	Long term	Short term	Outlook	Date of last rating action	Rating action type
Fitch	BBB+	F2	Stable	03 October 2016	Affirmed

In October 2016 the rating agency Fitch revised Virgin Money plc's outlook to Stable from Positive and affirmed its long-term rating at BBB+.

The table below sets out the amount of additional collateral the Company would need to provide in the event of a one and two notch downgrade by external credit ratings agencies.

	Cumulative adjustment for a one-notch downgrade £m	Cumulative adjustment for a two-notch downgrade £m
2016	**–**	**10.0**
2015	–	10.0

Capital

Definition

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

Risk appetite

The Group maintains a high-quality capital base, targeting capital ratios which support business development and the risks inherent in the strategic plan.

The Group's capital planning approach is focused on maintaining sufficient capital while optimising value for shareholders.

Measurement

The Group calculates capital resources and requirements using the CRD IV CRR regulatory framework as implemented by the PRA. Pillar 1 capital requirements are calculated in respect of credit risk, operational risk, market risk and credit valuation adjustments. The capital requirement for residential mortgages is measured using an Advanced Internal Ratings Based (AIRB) approach approved by the PRA, and all other requirements are calculated using the Standardised Approach.

The Group uses AIRB models in measuring the credit risk of secured loans and advances to customers as described on page 140. In contrast, impairment allowances are recognised for financial reporting purposes only for loss events that have occurred at the balance sheet date, based on objective evidence of impairment.

Due to the different methodologies applied, the amount of incurred credit loss provisions in the financial statements differs from the amount determined from expected loss models used for internal operational management, capital requirement and other banking regulation purposes. Page 147 provides details of the Group's approach to the impairment of financial assets.

The PRA supplements the Group's minimum total capital requirement by setting additional Pillar 2 requirements issued within the Group's Individual Capital Guidance (ICG). The PRA provided the Group's revised ICG in 2016 which included a Pillar 2A component of 3.87% of risk-weighted assets. The Group's ICG is the higher of Pillar 1 and 2A combined or the Basel I floor. The Basel I floor is a transitional capital minimum requirement based on the Basel I framework. Currently the Basel I floor is the higher requirement, as it exceeds the Pillar 1 and Pillar 2A requirement of 11.87% of the Group's risk-weighted assets. Any PRA buffer remains confidential between the Group and the PRA.

Risk Management Report

Full analysis of risk classes

As part of the capital planning process, capital positions are subjected to stress testing and sensitivity analysis to determine the adequacy of capital resources against minimum requirements, including ICG, over the forecast period.

Mitigation

The Group has capital management procedures that are designed to ensure compliance with risk appetite and regulatory requirements and are positioned to meet anticipated future changes to capital requirements.

The Group is able to accumulate additional capital through profit retention, by raising equity through, for example, a rights issue or debt exchange and by raising Tier 1 and Tier 2 capital by issuing subordinated liabilities. The cost and availability of additional capital is dependent upon market conditions and perceptions at the time. The Group is also able to manage the demand for capital through management actions including adjusting lending strategy, risk hedging strategies and through business disposals. If necessary, this could include limiting new business.

Monitoring

Capital is actively managed with regulatory ratios being a key factor in the Group's planning processes and stress analysis. A minimum of a three year forecast of the Group's capital position, based upon the strategic plan, is produced at least annually to inform the capital strategy. Shorter term forecasts are more frequently undertaken to understand and respond to variations of the Group's actual performance against the plan.

Regular reporting of actual and projected ratios is undertaken, including submissions to the Asset and Liability Committee, the Risk Management Committee and the Board.

Capital developments

CRD IV introduced new capital limits and buffers for banks, and includes a requirement to hold Common Equity Tier 1 capital to account for capital conservation, countercyclical and systemic risk buffers.

A capital conservation buffer of 0.625% was introduced on 1 January 2016. This will increase each year to 2019 in line with regulations. The countercyclical buffer applied to UK exposures is currently 0%. However, this has the potential to increase during 2017, up to a maximum of 2.5% by 2019. From a capital perspective, the Common Equity Tier 1 capital ratio for the Group was 15.2% as at 31 December 2016.

CRD IV also introduced a new leverage ratio requirement. The leverage ratio is a non-risk based measure that is designed to act as a supplement to risk based capital requirements. It is intended as a back stop measure. The leverage calculation determines a ratio based on the relationship between total Tier 1 capital and total consolidated exposures (total exposure is the sum of on-balance sheet exposures, derivative exposures, securities financing transaction exposures and off-balance sheet items). This applies to the Group from 1 January 2018. The Group is not subject to the PRA Leverage Framework until it has core deposits of £50 billion. To avoid capital cliffs the Group maintains a prudent risk appetite for leverage.

The leverage ratio for the Group (based on the Basel III definition of January 2014, and the revised CRD IV definition of October 2014) is 4.4% as at 31 December 2016.

The Financial Services (Banking Reform) Act 2013 introduces a ring-fence for UK retail banks, with the aim of separating core banking services critical to individuals and small and medium-sized enterprises from wholesale and investment banking services. The Group anticipates being a fully ring-fenced bank by the 2019 implementation date and is preparing for this change.

Minimum Requirements for Own Funds and Eligible Liabilities (MREL) were applicable from 1 January 2016 on a transitional basis with full implementation required by 1 January 2022. The BoE provided the Group's MREL guidance and transitional arrangements during 2016.

From 1 January 2020 until 31 December 2021 the Group will be required to hold 18% of risk-weighted assets. The Group is working towards implementation of these requirements and has reflected requirements in strategic plans.

The Group completed a £230 million Additional Tier 1 capital raise in November 2016 strengthening its capital base in support of business growth and supporting the leverage ratio.

The table below shows the Group's capital resources.

	2016 £m	2015 £m
Share capital and share premium account	**654.6**	654.6
Other equity instruments	**384.1**	156.5
Other reserves	**(27.4)**	(15.6)
Retained earnings	**659.2**	544.8
Total equity per balance sheet (audited)	**1,670.5**	1,340.3
Regulatory capital adjustments		
Deconsolidation of non-regulated companies	**5.4**	4.5
Foreseeable distribution on Additional Tier 1 securities	**(4.9)**	(2.1)
Foreseeable distribution on ordinary shares	**(15.5)**	(13.7)
Other equity instruments	**(384.1)**	(156.5)
Cash flow hedge reserve	**31.5**	15.3
Prudential valuation assessment	**(1.2)**	–
Intangible assets	**(80.6)**	(64.4)
Excess of expected loss over impairment	**(41.1)**	(35.4)
Deferred tax on tax losses carried forward	**(7.3)**	(18.0)
Common Equity Tier 1 capital	**1,172.7**	1,070.0
Additional Tier 1 securities	**384.1**	156.5
Total Tier 1 capital	**1,556.8**	1,226.5
Tier 2 capital		
General credit risk adjustments	**11.9**	7.6
Total Tier 2 capital	**11.9**	7.6
Total own funds	**1,568.7**	1,234.1
Common Equity Tier 1 ratio	**15.2%**	17.5%
Tier 1 ratio	**20.2%**	20.1%
Total capital ratio	**20.4%**	20.2%

As required by Article 26(2) of the Capital Requirements Regulation, a deduction has been made for foreseeable dividends on 2016 profits.

Risk Management Report

Full analysis of risk classes

The table below shows movements in Common Equity Tier 1 capital.

	2016 £m	2015 £m
At 1 January	**1,070.0**	980.5
Movement in retained earnings	**114.4**	110.3
Prudential valuation adjustment	**(1.2)**	–
Movement in available-for-sale reserve	**4.4**	(7.3)
Add back 2016 distributions made during the year	**13.7**	–
Additional foreseeable distributions on AT1 notes	**(2.8)**	–
Movements in foreseeable distribution on ordinary shares	**(15.5)**	(13.7)
Exclude losses from non-regulated companies	**0.9**	0.4
Movement in intangible assets	**(16.2)**	(18.3)
Movement in excess of expected loss over impairment	**(5.7)**	(2.0)
Movement in deferred tax on tax losses carried forward	**10.7**	20.1
At 31 December	**1,172.7**	1,070.0

The main driver for the increase in capital resources is the increase in retained earnings and the reduction in deferred tax asset on tax losses, offset by expected distributions, and other items as set out in the table above.

The table below shows risk-weighted assets.

	2016 £m	2015 £m
Retail mortgages	**4,764.5**	3,952.9
Retail unsecured lending	**1,847.4**	1,192.7
Treasury	**178.6**	229.0
Other assets	**226.4**	196.3
Credit valuation adjustments	**22.6**	14.3
Operational risk	**655.3**	525.2
Total risk-weighted assets	**7,694.8**	6,110.4

The table below shows Pillar 1 risk-weighted assets and capital requirements by business line.

	2016 Risk-weighted assets £m	2016 Pillar 1 Capital requirement £m	2015 Risk-weighted assets £m	2015 Pillar 1 Capital requirement £m
Mortgages and savings	**5,204.5**	**416.4**	4,284.5	342.8
Credit cards	**2,012.3**	**161.0**	1,334.7	106.8
Financial services	**50.4**	**4.0**	51.6	4.1
Central functions	**427.6**	**34.2**	439.6	35.1
Total	**7,694.8**	**615.6**	6,110.4	488.8

Movement in risk-weighted assets

The table below shows the movement in risk-weighted assets during the year to 31 December 2016. Growth in the mortgage and credit card books has resulted in a £1,823.9 million increase in risk-weighted assets. 'Other movements' includes a £369.6 million reduction, which relates primarily to changes in the quality of the assets already on the balance sheet and reflects lower arrears emergence and growth in HPI. This is offset by an increase in operational risk-weighted assets of £130.1 million.

Operational risk is calculated using the Standardised Approach, based on the average Group income over the past three years. The year-on-year increase reflects the increasing Group income from 2012 to 2015.

	IRB mortgage £m	Standardised lending £m	Other standardised assets £m	Credit valuation adjustment £m	Operational risks £m	Total £m
RWAs at 1 January 2016	3,952.9	1,192.7	425.3	14.3	525.2	6,110.4
Book size	1,168.1	655.8	–	–	–	1,823.9
Other movements	(356.5)	(1.1)	(20.3)	8.3	130.1	(239.5)
RWAs at 31 December 2016	4,764.5	1,847.4	405.0	22.6	655.3	7,694.8

Leverage ratio

CRD IV introduced a new balance sheet metric, the leverage ratio, as a requirement from 1 January 2014. The leverage ratio is risk insensitive, requiring capital to be held against total and off-balance sheet exposures such as undrawn credit facilities.

The Basel Committee is testing this ratio at a minimum threshold of 3.0% until 2017. The Group's leverage ratio as at 31 December 2016 was 4.4% (2015: 4.0%) as disclosed below.

A number of adjustments are applied to the exposures used in the leverage ratio, in line with CRD IV rules.

The derivative measure for leverage has been adjusted for regulatory netting rules, potential future exposures, and for 2016, cash collateral.

Off-balance sheet items include undrawn credit facilities or those that may be cancelled unconditionally at any time. Credit conversion factors have been applied to these items in accordance with the CRD IV rules subject to a floor of 10%.

Other regulatory adjustments include those applied to the Tier 1 capital (such as intangible assets, deferred tax on tax losses carried forward and excess expected losses). These are applied to the leverage ratio exposure measure to ensure consistency between the Tier 1 capital numerator and the total exposure denominator of the ratio.

	2016 £m	2015 £m
Tier 1 capital	1,556.8	1,226.5
Exposures measure		
Total regulatory balance sheet assets	35,060.9	30,233.2
Removal of accounting values for derivatives	(104.2)	(82.3)
Exposure value for derivatives	(29.4)	61.8
Exposure value for securities financing transactions	222.4	261.7
Off-balance sheet items	714.5	659.5
Other regulatory adjustments	(98.7)	(102.5)
Total exposures	35,765.5	31,031.4
Leverage ratio	4.4%	4.0%

Risk Management Report

Full analysis of risk classes

31 December 2016 accounting reconciliation

	Accounting balance sheet as in published financial statements £m	Deconsolidation of entities outside of regulatory scopes £m	Under regulatory scope of consolidation £m
Assets			
Cash and balances with central banks	786.3	–	786.3
Derivative financial instruments	104.2	–	104.2
Loans and receivables:			
Loans and advances to banks	635.6	(0.1)	635.5
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
Intangible assets	80.6	–	80.6
Tangible fixed assets	77.4	–	77.4
Deferred tax	23.0	–	23.0
Other assets	121.9	(0.3)	121.6
Intercompany assets	–	5.7	5.7
Total assets	35,055.6	5.3	35,060.9
Liabilities			
Deposits from banks	2,132.5	–	2,132.5
Customer deposits	28,106.3	–	28,106.3
Derivative financial instruments	229.7	–	229.7
Debt securities in issue	2,600.0	–	2,600.0
Provisions	8.5	(0.1)	8.4
Other liabilities	308.1	–	308.1
Intercompany liabilities	–	–	–
Total liabilities	33,385.1	(0.1)	33,385.0
Equity			
Share capital and share premium	654.6	–	654.6
Other equity instruments	384.1	–	384.1
Other reserves	(27.4)	–	(27.4)
Retained earnings	659.2	5.4	664.6
Total equity	1,670.5	5.4	1,675.9
Total liabilities and equity	33,055.6	5.3	35,060.9

Financial statements

Virgin Money Lounge, Norwich

Financial statements

Independent Auditors' Report to the members of Virgin Money Holdings (UK) plc

Report on the financial statements

Our opinion

In our opinion:

> Virgin Money Holdings (UK) plc's consolidated financial statements and Parent Company financial statements (the financial statements) give a true and fair view of the state of the Group's and of the Parent Company's affairs as at 31 December 2016 and of the Group's profit and the Group's and the Parent Company's cash flows for the year then ended;

> the consolidated financial statements have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union;

> the Parent Company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and

> the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the consolidated financial statements, Article 4 of the IAS Regulation.

What we have audited

The financial statements, included within the Annual Report and Accounts (the Annual Report), comprise:

> the consolidated income statement and the consolidated statement of comprehensive income for the year then ended;

> the consolidated and Parent Company balance sheet as at 31 December 2016;

> the consolidated and Parent Company statement of changes in equity for the year then ended;

> the consolidated and Parent Company cash flow statement for the year then ended; and

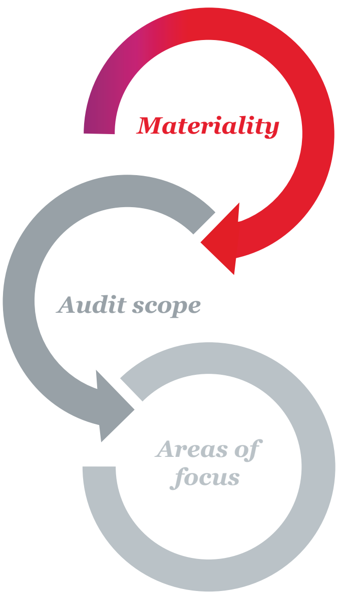
> the consolidated and Parent Company notes to the financial statements, which include a summary of significant accounting policies and other explanatory information.

Certain required disclosures have been presented elsewhere in the Annual Report, rather than in the notes to the financial statements. These are cross-referenced from the financial statements and are identified as audited.

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

Our audit approach

Overview



Overall Group materiality: £9.8 million which represents 5 per cent of profit before tax adjusted for £2.4 million of strategic items (as detailed on page 54), as these are not considered to be recurring. This adjusted measure of profit is deemed as the most appropriate measure of underlying business performance and hence an appropriate benchmark upon which to base our materiality.

The consolidated financial statements include its five 100% owned subsidiaries as well as a number of securitisation related Special Purpose Vehicles (SPVs). As the statutory audit of subsidiaries is undertaken concurrently with the Group audit, all five subsidiaries were designated as in-scope components for Group purposes. Additionally certain SPV balances were scoped in on a line by line basis based on their contribution to the consolidated financial statement line item. 99% of Revenue, 99% of profit before tax (99% of the adjusted profit before tax figure as used for our overall materiality calculation) and 99% of Total Assets were subject to audit.

> Impairment of loans and advances to customers;

> Revenue recognition – Effective Interest Rate (EIR) accounting; and

> Impairment of intangible assets.

Independent Auditor's Report to the members of Virgin Money Holdings (UK) plc

Report on the financial statements

The scope of our audit and our areas of focus

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) (ISAs (UK & Ireland)).

We designed our audit by determining materiality and assessing the risks of material misstatement in the financial statements. In particular, we looked at where the Directors made subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. As in all of our audits we also addressed the risk of management override of internal controls, including evaluating whether there was evidence of bias by the Directors that represented a risk of material misstatement due to fraud.

The risks of material misstatement that had the greatest effect on our audit, including the allocation of our resources and effort, are identified as 'areas of focus' in the table below. We have also set out how we tailored our audit to address these specific areas in order to provide an opinion on the financial statements as a whole, and any comments we make on the results of our procedures should be read in this context. This is not a complete list of all risks identified by our audit.

Area of focus	How our audit addressed the area of focus
Impairment of loans and advances to customers See note 1 of the financial statements for the Directors' disclosure of the related accounting policies and also page 99 for the Audit Committee's consideration of principal risks. The impairment provision of £50.1 million consists of provisions of £10.6 million in relation to secured lending and £39.5 million in relation to unsecured lending. Total loans and advances as at 31 December 2016 relating to secured lending was £29.8 billion and £2.5 billion for unsecured lending. We focused on this area because the Directors make complex and subjective judgments over both the timing of recognition and the size of provisions for impairment of the Group's loans and advances. This judgement includes considering the completeness of the provisions and whether any specific judgemental overlays are required to recognise the impact of emerging trends not captured in the impairment models. The Group have developed historic data based models that derive key assumptions used within the provision calculation such as Probability of Default and Loss Given Default. The output of these models is then applied to the provision calculation with other information including the selection of an appropriate Loss Emergence Period and the Exposure at Default.	We assessed and tested the design and operating effectiveness of the controls over data flows and model governance. Our detailed work in auditing the impairment provisions included: - Using credit risk modelling specialists to assess the provision and material assumption calculation methodology applied by the Group in the context of industry practice and the requirements of accounting standards; - Testing key assumptions used within the models to internal and external information where appropriate; - Comparing the key assumptions within the models with our industry experience; - Reading the model calculation scripts to ensure that their application was consistent with our understanding of the Group's methodology and the requirements of accounting standards; - Examining the basis for the judgemental overlays made to the results produced by models and agreeing the rationale for the adjustments to supporting data; and - Considering the appropriateness of judgemental overlays applied in the context of our industry experience. We found the approach taken in relation to the Group's impairment provisions to be consistent with the requirements of accounting standards. Our testing did not result in any material matters that we considered necessary to report to the Audit Committee.

Independent Auditor's Report to the members of Virgin Money Holdings (UK) plc

Area of focus	How our audit addressed the area of focus
Revenue Recognition – EIR accounting See note 1 of the financial statements for the Directors' disclosure of the related accounting policies and also page 98 for the Audit Committee's consideration of principal risks. The Group's total loans and advances to customers balance of £32.4 billion and net interest income of £522.4 million include certain EIR adjustments as per the requirements of IAS 39. The vast majority of the Group's income is system generated and requires minimal judgement, therefore we focused our work in relation to the risk of fraud in revenue recognition on EIR accounting due to the inherent subjectivity involved in forecasting future customer behaviour that is included in the EIR adjustment calculation. Changes in assumptions used in the forecasting model could have a material impact on EIR adjustments and hence, the revenue recognised in any one accounting period. The most significant assumption for secured lending EIR is the estimation of the expected life of the product over which fees are spread. In relation to unsecured lending, additional judgement is applied in calculating the EIR adjustment, by considering movements in customer balances over the expected life and the related future revenue associated with these balances in the context of the Group's historic experience of expected life cash flows on similar products.	Across both the secured and unsecured lending EIR calculation models, we tested controls over data input and checked the accuracy of model calculations by reading the formulas used and considering these with our expectation for an EIR calculation. In relation to secured lending EIR we completed the following testing: - Substantively tested a sample of fees incorporated within the calculation back to underlying secured lending agreements; and - Assessed the Group's estimate of the expected life applied and forecast cash flows during this life by comparing to recent Group experience and our industry experience. In relation to unsecured lending EIR we completed the following testing: - Tested controls over the Group's ongoing monitoring of actual vs. expected cash flows and compared 2016 experience with expected experience for that period on a sample basis; - Assessed the Group's assumption over expected life by comparing to recent Group experience and our industry experience; and - Performed sensitivity analyses of key judgements to understand the materiality of impact that potential realistic changes in assumptions may have, either individually or in combination, on the EIR asset. Our testing did not result in any material matters that we considered necessary to report to the Audit Committee.
Impairment of intangible assets See note 1 of the financial statements for the Directors' disclosure of the related accounting policies and also page 99 for the Audit Committee's consideration of principal risks. A fast changing economic and competitive landscape requires constant innovation and investment by banks in keeping up with consumer expectations. As technology and customer expectations continue to change there is a risk that certain technology assets may not generate the return that the Group had initially anticipated and therefore may be subject to impairment.	We read the Group's capitalisation policy to check that it met the requirements of IAS 38. We tested the design and operating effectiveness of the control environment in relation to the recording, budgeting and approval of project costs which form the basis of capitalisation accounting entries. We selected a sample of intangible assets and undertook the following procedures: - Substantively tested a selection of costs to check that these meet the criteria of IAS 38 for capitalisation as intangible assets; - Discussed the Group's stock of material capitalised assets with management to identify any that may be at higher risk of potential impairment; and - Where higher risk items were noted, we discussed the asset and related forecast economic benefits this would bring with management to inform our independent consideration as to whether any possible impairment triggers existed. Our testing did not identify any material matters which we considered necessary to report to the Audit Committee.

Independent Auditor's Report to the members of Virgin Money Holdings (UK) plc

Report on the financial statements

How we tailored the audit scope

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the financial statements as a whole, taking into account the geographic structure of the Group, the accounting processes and controls, and the industry in which the Group operates.

Because this was our first year as the Group's external auditors, we performed specific procedures over opening balances by shadowing the prior year audit clearance and year end Audit Committee meetings, reviewing the predecessor auditors' working papers and re-evaluating the key management judgements in the opening balance sheet at 1 January 2016.

We then performed year one process walkthroughs to understand and evaluate the key financial processes and controls across the Group and, in accordance with International Standard on Review Engagements (UK and Ireland) 2410, a review of the half year financial information. Following this work, we planned our audit and presented our audit plan to the Audit Committee. As we conducted our audit procedures, we identified changes that we needed to make to that initial plan and tailored our work accordingly. As required by ISAs (UK&I), we communicated these changes and the reasons for them, to the Audit Committee. These changes did not affect our assessment of the audit risk associated with any of the areas of focus described above. Following the changes in our audit approach, we were able to obtain sufficient appropriate audit evidence to form a basis for our audit opinion.

The consolidated financial statements include its five 100% owned subsidiaries as well as a number of securitisation related Special Purpose Vehicles (SPVs). As the statutory audit of subsidiaries is undertaken concurrently with the Group audit, all five subsidiaries were designated as in-scope components for Group purposes. Additionally certain SPV balances were scoped in on a line by line basis based on their contribution to the consolidated financial statement line item. 99% of Revenue, 99% of profit before tax (99% of the adjusted profit before tax figure as used for our overall materiality calculation) and 99% of Total Assets were subject to audit.

In establishing the overall approach to the Group audit, we determined the type of work that needed to be performed over the components. All of the audit work was completed by the Group engagement team.

Independent Auditor's Report to the members of Virgin Money Holdings (UK) plc

Other required reporting

Materiality

The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures on the individual financial statement line items and disclosures and in evaluating the effect of misstatements, both individually and on the financial statements as a whole.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

Overall Group materiality	£9.8 million
How we determined it	5 per cent of profit before tax adjusted for £2.4 million of strategic items (as detailed on page 54), as these are not considered to be recurring
Rationale for benchmark applied	This adjusted measure of profit is deemed as the most appropriate measure of underlying business performance and hence an appropriate benchmark upon which to base our materiality

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £0.47 million as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Going concern

Under the Listing Rules we are required to review the Directors' statement, set out on page 126, in relation to going concern. We have nothing to report having performed our review.

Under ISAs (UK & Ireland) we are required to report to you if we have anything material to add or to draw attention to in relation to the Directors' statement about whether they considered it appropriate to adopt the going concern basis in preparing the financial statements. We have nothing material to add or to draw attention to.

As noted in the Directors' statement, the Directors have concluded that it is appropriate to adopt the going concern basis in preparing the financial statements. The going concern basis presumes that the Group and Parent Company have adequate resources to remain in operation, and that the Directors intend them to do so, for at least one year from the date the financial statements were signed. As part of our audit we have concluded that the Directors' use of the going concern basis is appropriate. However, because not all future events or conditions can be predicted, these statements are not a guarantee as to the Group's and Parent Company's ability to continue as a going concern.

Consistency of other information and compliance with applicable requirements

Companies Act 2006 reporting

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

> the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements; and

> the Strategic Report and the Directors' Report have been prepared in accordance with applicable legal requirements.

In addition, in light of the knowledge and understanding of the Group, the Parent Company and their environment obtained in the course of the audit, we are required to report if we have identified any material misstatements in the Strategic Report and the Directors' Report. We have nothing to report in this respect.

Independent Auditor's Report to the members of Virgin Money Holdings (UK) plc

Other required reporting

ISAs (UK & Ireland) reporting

Under ISAs (UK & Ireland) we are required to report to you if, in our opinion:	
> information in the Annual Report is: – materially inconsistent with the information in the audited financial statements; or – apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Group and Parent Company acquired in the course of performing our audit; or – otherwise misleading.	We have no exceptions to report.
> the statement given by the Directors on page 131, in accordance with provision C.1.1 of the UK Corporate Governance Code (the Code), that they consider the Annual Report taken as a whole to be fair, balanced and understandable and provides the information necessary for members to assess the Group's and Parent Company's position and performance, business model and strategy is materially inconsistent with our knowledge of the Group and Parent Company acquired in the course of performing our audit.	We have no exceptions to report.
> the section of the Annual Report on pages 98 and 99, as required by provision C.3.8 of the Code, describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee.	We have no exceptions to report.

The Directors' assessment of the prospects of the Group and of the principal risks that would threaten the solvency or liquidity of the Group

Under ISAs (UK & Ireland) we are required to report to you if we have anything material to add or to draw attention to in relation to:	
> the Directors' confirmation on page 138 of the Annual Report, in accordance with provision C.2.1 of the Code, that they have carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency or liquidity.	We have nothing material to add or to draw attention to.
> the disclosures in the Annual Report that describe those risks and explain how they are being managed or mitigated.	We have nothing material to add or to draw attention to.
> the Directors' explanation on pages 126 and 127 of the Annual Report, in accordance with provision C.2.2 of the Code, as to how they have assessed the prospects of the Group, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.	We have nothing material to add or to draw attention to.
Under the Listing Rules we are required to review the Directors' statement that they have carried out a robust assessment of the principal risks facing the Group and the Directors' statement in relation to the longer-term viability of the Group. Our review was substantially less in scope than an audit and only consisted of making inquiries and considering the Directors' process supporting their statements; checking that the statements are in alignment with the relevant provisions of the Code; and considering whether the statements are consistent with the knowledge acquired by us in the course of performing our audit. We have nothing to report having performed our review.	

Adequacy of accounting records and information and explanations received

Under the Companies Act 2006 we are required to report to you if, in our opinion:

> we have not received all the information and explanations we require for our audit; or

> adequate accounting records have not been kept by the Parent Company, or returns adequate for our audit have not been received from branches not visited by us; or

> the Parent Company financial statements and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

Directors' remuneration

Directors' remuneration report – Companies Act 2006 opinion

In our opinion, the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006.

Other Companies Act 2006 reporting

Under the Companies Act 2006 we are required to report to you if, in our opinion, certain disclosures of Directors' remuneration specified by law are not made. We have no exceptions to report arising from this responsibility.

Corporate governance statement

Under the Listing Rules we are required to review the part of the Corporate Governance Statement relating to ten further provisions of the Code. We have nothing to report having performed our review.

Independent Auditor's Report to the members of Virgin Money Holdings (UK) plc

Responsibilities for the financial statements and the audit

Our responsibilities and those of the Directors

As explained more fully in the Statement of Directors' responsibilities set out on pages 130 and 131, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and ISAs (UK & Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the Parent Company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

What an audit of financial statements involves

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of:

> whether the accounting policies are appropriate to the Group's and the Parent Company's circumstances and have been consistently applied and adequately disclosed;

> the reasonableness of significant accounting estimates made by the Directors; and

> the overall presentation of the financial statements.

We primarily focus our work in these areas by assessing the Directors' judgements against available evidence, forming our own judgements, and evaluating the disclosures in the financial statements.

We test and examine information, using sampling and other auditing techniques, to the extent we consider necessary to provide a reasonable basis for us to draw conclusions. We obtain audit evidence through testing the effectiveness of controls, substantive procedures or a combination of both.

In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report. With respect to the Strategic Report and Directors' Report, we consider whether those reports include the disclosures required by applicable legal requirements.

Catrin Thomas

Catrin Thomas (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Edinburgh

27 February 2017

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 on pages 202 to 256 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.

Notes to the consolidated financial statements

Note 1: Basis of preparation and accounting policies (continued)

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

Notes to the consolidated financial statements

Note 1: Basis of preparation and accounting policies (continued)

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

Notes to the consolidated financial statements

Note 1: Basis of preparation and accounting policies (continued)

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

Notes to the consolidated financial statements

Note 1: Basis of preparation and accounting policies (continued)

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

Notes to the consolidated financial statements

Note 1: Basis of preparation and accounting policies (continued)

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

Notes to the consolidated financial statements

Note 1: Basis of preparation and accounting policies (continued)

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.

Notes to the consolidated financial statements

Note 1: Basis of preparation and accounting policies (continued)

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

Notes to the consolidated financial statements

Note 1: Basis of preparation and accounting policies (continued)

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

Notes to the consolidated financial statements

Note 1: Basis of preparation and accounting policies (continued)

> 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.

Notes to the consolidated financial statements

Note 1: Basis of preparation and accounting policies (continued)

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.

Notes to the consolidated financial statements

Note 1: Basis of preparation and accounting policies (continued)

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.

Notes to the consolidated financial statements

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

Notes to the consolidated financial statements

Note 2: Segmental analysis (continued)

	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.

Notes to the consolidated financial statements

Note 2: Segmental analysis (continued)

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.

Notes to the consolidated financial statements

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

Notes to the consolidated financial statements

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

Notes to the consolidated financial statements

Note 6: Operating expenses (continued)

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.

Notes to the consolidated 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.

Notes to the consolidated financial statements

Note 7: Share based payments (continued)

(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.

Notes to the consolidated financial statements

Note 7: Share based payments (continued)

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.

Notes to the consolidated financial statements

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)

Notes to the consolidated financial statements

Note 9: Taxation (continued)

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).

Notes to the consolidated financial statements

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.

Notes to the consolidated financial statements

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: Fair value hedges £m	Derivatives designated as hedging instruments: Cash flow hedges £m	Total £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

Notes to the consolidated financial statements

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: Fair value hedges £m	Derivatives designated as hedging instruments: Cash flow hedges £m	Total £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

Notes to the consolidated financial statements

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)

Notes to the consolidated financial statements

Note 13: Derivative financial instruments (continued)

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.

Notes to the consolidated financial statements

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.

Notes to the consolidated financial statements

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 £m	2015 £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.

Notes to the consolidated financial statements

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

Notes to the consolidated financial statements

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

Notes to the consolidated financial statements

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.

Notes to the consolidated financial statements

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.

Notes to the consolidated financial statements

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.

Notes to the consolidated financial statements

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.

Notes to the consolidated financial statements

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)

Notes to the consolidated financial statements

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

Notes to the consolidated financial statements

Note 32: Contingent liabilities and commitments (continued)

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

Notes to the consolidated financial statements

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

Notes to the consolidated financial statements

Note 33: Fair value of financial assets and financial liabilities (continued)

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.

Notes to the consolidated financial statements

Note 33: Fair value of financial assets and financial liabilities (continued)

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.

Notes to the consolidated financial statements

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] Subject to master netting agreements £m	Collateral received/ pledged £m	Potential net amounts if offset of related amounts permitted £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.

Notes to the consolidated financial statements

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.

Notes to the consolidated financial statements

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).

Notes to the consolidated financial statements

Note 36: Related party transactions (continued)

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.

Notes to the consolidated 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 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.	1 January 2018 (EU endorsed on 22 November 2016)

Notes to the consolidated financial statements

Note 38: Future accounting developments (continued)

Pronouncement	Nature of change	IASB effective date
	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.

Parent Company balance sheet

For the year ended 31 December

	Notes	2016 £ million	2015 £ million
Assets			
Loans and advances to banks		**41.0**	103.0
Derivative financial instruments		**4.6**	1.5
Investment in subsidiary undertakings	2	**1,370.4**	1,127.6
Deferred tax assets	3	**0.1**	0.1
Other assets	4	**17.0**	16.4
Total assets		**1,433.1**	1,248.6
Equity and liabilities			
Liabilities			
Deposits from banks		**2.5**	1.6
Derivative financial instruments		**4.3**	0.7
Other liabilities	5	**86.2**	164.7
Total liabilities		**93.0**	167.0
Equity			
Share capital and share premium	6	**654.6**	654.6
Other equity instruments	7	**384.1**	156.5
Retained earnings[1]	8	**301.4**	270.5
Total equity		**1,340.1**	1,081.6
Total equity and liabilities		**1,433.1**	1,248.6

1 The Company profit for the year was £56.3 million (2015: loss of £3.1 million)

The accompanying notes are an integral part of the parent company financial statements.

The financial statements on pages 257 to 266 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

Parent Company statement of changes in equity

For the year ended 31 December

	Share capital and share premium £ million	Other equity instruments £ million	Retained earnings £ million	Total equity £ million
Balance as at 1 January 2016	**654.6**	**156.5**	**270.5**	**1,081.6**
Profit for the year	**–**	**–**	**56.3**	**56.3**
Total comprehensive income for the year	**–**	**–**	**56.3**	**56.3**
Transactions with equity holders				
Capital contribution – share based payments	**–**	**–**	**12.8**	**12.8**
Purchase of own shares	**–**	**–**	**(7.3)**	**(7.3)**
Issue of Additional Tier 1 securities (net of issue costs)	**–**	**227.6**	**–**	**227.6**
Distribution to Additional Tier 1 noteholders	**–**	**–**	**(12.6)**	**(12.6)**
Group relief attributable to Tier 1 Securities	**–**	**–**	**2.5**	**2.5**
Dividends paid to ordinary shareholders	**–**	**–**	**(20.8)**	**(20.8)**
Balance as at 31 December 2016	**654.6**	**384.1**	**301.4**	**1,340.1**
Balance as at 1 January 2015	654.6	156.5	274.8	1,085.9
Loss for the year	–	–	(3.1)	(3.1)
Total comprehensive expense for the year	–	–	(3.1)	(3.1)
Transactions with equity holders				
Capital contribution – share based payments	–	–	20.0	20.0
Purchase of own shares	–	–	(5.0)	(5.0)
Distribution to Additional Tier 1 noteholders	–	–	(12.6)	(12.6)
Group relief attributable to Tier 1 Securities	–	–	2.6	2.6
Dividends paid to ordinary shareholders	–	–	(6.2)	(6.2)
Balance as at 31 December 2015	654.6	156.5	270.5	1,081.6

The accompanying notes are an integral part of the parent company financial statements.

Parent Company cash flow statement

For the year ended 31 December

	Notes	2016 £ million	2015 £ million
Profit/(loss) before taxation		**55.5**	(3.8)
Adjustments for:			
Change in operating assets	11(a)	**(2.8)**	–
Change in operating liabilities	11(b)	**4.5**	(0.7)
Non-cash and other items	11(c)	**1.0**	3.4
Movement in amounts due to group undertakings		**(78.5)**	0.6
Net cash used in operating activities		**(20.3)**	(0.5)
Net cash outflow from investing activities			
Investment in Additional Tier 1 instruments issued by subsidiary undertaking		**(227.7)**	–
Net cash used in investing activities		**(227.7)**	–
Net cash inflow/(outflow) from financing activities			
Issue of Additional Tier 1 securities (net of issue costs)		**227.6**	–
Distribution to Additional Tier 1 security holders		**(12.6)**	(12.6)
Purchase of own shares		**(7.3)**	(5.0)
Movements in amounts from group undertakings		**(0.9)**	(0.5)
Dividends paid on ordinary shares		**(20.8)**	(6.2)
Net cash provided by/(used in) financing activities		**186.0**	(24.3)
Change in cash and cash equivalents		**(62.0)**	(24.8)
Cash and cash equivalents at beginning of year		**103.0**	127.8
Cash and cash equivalents at end of year	11(d)	**41.0**	103.0

The accompanying notes are an integral part of the parent company financial statements.

Notes to the Parent Company financial statements

Note 1: Basis of preparation

1.1 Basis of preparation and accounting policies

The financial statements of Virgin Money Holdings (UK) plc, (the Parent Company, the Company), which should be read in conjunction with the Group Directors' Report, have been prepared on a going concern basis in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU and with those parts of the Companies Act 2006 applicable to companies reporting under IFRS. No individual statement of comprehensive income is presented for the Company, as permitted by Section 408(4) of the Companies Act 2006.

1.2 Basis of measurement

The financial statements have been prepared under the historical cost convention as modified by the revaluation of derivative financial instruments and other assets held at fair value through profit or loss.

The preparation of the 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, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimates are revised and in any future periods affected.

1.3 Accounting policies

The accounting policies of the Company are the same as those of the Group which are set out in note 1 of the consolidated financial statements except that the Company has no policy in respect of consolidation and investments in subsidiaries which are carried at historical cost, less any provision for impairment. These accounting policies have been applied consistently to all years presented in these financial statements.

Note 2: Investment in subsidiary undertakings

	2016 £m	2015 £m
At 1 January	**1,127.6**	1,107.6
Capital contribution – share based payments	**12.8**	20.0
Investment in Additional Tier 1 instruments issued by subsidiary undertaking	**230.0**	–
At 31 December	**1,370.4**	1,127.6

Notes to the Parent Company financial statements

Note 2: Investment in subsidiary undertakings (continued)

The following were subsidiaries of the Company or SPVs controlled by the Company during the year in accordance with note 1.5 to the consolidated financial statements:

Name	Class of Share	Holding
Direct holdings		
Virgin Money plc[1]	Ordinary	100%
Virgin Money Personal Financial Service Limited[1]	Ordinary	100%
Virgin Money Unit Trust Managers Limited[1]	Ordinary	100%
Virgin Money Management Services Limited[1]	Ordinary	100%
Virgin Money Giving Limited[1]	Ordinary	100%
Challenger (Norwich) Limited[1,2]	Ordinary	100%
Indirect holdings		
Virgin Card Limited[1,2]	Ordinary	100%
Eagle Place Covered Bonds LLP[1,3]	N/A	N/A[5]
Virgin Money Nominees Limited[1,3]	Ordinary	100%
Northern Rock Limited[1,3]	Ordinary	100%

Special purpose vehicles	Nature of business
Gosforth Funding 2011-1 plc[4]	Issue of securitised notes
Gosforth Funding 2012-1 plc[4]	Issue of securitised notes
Gosforth Funding 2012-2 plc[4]	Issue of securitised notes
Gosforth Funding 2014-1 plc[4]	Issue of securitised notes
Gosforth Funding 2015-1 plc[4]	Issue of securitised notes
Gosforth Funding 2016-1 plc[4]	Issue of securitised notes
Gosforth Funding 2016-2 plc[4]	Issue of securitised notes
Gosforth Mortgages Trustee 2011-1 Limited[4]	Trust
Gosforth Mortgages Trustee 2012-1 Limited[4]	Trust
Gosforth Mortgages Trustee 2012-2 Limited[4]	Trust
Gosforth Mortgages Trustee 2014-1 Limited[4]	Trust
Gosforth Mortgages Trustee 2015-1 Limited[4]	Trust
Gosforth Mortgages Trustee 2016-1 Limited[4]	Trust
Gosforth Mortgages Trustee 2016-2 Limited[4]	Trust
Gosforth Holdings 2011-1 Limited[4]	Holding company
Gosforth Holdings 2012-1 Limited[4]	Holding company
Gosforth Holdings 2012-2 Limited[4]	Holding company
Gosforth Holdings 2014-1 Limited[4]	Holding company
Gosforth Holdings 2015-1 Limited[4]	Holding company
Gosforth Holdings 2016-1 Limited[4]	Holding company
Gosforth Holdings 2016-2 Limited[4]	Holding company

1 Registered office: Jubilee House, Gosforth, Newcastle upon Tyne, NE3 4PL.

2 Dissolved 5 April 2016.

3 Dormant companies.

4 Registered office: Fifth Floor, 100 Wood Street, London, EC2V 7EX.

5 The entity does not have share capital.

Notes to the Parent Company financial statements

Note 3: Deferred tax

The Directors conclude that net deferred tax assets in relation to a change in accounting basis on adoption of IFRS of £0.1 million (2015: £0.1 million) should be recognised at the balance sheet date. This is based on their interpretation of the timing and level of reversal of existing taxable temporary differences, in line with relevant accounting standards.

The Company is expected to generate sufficient taxable profits in future periods to recover these assets. The Company has not recognised deferred tax assets in respect of gross unused tax losses of £31.1 million (2015: £31.1 million).

Note 4: Other assets

	2016 £m	2015 £m
Amounts owed from subsidiary undertakings	**13.7**	12.8
Group relief owed from related parties	**3.3**	3.3
Other	**–**	0.3
Total	**17.0**	16.4

Note 5: Other liabilities

	2016 £m	2015 £m
Amounts owed to subsidiary undertakings	**86.2**	164.7
Total	**86.2**	164.7

Note 6: Share capital and share premium

Details of the Company's share capital and share premium are given in note 28 of the consolidated financial statements.

Note 7: Other equity instruments

Details of the Company's other equity instruments are given in note 29 of the consolidated financial statements.

Notes to the Parent Company financial statements

Note 8: Retained earnings

Retained earnings comprise:

	Subsidiary contribution £m	Investment in own shares £m	Retained profits £m	Total £m
At 1 January 2015	18.5	(2.1)	258.4	274.8
Loss for the year	–	–	(3.1)	(3.1)
Dividends paid to ordinary shareholders	–	–	(6.2)	(6.2)
Distributions to Additional Tier 1 security holders (net of tax)	–	–	(10.0)	(10.0)
Purchase of own shares	–	(5.0)	–	(5.0)
Award of shares from own shares	–	4.2	(4.2)	–
Capital contribution – share based payments	20.0	–	–	20.0
As at 31 December 2015	38.5	(2.9)	234.9	270.5
Profit for the year	**–**	**–**	**56.3**	**56.3**
Dividends paid to ordinary shareholders	**–**	**–**	**(20.8)**	**(20.8)**
Distributions to Additional Tier 1 security holders (net of tax)	**–**	**–**	**(10.1)**	**(10.1)**
Purchase of own shares	**–**	**(7.3)**	**–**	**(7.3)**
Award of shares from own shares	**–**	**3.3**	**(3.3)**	**–**
Capital contribution – share based payments	**12.8**	**–**	**–**	**12.8**
As at 31 December 2016	**51.3**	**(6.9)**	**257.0**	**301.4**

Employee benefit trust

The Company established an EBT in 2011 in connection with the operation of the Company's share plans. For further details refer to note 31 in the consolidated financial statements.

Notes to the Parent Company financial statements

Note 9: Analysis of financial assets and financial liabilities by measurement basis

2016	Financial liabilities at amortised cost £m	Loans and receivables £m	Derivatives not in IAS 39 hedges £m	Total £m
Financial assets				
Loans and advances to banks	–	41.0	–	41.0
Derivative financial instruments	–	–	4.6	4.6
Amounts owed from subsidiary undertakings	–	13.7	–	13.7
Total financial assets	–	54.7	4.6	59.3
Non financial assets				1,373.8
Total assets				1,433.1
Financial liabilities				
Deposits from banks	2.5	–	–	2.5
Derivative financial instruments	–	–	4.3	4.3
Amounts owed to subsidiary undertakings	86.2	–	–	86.2
Total financial liabilities	88.7	–	4.3	93.0
Total liabilities				93.0
Equity				1,340.1
Total liabilities and equity				1,433.1

2015	Financial liabilities at amortised cost £m	Loans and receivables £m	Derivatives not in IAS 39 hedges £m	Total £m
Financial assets				
Loans and advances to banks	–	103.0	–	103.0
Derivative financial instruments	–	–	1.5	1.5
Amounts owed from subsidiary undertakings	–	12.8	–	12.8
Total financial assets	–	115.8	1.5	117.3
Non financial assets				1,131.3
Total assets				1,248.6
Financial liabilities				
Deposits from banks	1.6	–	–	1.6
Derivative financial instruments	–	–	0.7	0.7
Amounts owed to subsidiary undertakings	164.7	–	–	164.7
Total financial liabilities	166.3	–	0.7	167.0
Total liabilities				167.0
Equity				1,081.6
Total liabilities and equity				1,248.6

Notes to the Parent Company financial statements

Note 10: Fair value of financial assets and financial liabilities

				2016		2015	
	Level 1 £m	Level 2 £m	Level 3 £m	Total fair value £m	Total carrying value £m	Total fair value £m	Total carrying value £m
Financial assets							
Loans and advances to banks	–	41.0	–	41.0	41.0	103.0	103.0
Amounts due from subsidiary undertakings	–	13.7	–	13.7	13.7	12.8	12.8
Financial liabilities							
Amounts owed to subsidiary undertakings	–	86.2	–	86.2	86.2	164.7	164.7
Deposits from banks	–	2.5	–	2.5	2.5	1.6	1.6

The Company has £0.3 million (2015: £0.8 million) of net derivative financial instruments classified as level 2 in the fair value hierarchy.

Note 11: Cash flow statements

(a) Change in operating assets

	2016 £m	2015 £m
Change in derivative financial assets	(3.1)	(0.4)
Change in other operating assets	0.3	0.4
Change in operating assets	**(2.8)**	–

(b) Change in operating liabilities

	2016 £m	2015 £m
Change in derivative financial liabilities	3.6	0.5
Change in other operating liabilities	0.9	(1.2)
Change in operating liabilities	**4.5**	(0.7)

(c) Non-cash and other items

	2016 £m	2015 £m
Other non-cash items	1.0	3.4
Total non-cash and other items	**1.0**	3.4

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

Cash and cash equivalents consists of loans and advances to banks of £41.0 million at 31 December 2016 (31 December 2015: £103.0 million)

Notes to the Parent Company financial statements

Note 12: Related party transactions

Key Management Personnel

The Key Management personnel of the Company are Key Management personnel of the Group, with relevant disclosures given in note 36 to the consolidated financial statements. The Company has no employees (2015: nil).

As discussed in note 7 of the consolidated financial statements, the Group provides share based compensation to employees of subsidiary undertakings through a number of schemes. These awards are all in relation to shares in the Company and the cost of providing those benefits is not recharged to the subsidiary undertaking, therefore is recognised as a capital contribution.

Other transactions

	Transaction value Year ended 31 December		Balance outstanding at 31 December	
	2016 £m	2015 £m	**2016 £m**	2015 £m
Recharges and trading balances owed to/(from) subsidiaries	**0.7**	0.8	**(0.3)**	(2.6)
Loans from subsidiaries	**2.2**	3.8	**69.5**	151.2
Dividend payment to Virgin Group Holdings Limited	**7.3**	2.2	**–**	–

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

Glossary

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

Shareholder Information

Annual General Meeting

The AGM will be held on 3 May 2017 at the offices of Allen & Overy at One Bishops Square, London, E1 6AD. Further details about the meeting, including the proposed resolutions, can be found in our Notice of AGM which will be issued to shareholders and available on our website in due course.

Shareholder concentration

As of 31 December 2016	Number of shares – millions	Shareholdings	%
Individuals	0.5	481	0.1
Banks & Nominees	257.2	387	57.8
Other companies	172.5	84	38.8
Other corporates	14.7	43	3.3
	444.9	995	100.0

Range of shareholdings:	Number of shares – millions	Shareholdings	%
1-1,000	0.2	507	0.0
1,001-10,000	0.6	149	0.1
10,001-100,000	5.0	130	1.1
100,001-1,000,000	52.4	140	11.8
1,000,001-10,000,000	195.0	65	43.8
>10,000,001	191.7	4	43.2
	444.9	995	100.0

Registrar

The Virgin Money share register is maintained by Equiniti Limited. Equiniti is responsible for keeping Virgin Money's register of members up to date and for administering the payment of dividends.

Enquiries

Please contact Equiniti if you have any enquiries about your Virgin Money shareholding, including the following:

> Change of name or address.

> Change of bank account details.

> Loss of share certificate, dividend warrant or tax voucher.

> To obtain a form for dividends to be paid directly to your bank or building society account (tax vouchers will be sent to your registered address unless you request otherwise).

> Request for copies of the report and accounts in alternative formats for shareholders with disabilities.

> Lost or out of date dividend payments.

> Share transfers.

> Information regarding the administration of your shareholding.

UK – **0371 384 2937**
Textphone – **0371 384 2255**
Overseas – **+44 (0)121 415 0857**

Lines are open 8.30am to 5.30pm Monday to Friday (except UK public holidays).

Equinity operates a web-based enquiry and portfolio management service for shareholders www.shareview.co.uk

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