2017 HALF-YEAR RESULTS

News release

BASIS OF PRESENTATION

This report covers the results of Virgin Money Holdings (UK) plc together with its subsidiaries ('Virgin Money', 'Virgin Money Group' or 'the Group') for the half-year ended 30 June 2017.

Statutory basis

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

Underlying basis

In order to present a more meaningful view of business performance, the results of the Group are presented on an underlying basis, which excludes:

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

Reconciliations of the Group's statutory and underlying results are reported on pages 4 and 10 and in note 2 to condensed consolidated half-year financial statements.

Alternative performance measures

A number of 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 International Financial Reporting Standards (IFRS). Details of all APMs, including the rationale for their use and their bases of calculation, are set out on page 59.

Forward looking statements

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

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

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VIRGIN MONEY GROUP: RESULTS FOR THE HALF-YEAR TO 30 JUNE 2017

Business highlights

- **Underlying profit before tax up 26 per cent to £128.6 million and return on tangible equity increased to 13.3 per cent**
- **Disciplined approach to lending growth and high underwriting standards delivered 7 per cent growth in customer loan balances - low cost of risk stable at 0.13 per cent**
- **Recognised as Britain's most trusted bank[1] and overall Net Promoter Score (NPS) improved to +39, making Virgin Money one of the leading UK retail banks for customer satisfaction**
- **Virgin Money to become Virgin Atlantic's UK retail financial services partner in 2018. The partnership will offer customers a range of benefits, including Flying Club miles**

Excellent financial performance

- Underlying profit before tax increased to £128.6 million, from £101.8 million in H1 2016.
- Statutory profit before tax increased to £123.8 million, compared to £93.7 million in H1 2016.
- Net interest margin of 1.59 per cent, in line with guidance.
- Return on tangible equity increased to 13.3 per cent, from 12.2 per cent in H1 2016.
- Cost:income ratio reduced to 53.9 per cent, from 58.8 per cent in H1 2016.
- Common Equity Tier 1 ratio of 13.8 per cent and leverage ratio of 3.9 per cent.
- Interim dividend of 1.9 pence per ordinary share to be paid in September 2017.

Jayne-Anne Gadhia, Chief Executive said:

"The momentum of the business demonstrates the strength of our strategy and the focus we have on serving our customers. Our drive to maintain excellent asset quality, deliver customer satisfaction and retention, combined with continuing operational leverage, helped deliver a 26 per cent increase in underlying profit before tax to £128.6 million.

In line with our ambition to make 'everyone better off', our continued focus on delivering excellent customer service led to new highs in customer satisfaction with our overall Net Promoter Score improving to +39, making us one of the best-rated retail banks in the UK.

Our deposit franchise is flourishing, we have maintained our stringent focus on the prime segment of the credit card market, and continue to deliver high-quality mortgage lending growth.

We are delighted to announce our new partnership with Virgin Atlantic which will offer an exceptional experience for Flying Club members. With our shared brand and closely aligned values, we expect this to create a valuable strategic partnership for the business.

The development of our digital banking platform, in collaboration with 10x Future Technologies, is progressing to time and budget and we believe will be transformational for the business.

We will continue to drive growth, quality and returns, put customers at the heart of everything we do, and we remain on track to sustain a solid double-digit return on tangible equity (RoTE) in 2017."

1 The RepTrak survey is the result of more than 35,000 interviews with the UK general public (in Q1 2017) by the Reputation Institute.

Continued growth in customer balances

- Retail deposit balances increased to £29.6 billion, 5 per cent higher than FY 2016.
- Mortgage balances increased to £31.8 billion, 7 per cent higher than FY 2016.
- Gross mortgage lending of £4.3 billion and net lending of £2.1 billion.
- Gross mortgage market share of 3.5 per cent at the end of May 2017 and net lending share of 11.9 per cent.
- Credit card balances increased to £2.8 billion, 13 per cent higher than FY 2016.

Maintained focus on a high-quality balance sheet, underpinned by strong capital ratios

- Strong capital base, with a Common Equity Tier 1 ratio of 13.8 per cent.
- Total capital ratio of 18.4 per cent and a leverage ratio of 3.9 per cent.
- Mortgage arrears held at low levels, with loans over three months in arrears of 0.15 per cent unchanged from FY 2016 and well below the latest industry average of 0.91 per cent.
- Low credit card arrears maintained, with credit card balances two or more payments in arrears of 0.82 per cent, compared to 0.78 per cent at FY 2016 and the latest industry average of 2.4 per cent.

Differentiated business model continues to deliver for all stakeholders

- Customers: Two million visitors have now experienced the Virgin Money Lounges - a unique concept in UK retail banking. The Lounges deliver excellent customer satisfaction ratings with a NPS of +86.
- Communities: Helped charities raise over £56 million in H1 2017 through Virgin Money Giving, Virgin Money's not-for-profit online donation service.
- Corporate partners: Virgin Money to become Virgin Atlantic’s retail financial services partner in the UK from 2018. The partnership will offer customers a range of benefits, including Flying Club miles and Virgin Group discounts.
- Corporate partners: Our digital banking platform, being developed in collaboration with 10x Future Technologies, is on time and budget and meeting our expectations in every respect.

CONSOLIDATED INCOME STATEMENT

	Half-year to 30 Jun 2017 £ million	Half-year to 30 Jun 2016 £ million	**Change %**	Half-year to 31 Dec 2016 £ million	**Change %**
Net interest income	**288.5**	252.2	**14**	266.8	**8**
Other income	**38.7**	37.4	**3**	30.5	**27**
Total income	**327.2**	289.6	**13**	297.3	**10**
Costs	**(176.4)**	(170.4)	**4**	(165.6)	**7**
Impairment	**(22.2)**	(17.4)	**28**	(20.2)	**10**
Underlying profit before tax	**128.6**	101.8	**26**	111.5	**15**

CONSOLIDATED BALANCE SHEET

	At 30 Jun 2017 £ million	At 30 Jun 2016 £ million	**Change %**	At 31 Dec 2016 £ million	**Change %**
Assets					
Cash and balances at central banks	**3,677.0**	784.3	**369**	786.3	**368**
Loans and receivables	**35,206.7**	30,865.1	**14**	33,003.4	**7**
Available-for-sale financial assets	**1,046.7**	1,046.7	**-**	858.8	**22**
Other	**386.0**	451.9	**(15)**	407.1	**(5)**
Total assets	**40,316.4**	33,148.0	**22**	35,055.6	**15**
Liabilities and equity					
Deposits from banks	**6,124.7**	1,016.5	**503**	2,132.5	**187**
Customer deposits	**29,564.2**	27,128.4	**9**	28,106.3	**5**
Debt securities in issue	**2,298.8**	2,948.2	**(22)**	2,600.0	**(12)**
Other	**577.5**	673.8	**(14)**	537.8	**7**
Provisions	**13.2**	15.8	**(16)**	8.5	**55**
Total liabilities	**38,578.4**	31,782.7	**21**	33,385.1	**16**
Total equity	**1,738.0**	1,365.3	**27**	1,670.5	**4**
Total liabilities and equity	**40,316.4**	33,148.0	**22**	35,055.6	**15**

KEY RATIOS

		Half-year to 30 Jun 2017	Half-year to 30 Jun 2016	**Change**	Half-year to 31 Dec 2016	**Change**
Net interest margin	%	**1.59**	1.60	**(1)bp**	1.59	**-**
Cost:income ratio	%	**53.9**	58.8	**(4.9)pp**	55.7	**(1.8)pp**
Cost of risk	%	**0.13**	0.12	**1bp**	0.13	**-**
Statutory basic earnings per share	p	**17.7**	14.1	**26%**	15.2	**16%**
Tangible net asset value per share	£	**2.84**	2.58	**26p**	2.73	**11p**
Common Equity Tier 1 ratio	%	**13.8**	15.3	**(1.5)pp**	15.2	**(1.4)pp**
Leverage ratio	%	**3.9**	3.8	**0.1pp**	4.4	**(0.5)pp**
Return on tangible equity	%	**13.3**	12.2	**1.1pp**	12.9	**0.4pp**

Key ratios are presented on an underlying basis except where stated. Capital ratios include verified profit for H1 2017.

RECONCILIATION TO STATUTORY PROFIT

	Half-year to 30 Jun 2017 £ million	Half-year to 30 Jun 2016 £ million	**Change %**	Half-year to 31 Dec 2016 £ million	**Change %**
Underlying profit before tax	**128.6**	101.8	**26**	111.5	**15**
IPO share based payments	**(0.6)**	(1.4)		(0.6)	
Strategic items	**(5.5)**	1.7		(4.1)	
Simplification costs	**-**	(3.3)		(2.3)	
Fair value gains/(losses) on financial instruments	**1.3**	(5.1)		(3.8)	
Statutory profit before tax	**123.8**	93.7	**32**	100.7	**23**

CHIEF EXECUTIVE'S STATEMENT

Executive summary

The momentum of the business demonstrates the strength of our business model and the focus we have on serving our customers, and in doing so, pursuing our ambition to make 'everyone better off'. Our drive to maintain excellent asset quality, deliver customer satisfaction and retention, combined with continuing operational leverage, helped to deliver a 26 per cent increase in underlying profit before tax to £128.6 million.

By ensuring that customers are at the heart of our strategy of growth, quality and returns, we have seen significant further gains in customer satisfaction and retention. I am delighted that more customers than ever before would recommend Virgin Money to their friends and family with our overall Net Promoter Score (NPS) improving to +39 in the first half of the year, up from +29 at the year end.

Our deposit franchise is flourishing and we continue to target and deliver high-quality mortgage lending growth. We have maintained our stringent focus on the prime segment of the credit card market and we remain well-placed to manage growth towards £3 billion of high-quality card balances by the end of the year.

As a result of our disciplined approach to cost management and further operational efficiency, our cost:income ratio improved to 53.9 per cent, from 58.8 per cent in H1 2016.

We continue to manage our balance sheet within our prudent risk appetite with a view to maintaining its quality and efficiency. Our Common Equity Tier 1 ratio was 13.8 per cent at the end of the first half of 2017, while our total capital ratio was 18.4 per cent and our leverage ratio was 3.9 per cent.

We are delighted to announce our new partnership with Virgin Atlantic which will offer an exceptional experience for Flying Club members. With our shared brand and closely aligned values, we expect this to create a valuable partnership which will bring a new customer segment to the business.

The development of our digital banking platform, in collaboration with 10x Future Technologies, is progressing to time and budget and we believe will be transformational for the business.

As a result of the confidence we have in our strategy and prospects for the company, and our continued ability to best serve our customers, colleagues, corporate partners and communities in which we work, the Board has declared an interim dividend of 1.9 pence per share in respect of the half-year, which is up 19 per cent from the first half of 2016.

Operating environment

Although the UK economy has remained resilient during the first half of the year, including stable GDP and house prices and record employment, post referendum economic uncertainty remains. Our high-quality asset base, focus on customer affordability through the cycle, and lack of legacy conduct issues means that we are in a strong position to deal with a period of economic uncertainty.

The Prudential Regulation Authority (PRA) has undertaken a review of consumer credit lending, examining firms' asset quality and underwriting practices for credit cards, unsecured personal loans and motor finance. This follows a continued period of material growth in consumer credit.

Virgin Money does not lend in the unsecured personal loan or motor finance markets. We believe the high asset quality of our credit card book, both in absolute terms and relative to our peers, together with our strategic focus on asset quality is the only way to deliver safe growth and sustainable returns.

The strength of our franchise, our strategy and commercial agility, give us the flexibility to adapt to possible changes in the operating environment.

Customers and distribution

We remain focused on providing our customers with good value, straightforward products, supported by multi-channel distribution, outstanding service and a differentiated customer experience. Our approach has led to new highs in customer satisfaction with our overall NPS improving to +39, which makes Virgin Money one of the best-rated retail banks in the UK.

Our Lounges continue to be a standout success and we will be bringing our winning formula to Cardiff later in the year. With average footfall of over 60,000 visitors per month in the first half of the year, and over 2 million visits since launch, the Lounges deliver excellent customer satisfaction. They are a great example of our different approach to banking and our ambition to make 'everyone better off'. The Lounges complement our Stores, which continue to play an important role for customers, with around a quarter of deposits coming through this channel.

Our customers continue to choose our digital channels and our website remains the most popular channel, with over 13 million website visits, up from 11 million in H1 2016. Almost 80 per cent of sales were carried out digitally during the period. The use of mobile devices to access our products and services has increased to over 50 per cent compared to 45 per cent in H1 2016, and we continue to see this increase on a quarterly basis.

Business performance

Despite ongoing economic uncertainty, we continued to make good progress on our strategic priorities in H1 2017.

Our retail deposit franchise continues to go from strength to strength. We continue to offer good value, simple and transparent products and our multi-channel distribution model supports cost effective growth in our deposit business. Customers continue to recognise the value of our proposition and approach, demonstrated in strong retention levels with nine out of 10 savings customers coming to the end of their fixed rate choosing to remain with Virgin Money.

Our mortgage business remains high quality and performance continues to be driven by strong retention of maturing balances and an award-winning intermediary proposition. Despite a highly competitive market, we achieved a gross lending market share of 3.5 per cent to the end of May, while managing spreads and maintaining high asset quality. We were able to offset the pressure arising from lower mortgage spreads by improving our average cost of retail funds as well as selectively targeting growth opportunities with a wider product range. As a result, overall spread was 176 basis points, from 180 basis points in H1 2016. Asset quality remains a real strength with 99.2 per cent of all mortgage assets classified as neither past due nor impaired.

We are committed to helping more people achieve their dream of home ownership and we are delighted to be the first mainstream lender to launch a Custom Build proposition. Additionally, our new Shared Ownership range will give more people the opportunity to own their own home.

Since launching our own credit card operation in 2015, our focus has always been on delivering strong and sustainable risk-adjusted returns through a first-rate card proposition for customers in the prime segment of the market. I am delighted to report that we continue to make solid progress on all fronts, including growth in retail cards, an increase in average spend per card and active customer engagement through Virgin Red and Virgin Money Back. Our credit card book had a cost of risk in H1 2017 15 basis points lower than H1 2016 and arrears emergence remains low.

Our straightforward and transparent investment funds continue to support growing funds under management of £3.5 billion, up 4 per cent on FY 2016. Stocks and shares ISA sales were up 21 per cent compared with H1 2016.

Travel insurance sales were 22 per cent lower in the period as the market has become increasingly driven by price, at the expense of quality. This was offset by an excellent renewal performance which was up 28 per cent compared to H2 2016. In March we were pleased to enter into a new partnership with BGL Group to provide life insurance and we launched the first products in May.

As a result of our operational leverage and continuing improvements to operational efficiency, including further automation of the ISA transfer-in process and improved core back office processing systems, our cost:income ratio improved to 53.9 per cent, from 58.8 per cent in H1 2016.

Strategic partnerships

We are delighted to announce a new strategic partnership under which Virgin Money will become Virgin Atlantic's retail financial services partner in the UK. The partnership will offer customers innovative new products and a range of VAA, Virgin Money and Virgin Group benefits. We intend that the first of the new products will be launched in the first half of 2018.

We continue to make excellent progress in the development of our digital banking platform. In collaboration with 10x Future Technologies, the proposition is being designed and built on time and to budget. We believe our digital bank will be transformational both for customers and for the business and we look forward to updating the market at our investor day on 16 November 2017.

We are never complacent about our intermediary partnerships and the quality of the service we provide to intermediaries continues to be recognised by our winning numerous awards including Best Lender for Partnerships by Legal & General, Best Service from a Mortgage Provider at the Moneyfacts Awards and Lender of the Year 2016 by Tenet.

Differentiated business model continues to drive our ambition to make 'everyone better off'

The contribution to the communities in which we work is a fundamental part of Virgin Money's business model and strategy. Over 13,000 charities have registered with Virgin Money Giving, our not-for-profit online donation service, and more than £560 million has been donated to charities through the service since its launch in 2009.

The Virgin Money Foundation continues to tackle social and economic disadvantage in the North East. The Ripple Fund, which supports sustainable regeneration in local communities, awarded grants totaling over £750,000 during the first half of the year. The Foundation also awarded its first grant in Scotland and will extend its reach nationally over time.

LifeSavers, the financial education and savings programme supported by Virgin Money, has successfully launched in Newcastle, and continues to expand in other areas of England. The scheme is aimed at teaching primary school children good financial habits from an early age.

More than 15,000 young people participated in Make £5 Grow, our enterprise education programme which gives young people the experience of starting a small business. This represents an increase of 68 per cent compared to the first half of last year.

Outlook

Despite uncertainty relating to Brexit, we continue to experience a strong UK economy. Unemployment is at an all-time low which is positive for our business and consumers.

The UK housing market is expected to remain resilient, however, in the near term there may be some areas of weakness to be navigated. The growth in new homes represents an opportunity which we expect to take advantage of through our new build, shared ownership and custom build propositions. We remain vigilant about the potential for certain regions to see house price weakness and will continue to manage this through strict application of our existing lending policies and risk appetite. Mortgage spreads are expected to continue to face some pressure, however, we expect to see this alleviate as the Term Funding Scheme (TFS) is withdrawn and funding models normalise across the market.

We are committed to protecting the prime quality of our credit card book to maintain resilience through the economic cycle. We continue to expect to reach £3 billion of credit card receivables, with no deterioration of asset quality, by the end of 2017.

We are pleased with current progress on Other Operating Income, which we expect to remain above 10 percent of total income for the full year.

We have reduced travel insurance business in H1 2017 as some pricing has become uneconomic. Our optimism in the insurance segment remains however, as progress with life insurance has been strong and we expect to enter further insurance partnerships in the months ahead.

As a consequence of our stringent focus on asset quality, and on the assumption of a continued stable macro-economic environment, we expect the full year cost of risk to be only marginally higher than H1 2017.

Our continued tight control over costs combined with ongoing efficiency improvements mean that we remain on track to exit 2017 with a cost:income ratio of 50 per cent.

We are pleased to be able to build on our funding franchise. In the wholesale markets we are planning for a further RMBS issuance in the second half of the year and the authorisation of our covered bond programme gives us the opportunity to diversify our funding further. Our capital ratios remain robust and position us well for growth.

Our retail franchise remains very strong and we expect to see a continued reduction in our overall cost of funds. It is our intention to draw further from the TFS before the withdrawal of the scheme taking total drawing within previous guidance of between £5 billion and £6 billion.

We remain confident of sustaining a solid double-digit RoTE in 2017. However, our decision to accelerate TFS drawings means we anticipate full year NIM to be towards the lower end of our previous guidance of 157-160 basis points.

As we look beyond 2017, we have a number of significant and value accretive developments underway that we are excited about.

We remain confident about the organic growth in our existing plans. While we have always said we will review any M&A opportunities as they arise, the quality of our organic plan continues to set a very high bar against which we would assess any investment.

We continue to develop our product range. Our savings and investment franchise is growing ahead of our expectations and the arrival of a dedicated team, led by John Tracy, formerly CEO of TD Direct, gives us confidence in the development of this part of the business.

We are delighted to announce our strategic partnership with Virgin Atlantic which presents a real opportunity for the business.

We remain excited by the development of our digital banking platform. It is our expectation that we will be launching a digital bank on time and on budget towards the end of 2018. This development will increase our customer reach and our access to low cost retail funding.

To conclude, we are delighted that we have delivered strongly against our objectives in H1 2017 and I would like to thank our Virgin Money colleagues for their hard work and achievements so far this year. We will continue to put customers at the heart of everything we do and look to the future with confidence.

Jayne-Anne Gadhia CBE
Chief Executive
24 July 2017

FINANCIAL REVIEW

Overview: Stable asset quality and a further increase in scale and profitability

In the first half of 2017 we have experienced continued strong credit performance as we build scale and profitability. The successful performance of our savings franchise and additional TFS drawings supported continued development of our mortgage and credit card businesses. This strong balance sheet growth and a stable net interest margin (NIM) combined to increase net interest income. With our other operating income also showing continued improvement, total income on an underlying basis increased by 13.0 per cent to £327.2 million.

Our operational leverage continued to help increase efficiency. The 3.5 per cent increase in costs set against a 13.0 per cent increase in total income, delivered a 4.9 percentage point reduction in the cost:income ratio to 53.9 per cent. Growth did not come at the expense of quality. The cost of risk remained stable at 13 basis points.

Against that backdrop we have delivered an increase in underlying profit before tax of 26.3 per cent, rising to £128.6 million from £101.8 million. As a result, return on tangible equity improved to 13.3 per cent from 12.2 per cent in the first half of 2016.

Strong balance sheet growth

	At 30 Jun 2017 £ million	At 31 Dec 2016 £ million	**Change**
Loans and advances to customers	**34,683.9**	32,367.1	**7.2%**
Customer deposits	**29,564.2**	28,106.3	**5.2%**
Wholesale funding	**8,409.8**	4,718.0	**78.2%**
Wholesale funding <1 year maturity	**900.0**	575.0	**56.5%**
Loan-to-deposit ratio	**117.0%**	114.5%	**2.5pp**
High Quality Liquid Assets[1]	**6,516.7**	4,222.6	**54.3%**

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

The continuing strength of our lending franchise produced 7.2 per cent growth in total loans and advances to customers in the first half of 2017. Strong gross mortgage lending of £4.3 billion, supported by a 5.5 percentage point improvement in retention took net lending to £2.1 billion. Our credit card book grew by 12.6 per cent to reach £2.8 billion, reflecting the strength of our brand and in-house operation as we continued to progress towards our previous year end guidance of £3.0 billion of card balances.

This positive lending performance was funded by continued growth in our retail deposit franchise, as well as further drawings from the TFS. Total customer deposits grew by 5.2 per cent to £29.6 billion at 30 June 2017. We completed two reprices, each of approximately £5 billion in the first half of 2017, both of which were delivered with higher than expected retention.

We continued to optimise our funding base through participation in the TFS. In the first half, the strength of our net lending enabled us to draw substantially all of the scheme drawings which we had previously expected to draw by year end. Drawings under the scheme increased to £4.9 billion at 30 June 2017 following a £3.7 billion draw down in the first half of 2017. This included an accelerated draw down of £1.5 billion in June which represents the majority of remaining TFS funding we expect to utilise in 2017. Further growth in net lending in the second half of the year would create additional capacity to draw from the TFS in future. We continue to target total drawings of between £5 billion and £6 billion by the time the TFS closes at the end of February 2018 in order to maintain the planned balance between retail, wholesale and TFS funding and permit us to plan a prudent refinancing schedule for TFS drawings.

As a result, we continued to enjoy a high-quality balance sheet structure at the half-year. The loan-to-deposit ratio increased to 117.0 per cent at 30 June 2017, from 114.5 per cent at the end of 2016, in line with guidance of towards 120 per cent while we are participating in the TFS.

In wholesale funding we expect to continue to raise funding through our established Gosforth RMBS programme. Additionally, we have recently received approval for a regulated covered bonds programme.

The Group's liquidity position remained strong throughout the period, with strength at 30 June 2017 in part due to the accelerated draw down of TFS funding. At the balance sheet date high quality liquid assets stood at £6.5 billion. Our liquidity coverage ratio (LCR) was significantly above the 90 per cent regulatory minimum which came into force on 1 January 2017 at 246.7 per cent at 30 June 2017. The liquid asset portfolio represented more than seven 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.

Income benefited from growth in asset balances

	Half-year to 30 Jun 2017 £ million[1]	Half-year to 30 Jun 2016 £ million[1]	**Change**	Half-year to 31 Dec 2016 £ million[1]	**Change**
Net interest income	**288.5**	252.2	**14.4%**	266.8	**8.1%**
Other income	**38.7**	37.4	**3.5%**	30.5	**26.9%**
Total income	**327.2**	289.6	**13.0%**	297.3	**10.1%**
Net interest margin	**1.59%**	1.60%	**(1bp)**	1.59%	**-**
Average interest earning assets	**36,141**	31,411	**15.1%**	33,631	**7.5%**

1 On an underlying basis.

In the first half of 2017 we increased net interest income by 14.4 per cent to £288.5 million. This was driven by strong growth in asset balances and a stable net interest margin.

The continued growth in our mortgage portfolio was a key driver of income growth in the first half of the year. Mortgage spreads in the first half continued at levels lower than 2016, supported by lower funding costs in part as a result of the TFS. New lending in the first half of 2017 was priced at an average spread of 176 basis points, a level similar to the first half of 2016 of 180 basis points.

NIM was supported by the further optimisation of our funding base which resulted in the weighted average cost of funds reducing to 0.98 per cent compared to 1.38 per cent in the first half of 2016. Combined with the ongoing growth of our cards business, these factors resulted in a NIM of 159 basis points in the first half of 2017, in line with expectations.

The effective interest rate (EIR) of our credit cards portfolio was broadly stable at 6.8 per cent. Credit card EIR at inception is calculated over the expected card life, up to a maximum of seven years, a modelling period supported by an extensive data set covering many years. For illustration, if this modelling period had been restricted to five years at origination, the EIR rate would be reduced by 1.1 per cent and interest income recognised in the half-year would be reduced by £11 million.

Other income (on an underlying basis) was 3.5 per cent higher at £38.7 million. This included a gain of £6.1 million from the sale of Vocalink in the first half of 2017. Excluding both the gain from the sale of Vocalink and the gain of £5.3 million on the investment held in Visa Europe during the first half of 2016, other income increased by 1.6 per cent.

Operational efficiency improved with tightly controlled costs and increased investment

	Half-year to 30 Jun 2017 £ million[1]	Half-year to 30 Jun 2016 £ million[1]	**Change**	Half-year to 31 Dec 2016 £ million[1]	**Change**
Costs	**176.4**	170.4	**3.5%**	165.6	**6.5%**
Cost:income ratio	**53.9%**	58.8%	**(4.9pp)**	55.7%	**(1.8pp)**

1 On an underlying basis.

Set against total income growth of 13.0 per cent in the first half of 2017, total cost growth was constrained to just 3.5 per cent including the FSCS levy of £4.7 million. This produced positive JAWS of 9.5 per cent and reduced the cost:income ratio by 4.9 percentage points to 53.9 per cent. This controlled cost growth was achieved after an increase in revenue investment spend and depreciation, which together increased by 20.5 per cent to £22.3 million.

This continued improvement in operational efficiency demonstrated the benefit of our strong cost management and ongoing operational leverage and created the capacity for increased investment in the business. Our level of capital investment also increased by 168.9 per cent to £36.3 million, which includes capital expenditure of £20.4 million on the development of our digital banking platform.

Impairments reflected rigorous credit risk management

	Half-year to 30 Jun 2017 £ million	Half-year to 30 Jun 2016 £ million	**Change**	Half-year to 31 Dec 2016 £ million	**Change**
Mortgages					
Impairment charge	**1.4**	1.3	**7.7%**	1.5	**(6.7%)**
Cost of risk	**0.01%**	0.01%	**-**	0.01%	**-**
Cards					
Impairment charge	**20.8**	16.1	**29.2%**	18.7	**11.2%**
Cost of risk	**1.58%**	1.73%	**(15bps)**	1.64%	**(6bp)**
Group					
Impairment charge	**22.2**	17.4	**27.6%**	20.2	**9.9%**
Cost of risk	**0.13%**	0.12%	**1bps**	0.13%	**-**
Impaired loans as a % of loans and advances	**0.4%**	0.4%	**-**	0.4%	**-**
Provisions as a % of impaired loans	**41.6%**	39.9%	**1.7pp**	40.0%	**1.6pp**

We experienced strong credit performance in the first half of 2017 reflecting both the benign economic environment and our established risk appetite framework, continued focus on underwriting rigour and the origination of high credit quality customers and prime assets.

For mortgages, the cost of risk remained stable at 0.01 per cent. The high asset quality of the mortgage portfolio continued to benefit from our robust underwriting standards, cautious portfolio management and the economic environment.

For credit cards, set against the 33.4 per cent growth in balances compared to the first half of 2016, the impairment charge increased by 29.2 per cent to £20.8 million, while the cost of risk reduced to 1.58 per cent from 1.73 per cent. This demonstrated the continued high quality of new and existing cards and the expected low rate of default during the early stages of card lives. New lending continues to outperform previous tranches at this point and when accounts under 18 months are excluded the cost of risk remains low at 1.8 per cent.

Impaired loans as a percentage of loans and advances was stable at 0.4 per cent. Provisions as a percentage of impaired loans increased to 41.6 per cent.

Underlying profit to statutory profit reconciliation

	Half-year to 30 Jun 2017 £ million	Half-year to 30 Jun 2016 £ million	Half-year to 31 Dec 2016 £ million
Underlying profit before tax	**128.6**	101.8	111.5
IPO share based payments	**(0.6)**	(1.4)	(0.6)
Strategic items	**(5.5)**	1.7	(4.1)
Simplification costs	**-**	(3.3)	(2.3)
Fair value gains/(losses) on financial instruments	**1.3**	(5.1)	(3.8)
Statutory profit before tax	**123.8**	93.7	100.7
Taxation	**(33.3)**	(26.2)	(28.1)
Profit for the half-year – statutory	**90.5**	67.5	72.6
Basic earnings per share – statutory (pence)	**17.7**	14.1	15.2

Note: The reconciliation of the Group's statutory and underlying results are reported above and in note 2 to the condensed consolidated half-year financial statements.

As the business matures the number of adjusting items in arriving at underlying profit continues to reduce. In 2017 the items affecting underlying performance relate to three categories: the final charge for IPO share based payments; costs incurred as a result of the initial set up of the digital bank which will launch in 2018; and the non-cash movement in the fair value of financial instruments. Further detail is given below:

> 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. 2017 is the last year in which such charges will be incurred.

> Strategic items

We incurred strategic investment costs of £5.5 million in the first half of 2017, entirely related to the development of our digital banking platform which is not, at this stage, considered part of our underlying results. Included within this amount is a non-cash impairment charge of £4.8 million in respect of previous software development on an earlier digital project which has been discontinued in light of the strategic decision taken in May 2017 to consolidate activities within the digital bank programme.

> Simplification costs

In 2016 we took the opportunity to focus on simplification activity, including de-layering our organisational structure. This led to one-off costs incurred in 2016 in relation to a number of senior leavers, which included accelerated share based payment charges. These were not considered part of the underlying results and were not repeated in the first half of 2017.

> Fair value gains/(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.

Taxation

The Group's effective tax rate reduced to 26.9 per cent. In the first half of 2017, the Group recognised a corporation tax charge of £33.3 million.

Continued strong progression in returns

		Half-year to 30 Jun 2017	Half-year to 30 Jun 2016	**Change**	Half-year to 31 Dec 2016	**Change**
Return on tangible equity	%	**13.3**	12.2	**1.1pp**	12.9	**0.4pp**
Return on assets[1]	%	**0.45**	0.41	**4bps**	0.41	**4bps**

1 Statutory basis.

The strength of income growth and continued operational leverage, combined with our rigorous approach to underwriting and asset quality, has driven a significant enhancement to returns in the first half of 2017.

Return on tangible equity increased to 13.3 per cent in the first half of 2017, higher than both our cost of capital and the 12.2 per cent generated in the first half of 2016. At the same time, the statutory return on assets grew by 4 basis points to 0.45 per cent in the first half of 2017 from 0.41 per cent in the first half of 2016.

Strong capital structure

		At 30 Jun 2017	At 31 Dec 2016	Change
Common Equity Tier 1 capital (CET1)	£ million	**1,220.1**	1,172.7	**4.0%**
Risk-weighted assets (RWAs)	£ million	**8,812.9**	7,694.8	**14.5%**
Common Equity Tier 1 ratio	%	**13.8**	15.2	**(1.4)pp**
Tier 1 ratio	%	**18.2**	20.2	**(2.0)pp**
Total capital ratio	%	**18.4**	20.4	**(2.0)pp**
Leverage ratio	%	**3.9**	4.4	**(0.5)pp**

Note: inclusive of verified profit for H1 2017

The development of capital ratios during the first half of 2017 continued to reflect our strategy of ensuring strong capital resources 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.

During the period we generated capital before investment and distributions of £90.5 million, an increase of 34.1 per cent when compared to the same period in 2016. This capital has predominantly been utilised in supporting growth and investment in the business. Lending growth and the mix impact from front book lending increased RWAs by 14.5 per cent to £8.8 billion. Investment in intangible assets during the period was £34.6 million, with £20.4 million arising from the investment in our digital banking platform. This growth and investment, as well as coupon and dividend distributions, reduced the CET1 ratio to 13.8 per cent at 30 June 2017 compared with 15.2 per cent at the end of 2016. This was in line with the expected development of our business and well in excess of our own minimum CET1 ratio of 12 per cent.

Our total capital ratio was 18.4 per cent at 30 June 2017, compared to 20.4 per cent at the end of 2016, due to the same drivers as the reduction in CET1 capital ratio.

As a consequence of the increase in leverage ratio eligible assets, including the accelerated draw down of TFS funds in the second half of June 2017, our leverage ratio was 3.9 per cent at the end of the first half compared to 4.4 per cent at the end of 2016.

We are at an advanced stage in our IFRS 9 implementation programme. We have built new expected credit loss (ECL) models and are entering our parallel run phase for the remainder of 2017 during which we will monitor model performance, refine our approach and finalise the ECL models. Based on our current models and our current macro economic assumptions, had we applied an IFRS 9 ECL approach at 30 June 2017, the adjustment to our loan loss allowance would have been below the £50 million we previously estimated within our internal capital plans.

Dividend

The Board has recommended a 18.8 per cent increase in the interim dividend to 1.9 pence per ordinary share, reflecting the performance of the business and our confidence in our future plans.

Conclusion

In the first half of 2017 we delivered continued excellent performance with a further increase in returns. 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.

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
24 July 2017

BUSINESS LINE HIGHLIGHTS

MORTGAGES AND SAVINGS

We provide mortgages, savings and current accounts to more than 1.7 million customers. Mortgages are sold primarily through our intermediary partners and retail deposits are largely originated directly through our digital channel and store network

Our Mortgage & Savings business line is an important revenue driver for the Group, contributing 63.8 per cent of total income in the first half of 2017.

Half-year highlights

- net interest income increased by 8.9 per cent to £207.0 million largely driven by the growth in mortgage balances. Total income rose by 8.7 per cent to £208.6 million;
- new business spreads moderated when compared to both the same period last year and the second half of 2016, at 176 basis points, which reflected the impact on asset pricing of lower funding costs across the market. As a result, we delivered a NIM of 1.34 per cent in the mortgage and savings business, compared to 1.43 per cent in the first half of 2016 and 1.34 per cent in the second half of 2016;
- mortgage balances grew by £2.1 billion, more than offsetting the reduction in NIM;
- the quality of the mortgage book remains strong with the cost of risk stable at 1 basis point;
- buy-to-let mortgages as a percentage of the overall mortgage book remained stable at 18.6 per cent; and
- risk-weighted assets at the end of June 2017 increased by 15.4 per cent. This growth was driven by overall balance growth, an increase in the size of the pipeline and operational risk weighted assets attributed to the business, reflecting increased income in the prior three years.

Performance summary

	Half-year to 30 Jun 2017 £ million	Half-year to 30 Jun 2016 £ million	**Change**	Half-year to 31 Dec 2016 £ million	**Change**
Net interest income	**207.0**	190.0	**8.9%**	193.0	**7.3%**
Other income	**1.6**	1.9	**(15.8%)**	0.1	**1,500%**
Total income	**208.6**	191.9	**8.7%**	193.1	**8.0%**
Impairment	**(1.4)**	(1.3)	**7.7%**	(1.5)	**(6.7%)**
Mortgages and savings net interest margin	**1.34%**	1.43%	**(9bps)**	1.34%	**-**
Cost of risk	**0.01%**	0.01%	**-**	0.01%	**-**

Key balance sheet items

	At 30 Jun 2017 £ million	At 31 Dec 2016 £ million	**Change**
Loans and advances to customers	**31,826.3**	29,740.8	**7.0%**
– of which prime residential	**25,893.1**	24,273.6	**6.7%**
– of which buy-to-let	**5,933.2**	5,467.2	**8.5%**
Customer deposits	**29,564.2**	28,106.3	**5.2%**
Total customer balances	**61,390.5**	57,847.1	**6.1%**
Risk-weighted assets	**6,007.9**	5,204.5	**15.4%**

Mortgages

We offer a wide range of mortgage products with a strong focus on providing excellent customer service. Our intermediary partners are the primary distribution channel for our mortgages, supplemented by direct distribution. Additionally, our performance has benefitted from continued investment in the retention of our existing customers.

In the first half we have maintained our focus on strong growth in prime residential balances which represented 81.4 per cent of mortgage balances with buy-to-let representing 18.6 per cent at 30 June 2017.

Key developments – Mortgages

- we delivered strong growth in mortgage balances in the first half of 2017, with an increase of 7.0 per cent to £31.8 billion at 30 June 2017;
- we successfully retained 72.6 per cent of customers with maturing fixed rate or tracker products, a 5.5 percentage point increase on the first half of 2016;
- the overall growth in balances was supported by strong gross lending of £4.3 billion in the half-year, equivalent to a 3.5 per cent market share of gross lending to the end of May 2017;
- prime residential balances grew by 6.7 per cent to £25.9 billion representing 81.4 per cent of the overall mortgage book and 81.0 per cent of new lending in the first half of the year; and
- in line with our quest to help more people into home ownership, we increased our proportion of purchase business to 57.6 per cent of residential lending in the first half of 2017, up from 52.8 per cent in 2016 driven by first time buyers and further success in new build loans.

Savings

We offer customers a range of competitively-priced instant access and fixed term savings products. These are both available as ISAs and are distributed through all our channels: store, digital, postal and telephone.

Our savings products are simple and transparent. We encourage customer retention with enduring, good value offers.

Key developments – Savings

- we grew retail savings balances by 5.2 per cent to £29.6 billion at 30 June 2017, up from £28.1 billion at the end of 2016;
- we opened over 180,000 new savings accounts in the first six months of the year;
- we had more than 1.2 million savings customers at 30 June 2017 and balances were higher than at any point in Virgin Money's history;
- we took a 5.4 per cent market share of net inflows, and grew our market share of savings stock from 1.6 per cent at the end of 2016 to 1.7 per cent at the end of May 2017;
- we continued to manage down the cost of funding and total savings interest expense in the first half of the year was approximately 20 per cent lower than in the first half of 2016, despite balances being on average £2.5 billion higher over the period; and
- our Cash ISA performance was particularly strong, taking an 11.2 per cent market share of net inflows to the end of May 2017, which reflected the strong appeal of our customer proposition. This performance resulted in our Cash ISA market share increasing to 5.3 per cent at the end of May, from 4.8 per cent at the end of 2016.

CREDIT CARDS

We provide credit card products, predominantly online, to over one million customers. Our portfolio is a mix of balance transfer and retail credit cards, offering a broad range of products covering three key customer needs: debt consolidation, borrowing and everyday spending.

Our credit cards business line contributed 27.9 per cent of total income in the first half of 2017.

Half-year highlights

- credit card balances increased to £2.8 billion at 30 June 2017, an increase of 12.6 per cent since the end of 2016 and the business remains on track to grow towards an expected £3.0 billion of balances by the end of 2017;
- net interest income increased by 31.0 per cent to £81.5 million, driven by growth in credit card balances. Growth in the proportion of balances with newer customers on promotional terms contributed to NIM reducing by 65 basis points to 6.19 per cent;
- other income increased to £9.7 million, reflecting fees from promotional cash volumes and increased interchange income due to an increase in the proportion of retail products within the portfolio;
- the lead indicators of credit stress in the credit card book, such as spending patterns and customers switching to minimum payment by direct debit, showed no sign of deterioration; and
- impairments increased in line with the growth in credit card balances. Underlying portfolio arrears and charge offs remain low reflecting the strong credit quality of the book, with the cost of risk falling from 1.73 per cent to 1.58 per cent.

Performance summary

	Half-year to 30 Jun 2017 £ million	Half-year to 30 Jun 2016 £ million	**Change**	Half-year to 31 Dec 2016 £ million	**Change**
Net interest income	**81.5**	62.2	**31.0%**	73.8	**10.4%**
Other income	**9.7**	8.5	**14.1%**	9.2	**5.4%**
Total income	**91.2**	70.7	**29.0%**	83.0	**9.9%**
Impairment charge	**(20.8)**	(16.1)	**29.2%**	(18.7)	**11.2%**
Credit cards net interest margin	**6.19%**	6.84%	**(65bps)**	6.57%	**(38bps)**
Cost of risk	**1.58%**	1.73%	**(15bps)**	1.64%	**(6bps)**

Key balance sheet items

	At 30 Jun 2017 £ million	At 31 Dec 2016 £ million	**Change**
Credit card balances	**2,756.4**	2,447.1	**12.6%**
Risk-weighted assets	**2,265.6**	2,012.3	**12.6%**

Key developments

- we continue to improve our customer service and this was reflected in an increase in NPS to +49 in the first half of 2017 making credit cards the highest scoring product;
- retail cards made up 42.2 per cent of new business and retail spend increased by 52.9 per cent during the first half of the year relative to the same period in 2016; and
- Virgin Red and Virgin Money Back incentive schemes were launched in the first half of 2017.

FINANCIAL SERVICES

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

Our Financial Services business line contributed 5.4 per cent of total income in the first half of 2017.

Half-year highlights

- total funds under management increased to £3.5 billion, up 12.2 per cent on the first half of 2016;
- investments and pensions income increased by 1.3 per cent on the same period in 2016 to £15.8 million;
- our investments and pensions income is hedged to reduce the income volatility arising from market movements. In the first half of the year the hedging cap level resulted in income being broadly flat year-on-year, despite the average FTSE index level being 1,228 points higher than in the comparable period; and
- adjusting for a one off gain in the first half of 2016 of £1.1 million, our insurance and other income fell from £2.6 million to £2.0 million in the first half of 2017 as we focused on direct customers and profitable segments of the aggregator market, in a competitive environment.

Performance summary

	Half-year to 30 Jun 2017 £ million	Half-year to 30 Jun 2016 £ million	**Change**	Half-year to 31 Dec 2016 £ million	**Change**
Investments and pensions	**15.8**	15.6	**1.3%**	16.1	**(1.9%)**
Insurance and other	**2.0**	3.7	**(45.9%)**	2.1	**(4.8%)**
Total income	**17.8**	19.3	**(7.8%)**	18.2	**(2.2%)**

Key balance sheet items

	At 30 Jun 2017 £ million	At 31 Dec 2016 £ million	**Change**
Risk-weighted assets	**53.4**	50.4	**6.0%**

Key developments

- Stocks and Shares ISA sales in the first half of 2017 were 21.4 per cent higher than the same period of 2016, reflecting a strong ISA season, increased transfers into Stocks and Shares products and continued improvements to the customer journey;
- to raise our profile as a Stocks and Shares ISA provider further, we have initiated a 6 month partnership with Moneywise; and
- we launched a new Life Insurance proposition in partnership with BGL Group during the first half of the year and this is expected to start to deliver improvements in income during the second half.

CENTRAL FUNCTIONS

Following a decision in 2016 to consolidate the commercial management of all of our products and services under a single commercial function, we no longer manage our cost base on a segmental basis. This has the benefit of a more holistic approach to cost management as we continue to drive improvements to our cost:income ratio through effective cost control. Therefore, it is no longer our policy to allocate the costs to each business line. Further details are provided in note 1.2 to the condensed consolidated half-year financial statements.

Half-year highlights

- other income includes gains from the sale of available-for-sale assets and debt securities. In the first half of 2017 this included a gain of £6.1 million arising from the sale of our investment in Vocalink. The first half of 2016 included a gain of £5.3 million on the investment held in Visa Europe during the first half of 2016;
- total costs remained tightly controlled, growing by 3.5 per cent, reflecting the focus on the benefits of our scalable platform and continued cost management to drive out efficiencies;
- the primary driver of cost growth was depreciation which reflects the ongoing investment in systems and processes to enhance efficiency and extend the product range; and
- a strong trading performance in the period has materialised in additional volumes, coupled with incremental regulatory costs both of which have been largely absorbed within the overall charge driven through operational process efficiencies targeted at improving customer experience. Mortgage retention exceeded expectations and unit cost per card reduced by 25 per cent compared to the first half of 2016.

Performance summary

	Half-year to 30 Jun 2017 £ million	Half-year to 30 Jun 2016 £ million	**Change**	Half-year to 31 Dec 2016 £ million	**Change**
Other income	**9.6**	7.7	**24.7%**	3.0	**220.0%**
Total income	**9.6**	7.7	**24.7%**	3.0	**220.0%**
Total costs	**176.4**	170.4	**3.5%**	165.6	**6.5%**

Key balance sheet items

	At 30 Jun 2017 £ million	At 31 Dec 2016 £ million	**Change**
Risk-weighted assets	**486.0**	427.6	**13.7%**

Operating costs

	Half-year to 30 Jun 2017 £ million	Half-year to 30 Jun 2016 £ million	**Change**	Half-year to 31 Dec 2016 £ million	**Change**
Staff costs	**88.2**	87.2	**1.1%**	97.8	**(9.8%)**
Premises and equipment	**9.7**	9.2	**5.4%**	9.7	**-**
Other expenses	**63.5**	64.0	**(0.8%)**	46.2	**37.4%**
Depreciation, amortisation and impairment	**15.0**	10.0	**50.0%**	11.9	**26.1%**
Total costs	**176.4**	170.4	**3.5%**	165.6	**6.5%**

Segmental analysis of total costs

The allocation of costs according to the prior segmental presentation, where costs were allocated to each business line, is set out for the last time below:

	Half-year to 30 Jun 2017 £ million	Half-year to 30 Jun 2016 £ million	**Change**	Half-year to 31 Dec 2016 £ million	**Change**
Mortgages & Savings	**49.7**	51.0	**(2.5%)**	46.4	**7.1%**
Credit Cards	**19.5**	19.3	**1.0%**	18.5	**5.4%**
Financial Services	**8.1**	7.7	**5.2%**	7.9	**2.5%**
Central Functions	**99.1**	92.4	**7.3%**	92.8	**6.8%**
Total costs	**176.4**	170.4	**3.5%**	165.6	**6.5%**

RISK MANAGEMENT REPORT

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.

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.

PRINCIPAL RISKS AND UNCERTAINTIES

The principal risks faced by the Group are summarised below. Except where noted, there has been no significant change to the description of these risks or key mitigating actions disclosed in the Group's 2016 Annual Report and Accounts (pages 48 to 51), with any quantitative disclosures updated below.

Credit risk
We provide residential and buy-to-let (BTL) 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.

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 is the only material category of market risk for the Group.

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, cybercrime and information security remain a key focus for the Group.

Conduct risk and compliance
Conduct and compliance risk is the risk that the Group's operating model, culture or actions result in failure to comply with law and regulation or unfair outcomes for customers. This could give rise to 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.

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 and assumption risk. Credit concentration risk is managed for retail and wholesale credit exposures at portfolio, product and counterparty levels. Assumption risk could arise if customer behaviour turns out to be materially different from that assumed at the point the product is sold and consequently the profitability of products may be adversely affected. Customer behaviour is monitored monthly and reviewed quarterly at cohort, product and portfolio levels.

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

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.

Capital risk
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.

CREDIT RISK MANAGEMENT

Overview

The Group's impairment provisions increased by 11.2% to £55.7 million as at 30 June 2017 (31 December 2016: £50.1 million), reflecting overall book growth of 7.4%. Impairment provisions as a percentage of loans and advances to customers remained stable at 0.16%.The proportion of impaired assets as a percentage of loans and advances to customers remained at 0.4% as at 30 June 2017 (31 December 2016: 0.4%). There were no wholesale impairment provisions as at 30 June 2017.

The following categorisations are used for segmenting the portfolio.

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.

Loans and advances to customers

	At 30 Jun 2017 £m	At 31 Dec 2016 £m
Advances secured on residential property not subject to securitisation	**21,323.1**	19,375.2
Advances secured on residential property subject to securitisation	**4,579.6**	4,907.8
Total advances secured on residential property	**25,902.7**	24,283.0
Residential buy-to-let loans not subject to securitisation	**5,935.3**	5,468.4
Total loans and advances to customers secured on residential property	**31,838.0**	29,751.4
Impairment allowance - secured	**(11.7)**	(10.6)
Total loans and advances - secured	**31,826.3**	29,740.8
Credit cards	**2,800.3**	2,486.5
Overdrafts	**0.1**	0.1
Unsecured receivables not subject to securitisation	**2,800.4**	2,486.6
Impairment allowance - unsecured	**(44.0)**	(39.5)
Total loans and advances- unsecured	**2,756.4**	2,447.1
Total loans and advances to customers excluding portfolio hedging	**34,582.7**	32,187.9

The mortgage portfolio is secured on residential and BTL properties and represented 91.9% of total loans and advances to customers at 30 June 2017. Residential lending grew by 6.7% (£1.6 billion) during the first half of 2017 and credit quality remained strong with 99.2% of loans classified as neither past due nor impaired. BTL loans grew by 8.5% (£0.5 billion) to £5.9 billion but remained low as a percentage of total secured loans at 18.6% (31 December 2016: 18.4%).

Our prime credit card portfolio represented 8.1% of total loans and advances to customers at 30 June 2017. Unsecured card lending increased by £313.8 million since 31 December 2016 to £2.8 billion and the quality of new business remained strong. New lending was well within the approved policy, lending and concentration limits.

Secured impairment allowances increased from £10.6 million to £11.7 million during the first six months of 2017 in line with book growth, resulting in an impaired assets coverage ratio of 11.9%. Unsecured impairment allowances increased by £4.5 million in the first half of 2017 to £44.0 million, in line with the increase in new lending, resulting in an impaired assets coverage ratio of 123.6%.

Wholesale credit risk

	At 30 Jun 2017 £m	At 31 Dec 2016 £m
Loans and advances to banks excluding Bank of England	**522.3**	635.6
Cash and balances at central banks	**3,677.0**	786.3
Debt securities classified as loans and receivables	**0.5**	0.7
Debt securities classified as available-for-sale financial assets	**1,041.3**	850.9
Gross positive fair value of derivative contracts	**89.2**	104.2
Total	**5,330.3**	2,377.7

Wholesale credit risk exposures increased by £3.0 billion during the first six months of the year to £5.3 billion at 30 June 2017, due to increased drawings from the Bank of England's (BoE) Term Funding Scheme (TFS), to support additional lending. Wholesale credit risk exposures are assessed by reference to credit rating. All of the Group's wholesale exposures were investment grade and classified as low risk at 30 June 2017. There were no wholesale credit exposures classified as past due or impaired at 30 June 2017 or at 31 December 2016.

Loans and advances which are past due and not impaired

The balance of mortgages which were past due and not impaired totaled £153.6 million at 30 June 2017. This represented a 9.1% (£15.3 million) reduction from 31 December 2016, attributable to improved arrears performance. These assets represented 0.5% of secured loans at 30 June 2017 (31 December 2016: 0.6%). All unsecured assets which are past due are treated as impaired.

	Residential mortgage loans		**Residential buy-to-let mortgage loans**		**Total**	
At 30 Jun 2017	**£m**	**%**	**£m**	**%**	**£m**	**%**
Up to one month	**46.7**	**33.9**	**4.5**	**29.1**	**51.2**	**33.4**
One to three months	**62.2**	**45.0**	**7.6**	**49.0**	**69.8**	**45.4**
Three to six months	**19.4**	**14.0**	**2.9**	**18.7**	**22.3**	**14.5**
Over six months	**9.8**	**7.1**	**0.5**	**3.2**	**10.3**	**6.7**
Total past due and not impaired	**138.1**	**100.0**	**15.5**	**100.0**	**153.6**	**100.0**

	Residential mortgage loans		Residential buy-to-let mortgage loans		Total	
At 31 Dec 2016	£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

Impaired assets

An analysis of impaired assets by overdue term and assets where the borrower's property was in possession is provided in the tables below.

At 30 Jun 2017	**Residential mortgage loans £m**	**%**	**Residential buy-to-let mortgage loans £m**	**%**	**Credit cards £m**	**%**	**Overdrafts £m**	**%**	**Total £m**	**%**
Up to one month	**65.9**	**75.0**	**7.5**	**72.2**	**12.6**	**35.4**	**-**	**-**	**86.0**	**64.2**
One to three months	**14.0**	**15.9**	**2.0**	**19.2**	**11.4**	**32.0**	**-**	**-**	**27.4**	**20.5**
Three to six months	**4.1**	**4.7**	**0.5**	**4.8**	**11.4**	**32.0**	**-**	**-**	**16.0**	**11.9**
Over six months	**2.9**	**3.3**	**0.2**	**1.9**	**0.2**	**0.6**	**-**	**-**	**3.3**	**2.5**
Possession	**1.0**	**1.1**	**0.2**	**1.9**	**-**	**-**	**-**	**-**	**1.2**	**0.9**
Total impaired assets	**87.9**	**100.0**	**10.4**	**100.0**	**35.6**	**100.0**	**-**	**-**	**133.9**	**100.0**

At 31 Dec 2016	Residential mortgage loans £m	%	Residential buy-to-let mortgage loans £m	%	Credit cards £m	%	Overdrafts £m	%	Total £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

The stock of repossessions increased during the reporting period, representing 16 cases at 30 June 2017, compared to 6 cases at 31 December 2016.

Impaired assets and impairment provisions

At 30 Jun 2017	**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	**25,902.7**	**87.9**	**0.3**	**9.6**	**10.9**
Residential buy-to-let mortgage loans	**5,935.3**	**10.4**	**0.2**	**2.1**	**20.2**
Total secured	**31,838.0**	**98.3**	**0.3**	**11.7**	**11.9**
Credit cards	**2,800.3**	**35.6**	**1.3**	**43.9**	**123.3**
Overdrafts	**0.1**	**-**	**-**	**0.1**	**-**
Total unsecured	**2,800.4**	**35.6**	**1.3**	**44.0**	**123.6**
Wholesale treasury assets	**5,246.5**	**-**	**-**	**-**	**-**
Wholesale derivative exposures	**89.2**	**-**	**-**	**-**	**-**
Total wholesale	**5,335.7**	**-**	**-**	**-**	**-**
Total	**39,974.1**	**133.9**	**0.3**	**55.7**	**41.6**

At 31 Dec 2016	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

Impaired assets
Total impaired assets increased by 6.9% (£8.6 million) in the first half of 2017. This increase is in line with growth in loans and advances to customers of 7.4%. Impaired assets as a proportion of total loans remained at 0.3% for secured lending and 1.3% for unsecured lending as at 30 June 2017.

Impairment provisions
Secured impairment allowances increased by £1.1 million in the first half of the year. Reductions due to continued HPI growth and favourable arrears performance were offset by one-off operational losses and book growth.

In line with the growth in new lending, unsecured impairment allowances increased by £4.5 million in the first half of the year.

Period end and average LTVs across the retail mortgage portfolios are shown in the table below.

At 30 Jun 2017	Residential mortgage loans £m	%	Residential buy-to-let mortgage loans £m	%	Total £m	%
<50%	**9,755.4**	**37.7**	**2,078.9**	**34.9**	**11,834.3**	**37.1**
50%-<60%	**5,150.2**	**19.9**	**1,655.7**	**27.9**	**6,805.9**	**21.4**
60%-<70%	**4,205.7**	**16.2**	**1,362.4**	**23.0**	**5,568.1**	**17.5**
70%-<80%	**3,547.9**	**13.7**	**834.1**	**14.1**	**4,382.0**	**13.8**
80%-<90%	**2,725.9**	**10.5**	**3.5**	**0.1**	**2,729.4**	**8.6**
90%-<100%	**514.6**	**2.0**	**0.5**	**-**	**515.1**	**1.6**
>100%	**3.0**	**-**	**0.2**	**-**	**3.2**	**-**
Total	**25,902.7**	**100.0**	**5,935.3**	**100.0**	**31,838.0**	**100.0**
Average loan-to-value[1] of stock – indexed		**56.2%**		**54.7%**		**55.9%**
Average loan-to-value of new business[2]		**70.1%**		**60.0%**		**68.2%**

1 The average loan-to-value of stock and new business is balance weighted.

2 New business includes lending since 1 January 2017.

At 31 Dec 2016	Residential mortgage loans £m	%	Residential buy-to-let mortgage loans £m	%	Total £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 loan-to-value[1] of stock – indexed		55.6%		54.8%		55.4%
Average loan-to-value of new business[2]		69.8%		60.5%		68.0%

1 The average loan-to-value of stock and new business is balance weighted.

2 New business includes lending since 1 January 2016.

The average indexed LTV of the overall mortgage portfolio increased marginally by 0.5 percentage points as at 30 June 2017, reflecting new business growth which partially offset positive house price movements observed during the reporting period. This is well within the current Group portfolio risk appetite limit of 70%. The average LTV for new business increased to 68.2% as at 30 June 2017.

Forbearance

The value of forbearance stock totaled £314.0 million at 30 June 2017, representing a 12.6% (£35.2 million) increase since 31 December 2016.

Secured

At 30 June 2017, £299.9 million (31 December 2016: £266.1 million) of retail secured loans and advances were subject to forbearance. The introduction of BTL retention products resulted in an increased number of BTL customers going through mortgage reviews compared to previous periods. As a result, we have seen an increase in routine term extensions and transfers to interest only. Prudently, these are caught within our definition of forbearance. This has resulted in a £37.7 million increase in forbearance, all of which is classified as neither past due nor impaired. Secured forbearance as a percentage of stock remains below 1% of the portfolio.

Loans which are forborne are grouped with other assets with similar risk characteristics and assessed collectively for impairment. The loans are not considered as impaired loans unless they meet the Group's definition of an impaired asset.

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, taking a range of potential indicators of customer financial distress into account.

Unsecured

At 30 June 2017, total retail unsecured loans and advances benefiting from forbearance totaled £14.1 million (31 December 2016: £12.7 million).

Credit risk provisioning for the retail unsecured portfolio is undertaken on a collective basis, except for fraud cases which are fully provided for. The approach used is based on the 'probability of default' (PD) for various behavioural and arrears status segments, measuring the likelihood of default and the probability of charge-off given default.

A breakdown of secured and unsecured forbearance is shown below.

	Neither past due nor impaired		**Past due not impaired**		**Impaired**		**Total**	
At 30 Jun 2017	**£m**	**%**	**£m**	**%**	**£m**	**%**	**£m**	**%**
Secured								
Payment arrangement	**1.4**	**0.4**	**0.4**	**5.9**	**-**	**-**	**1.8**	**0.6**
Transfer to interest only	**25.8**	**8.9**	**0.9**	**13.2**	**0.1**	**6.2**	**26.8**	**8.9**
Term extension	**209.8**	**72.0**	**3.2**	**47.1**	**0.7**	**43.8**	**213.7**	**71.3**
Payment holiday	**54.5**	**18.7**	**2.3**	**33.8**	**0.8**	**50.0**	**57.6**	**19.2**
Total secured forbearance	**291.5**	**100.0**	**6.8**	**100.0**	**1.6**	**100.0**	**299.9**	**100.0**
Unsecured								
Accounts where the customer has been approved on a payment plan	**3.4**	**100.0**	**-**	**-**	**10.7**	**100.0**	**14.1**	**100.0**
Total forbearance	**294.9**	**100.0**	**6.8**	**100.0**	**12.3**	**100.0**	**314.0**	**100.0**

	Neither past due nor impaired		Past due not impaired		Impaired		Total	
At 31 Dec 2016	£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 payment 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

FUNDING AND LIQUIDITY MANAGEMENT

Overview

The Group is predominantly funded through customer deposits. During the first six months of 2017, the Group maintained a strong presence in the retail savings market. Total customer deposits increased by £1.5 billion in the first half of 2017 and represented 74.4% of the Group's funding at 30 June 2017. The Group's retail funding portfolio demonstrated resilience throughout the first six months of 2017 with the retail product mix, level of concentration risk and contractual tenor remaining materially unchanged following repricing activities.

The Group adopts a prudent wholesale funding strategy which is planned and controlled by a series of balance sheet metrics to limit concentration and refinancing risk exposures. During the first half of 2017 the Group repaid £548.9 million of FLS funding and £302.7 million through the redemption of RMBS. Concurrently, the Group continued to make use of the TFS, drawing £3.7 billion during the period, taking total drawings to support lending activities to £4.9 billion as at 30 June 2017.

Group funding sources

The Group's loan-to-deposit ratio increased to 117.0% during the first half of 2017 from 114.5% at 31 December 2016, in line with published guidance of up to 120% whilst the Group is participating in the TFS. The following table shows the Group's funding position.

	At 30 Jun 2017 £m	At 31 Dec 2016 £m
Loans and advances to customers	**34,683.9**	32,367.1
Loans and advances to banks	**522.3**	635.6
Debt securities held as loans and receivables	**0.5**	0.7
Available-for-sale financial asset (encumbered)	**-**	10.6
Cash and balances at central banks (encumbered)	**195.8**	168.1
Funded assets	**35,402.5**	33,182.1
Other assets	**386.0**	407.1
Total assets (excluding liquid assets)	**35,788.5**	33,589.2
On balance sheet primary liquid assets		
Cash and balances at central banks – primary	**3,481.2**	618.2
Available-for-sale financial assets (unencumbered)	**1,046.7**	848.2
Total assets	**40,316.4**	35,055.6
Less: Other liabilities	**(604.4)**	(560.8)
Funding requirement	**39,712.0**	34,494.8
Funded by		
Customer deposits	**29,564.2**	28,106.3
Wholesale funding	**8,409.8**	4,718.0
Total equity	**1,738.0**	1,670.5
Total funding	**39,712.0**	34,494.8

Analysis of total wholesale funding by residual maturity

At 30 Jun 2017	Within 3 months £m	3-12 months £m	1-5 years £m	After 5 years £m	Total £m
Debt securities in issue	-	-	304.1	1,994.7	2,298.8
Liabilities in respect of securities sold under repurchase agreements	350.0	550.0	275.0	-	1,175.0
Secured loans	-	-	4,936.0	-	4,936.0
Total on-balance sheet sources of funds	**350.0**	**550.0**	**5,515.1**	**1,994.7**	**8,409.8**
Treasury bills raised through FLS	99.9	599.6	1,435.3	-	2,134.8
Total	**449.9**	**1,149.6**	**6,950.4**	**1,994.7**	**10,544.6**

At 31 Dec 2016	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

The Group manages funding concentration risk arising from wholesale maturities through Board-approved risk appetite which limits the amount of funding refinancing over a 90-day period and minimum tenor.

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.

	Encumbered assets		Unencumbered assets		
At 30 Jun 2017	Pledged as collateral[1] £m	Other[2] £m	Available as collateral[3] £m	Other[4] £m	Total £m
Cash and balances at central banks	-	195.8	-	3,481.2	3,677.0
Debt securities held as loans and receivables	-	-	0.5	-	0.5
Available-for-sale financial assets	-	-	1,041.3	5.4	1,046.7
Derivative financial assets	-	-	-	89.2	89.2
Loans and advances to banks	124.6	339.9	-	57.8	522.3
Loans and advances to customers	14,068.7	-	2,899.1	17,716.1	34,683.9
Other assets	28.2	-	-	268.6	296.8
Total assets	**14,221.5**	**535.7**	**3,940.9**	**21,618.3**	**40,316.4**
Treasury bills raised through FLS held off balance sheet[5]	104.9	-	2,029.9	-	2,134.8
Total assets plus off-balance sheet Treasury bills raised through FLS	**14,326.4**	**535.7**	**5,970.8**	**21,618.3**	**42,451.2**

	Encumbered assets		Unencumbered assets		
	Pledged as collateral[1]	Other[2]	Available as collateral[3]	Other[4]	Total
At 31 Dec 2016	£m	£m	£m	£m	£m
Cash and balances at central banks	-	168.1	-	618.2	786.3
Debt securities held 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[5]	-	-	2,683.7	-	2,683.7
Total assets plus off balance sheet FLS	9,671.2	522.5	6,457.6	21,088.0	37,739.3

1 Encumbered assets pledged as collateral include amounts to OTC derivative counterparties of £124.6 million (2016: £181.1 million) and amounts in respect of centrally cleared derivatives of £28.2 million (2016: £53.9 million). Encumbered loans and advances to customers of £14,068.7 million (2016: £9,425.6 million) consist 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 30 June 2017, £7,442.8 million (2016: £2,302.3 million) of loan pools have been pledged as collateral in respect of secured loans and repo agreements.

2 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 £195.8 million (2016: £168.1 million) and cash reserves supporting secured funding structures of £339.9 million (2016: £354.4 million).

3 Unencumbered assets 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.

4 Other unencumbered assets are assets which are not subject to any restrictions and are not readily available for use.

5 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 re-purchase transactions or unencumbered when it has not.

The Group's total level of asset encumbrance increased by £4.7 billion to 35.0%. This was primarily due to using the TFS to support increased lending, including an accelerated drawing in late June 2017 in anticipation of potential changes to the TFS, which took total drawings to £4.9 billion at 30 June 2017. The Group manages the volume of available unencumbered collateral to meet requirements arising from current and future secured funding transactions.

Liquidity portfolio

The Group maintains a portfolio of liquid assets, predominantly in high-quality unencumbered securities issued by the UK Government or Supranational institutions and deposits with the BoE. 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 cover more extreme stress events and provide flexibility for liquidity management. The table below shows the composition of the Group's liquidity portfolio.

Level 1	**At 30 Jun 2017 £m**	**2017 Average £m**	At 31 Dec 2016 £m	2016 Average £m
Cash and balances at central banks	**3,626.2**	**1,463.4**	737.2	819.6
UK Government securities	**186.9**	**246.2**	306.7	339.3
Other HQLA level 1 eligible	**-**	**-**	-	33.8
Supranational securities	**162.6**	**145.5**	129.3	222.0
Treasury bills raised through FLS	**2,029.9**	**2,502.2**	2,683.7	2,528.2
Covered bonds (Level 1 eligible)	**422.0**	**363.6**	304.9	434.4
Total level 1	**6,427.6**	**4,720.9**	4,161.8	4,377.3
Level 2a				
Covered bonds (Level 2a eligible)	**22.2**	**22.2**	22.2	22.4
Total level 2a	**22.2**	**22.2**	22.2	22.4
Level 2b				
Eligible RMBS	**66.9**	**46.5**	38.6	49.1
Total level 2b	**66.9**	**46.5**	38.6	49.1
High quality liquid assets (Level 1 + 2a + 2b)	**6,516.7**	**4,789.6**	4,222.6	4,448.8
Other liquidity resources				
Covered bonds	**-**	**-**	-	1.2
Non-eligible RMBS	**12.5**	**5.7**	13.6	11.6
Certificates of deposit	**143.2**	**20.5**	-	44.5
Floating rate notes	**25.0**	**10.8**	25.0	9.6
Money market loans	**13.3**	**17.8**	26.0	38.8
Total other liquidity resources	**194.0**	**54.8**	64.6	105.7
Self-issued RMBS	**708.4**	**669.8**	1,306.4	550.8
Total liquidity	**7,419.1**	**5,514.2**	5,593.6	5,105.3

During the first half of 2017, the Group maintained a strong funding and liquidity position in excess of risk appetite and the short-term liquidity stress metric, the Liquidity Coverage Ratio (LCR). The Group's LCR as at 30 June 2017 was 246.7%, representing a material surplus above the UK regulatory minimum requirement of 90%. The LCR improved from 153.7% at 31 December 2016 due to TFS drawings made during June, to fund lending throughout the second half of the year, increasing the High Quality Liquid Asset (HQLA) portfolio. The Net Stable Funding Ratio (NSFR) is due to become a minimum standard from 1 January 2018. The Group expects to meet the minimum requirements once they are fully implemented into liquidity regulation.

CAPITAL MANAGEMENT

Overview

The Common Equity Tier 1 capital ratio for the Group was 13.8% as at 30 June 2017. It reduced by 1.4 percentage points since 31 December 2016, in line with expectations, due to the Group's planned asset growth and increased investment in intangibles.

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 3.9%. The Group is not required to comply with the PRA leverage ratio framework until core retail deposits exceed the £50 billion threshold. However, to avoid capital cliffs the Group maintains a prudent risk appetite for leverage.

The Group reviews the capital structure on an on-going basis to ensure it is well placed to react to prevailing economic and regulatory conditions.

Regulation

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. These new buffers will influence the type of capital instruments that best meet the requirements likely to be expected of the Group. A capital conservation buffer of 2.5% was introduced on 1 January 2016. This is being introduced through a transitionary period of four years with the buffer increasing by 0.625% per annum from 1 January 2016.

The BoE announced in June that they would increase the countercyclical capital buffer from 0% to 0.5% from 27 June 2018. The BoE expect that a further announcement will be made in November, increasing the buffer to 1%, which would come into effect from November 2018. The Group expects to be able to accommodate these stepped increases as and when implemented within existing buffers.

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 the second half of 2016. From 1 January 2020 until 31 December 2021 the Group will be required to hold 18% of risk-weighted assets, in the form of MREL. The Group is working towards implementation of these requirements and has reflected them in the strategic planning process.

The table below shows the Group's capital resources.

	At 30 Jun 2017 £m	At 31 Dec 2016 £m
Share capital and share premium account	**654.6**	654.6
Other equity instruments	**384.1**	384.1
Other reserves	**(19.9)**	(27.4)
Retained earnings	**719.2**	659.2
Total equity per balance sheet	**1,738.0**	1,670.5
Regulatory capital adjustments		
Deconsolidation of non-regulated companies	**5.6**	5.4
Foreseeable distributions on Additional Tier 1 securities	**(4.9)**	(4.9)
Foreseeable distribution on ordinary shares	**(12.0)**	(15.5)
Other equity instruments	**(384.1)**	(384.1)
Cash flow hedge reserve	**25.2**	31.5
Prudential valuation adjustment	**(1.3)**	(1.2)
Intangible assets	**(99.7)**	(80.6)
Excess of expected loss over impairment allowance	**(44.5)**	(41.1)
Deferred tax on brought forward tax losses	**(2.2)**	(7.3)
Common Equity Tier 1 capital	**1,220.1**	1,172.7
Additional Tier 1 securities	**384.1**	384.1
Total Tier 1 capital	**1,604.2**	1,556.8
Tier 2 capital		
General credit risk adjustments	**13.6**	11.9
Total Tier 2 capital	**13.6**	11.9
Total own funds	**1,617.8**	1,568.7

Common Equity Tier 1 ratio	**13.8%**	15.2%
Tier 1 ratio	**18.2%**	20.2%
Total capital ratio	**18.4%**	20.4%

As required by Article 26(2) of the Capital Requirements Regulation, a deduction has been made for foreseeable dividends on 2017 profit. Capital ratios include verified profit for H1 2017.

Movements in Common Equity Tier 1 Capital

	2017 £m
At 1 Jan 2017	**1,172.7**
Movement in retained earnings	**60.0**
Prudential valuation adjustment	**(0.1)**
Movement in available-for-sale reserve	**1.2**
Movement in foreseeable distributions on ordinary shares	**3.5**
Exclude losses from non-regulated companies	**0.2**
Movement in intangible assets	**(19.1)**
Movement in excess of expected loss over impairment	**(3.4)**
Movement in deferred tax on tax losses carried forward	**5.1**
At 30 Jun 2017	**1,220.1**

The main drivers for the increase in capital resources are the increase in retained earnings and the reduction in deferred tax asset on tax losses, offset by increased intangible assets and other items as set out in the table above.

Risk-weighted assets

	At 30 Jun 2017 £m	At 31 Dec 2016 £m
Retail mortgages	**5,490.3**	4,764.5
Retail unsecured lending	**2,080.9**	1,847.4
Treasury	**247.6**	178.6
Other assets	**224.7**	226.4
Credit valuation adjustments	**13.7**	22.6
Operational risk	**755.7**	655.3
Total risk-weighted assets	**8,812.9**	7,694.8

Movement in risk-weighted assets

	IRB mortgage £m	**Standardised lending £m**	**Other standardised assets £m**	**Credit valuation adjustment £m**	**Operational risks £m**	**Total £m**
RWAs at 1 Jan 2017	**4,764.5**	**1,847.4**	**405.0**	**22.6**	**655.3**	**7,694.8**
Book growth	**795.8**	**233.5**	**-**	**-**	**-**	**1,029.3**
Other movements	**(70.0)**	**-**	**67.3**	**(8.9)**	**100.4**	**88.8**
RWAs at 30 Jun 2017	**5,490.3**	**2,080.9**	**472.3**	**13.7**	**755.7**	**8,812.9**

The table above shows the movement in risk-weighted assets during the six months to 30 June 2017. Growth in the mortgage and credit card books resulted in a £1.0 billion increase in risk-weighted assets. Strong new business, which attracts a higher risk weight, also contributed to the movement. 'Other movements' includes a £70.0 million decrease which relates primarily to improvements in the quality of the assets already on the balance sheet. In addition, there are £67.3 million of treasury risk-weighted assets due to certificate of deposit purchases made during the period.

There was an additional increase in operational risk-weighted assets of £100.4 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 increase in Group income from 2013 to 2016.

Leverage ratio

The leverage ratio is risk insensitive, requiring capital to be held against total on and off-balance sheet exposures, including undrawn credit facilities.

The Group's leverage ratio as at 30 June 2017 was 3.9% (2016: 4.4%) as a result of the increase in leverage ratio eligible assets, including the accelerated drawdown of TFS funds in the second half of June 2017.

	At 30 Jun 2017 £m	At 31 Dec 2016 £m
Tier 1 capital	**1,604.2**	1,556.8
Exposures measure		
Total regulatory balance sheet assets	**40,321.9**	35,060.9
Removal of accounting values for derivatives	**(89.2)**	(104.2)
Exposure value for derivatives	**83.9**	(29.4)
Exposure value for securities financing transactions	**383.7**	222.4
Off-balance sheet items	**776.5**	714.5
Other regulatory adjustments	**(122.5)**	(98.7)
Total exposures	**41,354.3**	35,765.5
Leverage ratio	**3.9%**	4.4%

Exposure values associated with derivatives and securities financing transactions have been reported in compliance with CRD IV rules. For the purposes of the leverage ratio, the derivative measure has been adjusted for regulatory netting rules, potential future exposures and cash collateral.

Off-balance sheet items were made up of undrawn credit facilities. Credit conversion factors have been applied to these items to convert them to an on-balance sheet equivalent in compliance with the CRD IV rules.

Other regulatory adjustments consist of adjustments that have been applied to Tier 1 capital which are also applied to the leverage ratio exposure measure. This ensures consistency between Tier 1 capital and the total exposures component of the ratio.

CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS (UNAUDITED)

Condensed Consolidated Income Statement

Condensed Consolidated Statement of Comprehensive Income

Condensed Consolidated Balance Sheet

Condensed Consolidated Statement of Changes in Equity

Condensed Consolidated Cash Flow Statement

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CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS (UNAUDITED) (continued)

CONDENSED CONSOLIDATED INCOME STATEMENT

	Note	**Half-year to 30 Jun 2017 £ million**	Half-year to 30 Jun 2016 £ million	Half-year to 31 Dec 2016 £ million
Interest and similar income		**465.4**	473.9	474.2
Interest and similar expense		**(176.9)**	(218.3)	(207.4)
Net interest income	3	**288.5**	255.6	266.8
Net fee and commission income		**14.4**	14.5	13.1
Other operating income		**24.3**	23.0	17.3
Fair value gains/(losses) on financial instruments		**1.3**	(5.1)	(3.8)
Other income		**40.0**	32.4	26.6
Total income		**328.5**	288.0	293.4
Operating expenses	4	**(182.5)**	(176.9)	(172.5)
Profit before tax from operating activities		**146.0**	111.1	120.9
Impairment	6	**(22.2)**	(17.4)	(20.2)
Profit before tax		**123.8**	93.7	100.7
Taxation	7	**(33.3)**	(26.2)	(28.1)
Profit for the period		**90.5**	67.5	72.6
Profit attributable to equity owners		**90.5**	67.5	72.6
Profit for the period		**90.5**	67.5	72.6
Basic earnings per share (pence)	8	**17.7**	14.1	15.2
Diluted earnings per share (pence)	8	**17.5**	14.0	15.1

The accompanying notes are an integral part of these condensed consolidated half-year financial statements.

CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS (UNAUDITED) (continued)

CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

	Half-year to 30 Jun 2017 £ million	Half-year to 30 Jun 2016 £ million	Half-year to 31 Dec 2016 £ million
Profit for the period	**90.5**	67.5	72.6
Other comprehensive income/(expense) *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	**12.0**	30.5	13.9
Income statement transfers in respect of disposals	**(10.4)**	(32.2)	(6.1)
Taxation	**(0.4)**	0.5	(2.2)
	1.2	(1.2)	5.6
Movements in cash flow hedging reserve:			
Effective portion of changes in fair value taken to other comprehensive income	**2.1**	(41.3)	5.2
Net income statement transfers	**6.6**	4.4	9.2
Taxation	**(2.4)**	10.3	(4.0)
	6.3	(26.6)	10.4
Other comprehensive income/(expense) for the period, net of tax	**7.5**	(27.8)	16.0
Total comprehensive income for the period	**98.0**	39.7	88.6
Total comprehensive income attributable to equity shareholders	**98.0**	39.7	88.6

The accompanying notes are an integral part of these condensed consolidated half-year financial statements.

CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS (UNAUDITED) (continued)

CONDENSED CONSOLIDATED BALANCE SHEET

	Note	**At 30 Jun 2017 £ million**	At 31 Dec 2016 £ million
Assets			
Cash and balances at central banks		**3,677.0**	786.3
Derivative financial instruments		**89.2**	104.2
Loans and receivables:			
Loans and advances to banks		**522.3**	635.6
Loans and advances to customers	10	**34,683.9**	32,367.1
Debt securities		**0.5**	0.7
		35,206.7	33,003.4
Available-for-sale financial assets		**1,046.7**	858.8
Intangible assets	11	**99.7**	80.6
Tangible fixed assets		**74.8**	77.4
Deferred tax assets		**16.6**	23.0
Other assets		**105.7**	121.9
Total assets		**40,316.4**	35,055.6

CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS (UNAUDITED) (continued)

CONDENSED CONSOLIDATED BALANCE SHEET (continued)

Equity and liabilities	Note	At 30 Jun 2017 £ million	At 31 Dec 2016 £ million
Liabilities			
Deposits from banks		**6,124.7**	2,132.5
Customer deposits	12	**29,564.2**	28,106.3
Derivative financial instruments		**142.0**	229.7
Debt securities in issue	13	**2,298.8**	2,600.0
Provisions	14	**13.2**	8.5
Other liabilities		**409.8**	291.4
Current tax liabilities		**25.7**	16.7
Total liabilities		**38,578.4**	33,385.1
Equity			
Share capital and share premium		**654.6**	654.6
Other equity instruments		**384.1**	384.1
Other reserves		**(19.9)**	(27.4)
Retained earnings		**719.2**	659.2
Total equity		**1,738.0**	1,670.5
Total liabilities and equity		**40,316.4**	35,055.6

The accompanying notes are an integral part of these condensed consolidated half-year financial statements.

CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS (UNAUDITED) (continued)

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

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 2017	**654.6**	**384.1**	**(27.4)**	**659.2**	**1,670.5**
Comprehensive income					
Profit for the period	**-**	**-**	**-**	**90.5**	**90.5**
Other comprehensive income					
Net movement in revaluation reserve in respect of available-for-sale financial assets	**-**	**-**	**1.2**	**-**	**1.2**
Net movement in cash flow hedge reserve	**-**	**-**	**6.3**	**-**	**6.3**
Total other comprehensive income	**-**	**-**	**7.5**	**-**	**7.5**
Total comprehensive (expense)/income for the period	**-**	**-**	**7.5**	**90.5**	**98.0**
Transactions with equity holders					
Dividends paid to ordinary shareholders	**-**	**-**	**-**	**(15.5)**	**(15.5)**
Distribution to Additional Tier 1 security holders	**-**	**-**	**-**	**(16.4)**	**(16.4)**
Tax attributable to Additional Tier 1 securities	**-**	**-**	**-**	**4.0**	**4.0**
Purchase of own shares	**-**	**-**	**-**	**(7.7)**	**(7.7)**
Issue of Additional Tier 1 securities	**-**	**-**	**-**	**-**	**-**
Share based payments – charge for the period	**-**	**-**	**-**	**5.1**	**5.1**
Deferred tax on share based payments	**-**	**-**	**-**	**-**	**-**
Total transactions with equity holders	**-**	**-**	**-**	**(30.5)**	**(30.5)**
Balance at 30 June 2017	**654.6**	**384.1**	**(19.9)**	**719.2**	**1,738.0**

CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS (UNAUDITED) (continued)

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (continued)

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 period	-	-	-	67.5	67.5
Other comprehensive expense					
Net movement in revaluation reserve in respect of available-for-sale financial assets	-	-	(1.2)	-	(1.2)
Net movement in cash flow hedge reserve	-	-	(26.6)	-	(26.6)
Total other comprehensive expense	-	-	(27.8)	-	(27.8)
Total comprehensive (expense)/income for the period	-	-	(27.8)	67.5	39.7
Transactions with equity holders					
Dividends paid to ordinary shareholders	-	-	-	(13.7)	(13.7)
Distribution to Additional Tier 1 security holders	-	-	-	(6.3)	(6.3)
Tax attributable to Additional Tier 1 securities	-	-	-	1.3	1.3
Purchase of own shares	-	-	-	(2.4)	(2.4)
Issue of Additional Tier 1 securities	-	-	-	-	-
Share based payments – charge for the period	-	-	-	6.4	6.4
Deferred tax on share based payments	-	-	-	-	-
Total transactions with equity holders	-	-	-	(14.7)	(14.7)
Balance at 30 June 2016	654.6	156.5	(43.4)	597.6	1,365.3

CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS (UNAUDITED) (continued)

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (continued)

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 July 2016	654.6	156.5	(43.4)	597.6	1,365.3
Comprehensive income					
Profit for the period	-	-	-	72.6	72.6
Other comprehensive income					
Net movement in revaluation reserve in respect of available-for-sale financial assets	-	-	5.6	-	5.6
Net movement in cash flow hedge reserve	-	-	10.4	-	10.4
Total other comprehensive income	-	-	16.0	-	16.0
Total comprehensive income for the period	-	-	16.0	72.6	88.6
Transactions with equity holders					
Dividends paid to ordinary shareholders	-	-	-	(7.1)	(7.1)
Distribution to Additional Tier 1 security holders	-	-	-	(6.3)	(6.3)
Tax attributable to Additional Tier 1 securities	-	-	-	1.2	1.2
Purchase of own shares	-	-	-	(4.9)	(4.9)
Issue of Additional Tier 1 securities	-	227.6	-	-	227.6
Share based payments – charge for the period	-	-	-	6.4	6.4
Deferred tax on share based payments	-	-	-	(0.3)	(0.3)
Total transactions with equity holders	-	227.6	-	(11.0)	216.6
Balance at 31 December 2016	654.6	384.1	(27.4)	659.2	1,670.5

CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS (UNAUDITED) (continued)

CONDENSED CONSOLIDATED CASH FLOW STATEMENT

	Half-year to 30 Jun 2017 £ million	Half-year to 30 Jun 2016 £ million	Half-year to 31 Dec 2016 £ million
Profit before taxation	**123.8**	93.7	100.7
Adjustments for:			
Changes in operating assets	**(2,309.5)**	(3,076.1)	(2,311.2)
Changes in operating liabilities	**5,511.7**	1,991.3	1,966.0
Non-cash and other items	**34.5**	(45.9)	106.2
Tax paid	**(16.6)**	(6.1)	(16.0)
Net cash provided by/(used in) operating activities	**3,343.9**	(1,043.1)	(154.3)
Cash flows from investing activities			
Purchase of securities	**(374.7)**	(471.7)	(198.3)
Proceeds from sale and redemption of securities	**185.7**	766.3	383.7
Purchase and investment in intangible assets	**(34.6)**	(9.7)	(21.9)
Purchase of tangible fixed assets	**(1.7)**	(3.7)	(4.9)
Disposal of tangible fixed assets	**-**	0.3	0.4
Net cash (used in)/provided by investing activities	**(225.3)**	281.5	159.0
Cash flows from financing activities			
Dividends paid to ordinary shareholders	**(15.5)**	(13.7)	(7.1)
Distributions to Additional Tier 1 security holders	**(16.4)**	(6.3)	(6.3)
Net proceeds from issue of debt securities	**-**	1,278.9	-
Repayments of debt securities in issue	**(302.7)**	(425.8)	(372.3)
Purchase of own shares	**(7.7)**	(2.4)	(4.9)
Issue of Additional Tier 1 securities (net of costs)	**-**	-	227.6
Net cash (used in)/provided by financing activities	**(342.3)**	830.7	(163.0)
Change in cash and cash equivalents	**2,776.3**	69.1	(158.3)
Cash and cash equivalents at beginning of period	**1,372.2**	1,461.4	1,530.5
Cash and cash equivalents at end of period[1]	**4,148.5**	1,530.5	1,372.2

1 Cash and cash equivalents comprise cash and balances at central banks (excluding mandatory reserve deposits) and loans and advances to banks.

NOTES TO THE CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS

Note 1: Basis of preparation

1.1 Basis of preparation and going concern

The condensed consolidated half-year financial statements of Virgin Money Holdings (UK) plc and its subsidiaries (the Group) for the six months ended 30 June 2017 were authorised for issue in accordance with a resolution of the Directors on 24 July 2017.

These condensed consolidated half-year financial statements for the six months ended 30 June 2017 have been prepared in accordance with the Disclosure and Transparency Rules of the Financial Conduct Authority (FCA) and IAS 34 '*Interim Financial Reporting'* as adopted by the European Union (EU). They do not include all the information required by International Financial Reporting Standards (IFRS) in full annual financial statements and should be read in conjunction with the Annual Report and Accounts for the year ended 31 December 2016. Copies of the 2016 Annual Report and Accounts are available on the Group's website.

The comparative financial information for the year ended 31 December 2016 does not constitute statutory accounts as defined in section 434 of the Companies Act 2006. A copy of the statutory accounts for that year has been delivered to the Registrar of Companies. The auditors' report on those accounts was not qualified, did not include a reference to any matters to which the auditors drew attention by way of emphasis without qualifying the report and did not contain statements under section 498(2) or (3) of the Companies Act 2006.

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 continue to operate for a period of at least 12 months from the date of approval of the condensed consolidated half-year financial statements. Accordingly the Directors believe that it remains appropriate to prepare the condensed consolidated half-year financial statements on a going concern basis.

1.2 Accounting policies

The accounting policies and methods of computation are consistent with those applied in the 2016 Annual Report and Accounts (pages 209 to 218) with the exception of IFRS 8 *'Operating Segments'*.

The operating segments have been revised to reflect how the Group's chief operating decision maker assesses performance and makes decisions regarding the allocation of resources. All product lines are now managed under a single centralised function.

1.3 Future accounting developments

A number of IFRS pronouncements of new accounting standards and amendments to accounting standards have been issued by the IASB that are not yet effective and therefore have not been applied in preparing these condensed consolidated half-year financial statements. Those which may have a significant impact on the Group in future periods are consistent with those disclosed in the 2016 Annual Report and Accounts (pages 255 to 256) and further disclosures relating to IFRS 9 '*Financial Instruments*' are included within note 19.

1.4 Presentation of information

Presentation of risk disclosures

IAS 34 '*Interim Financial Statements'* requires certain disclosures outlined in IFRS 7 '*Financial Instruments: Disclosure'*. These include disclosures concerning the nature and extent of risks relating to financial instruments and have been included within the Risk Management Report.

1.5 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, due to inherent uncertainty in making estimates, actual results in future periods may include amounts which differ from those estimates.

The areas of critical estimate and judgement are effective interest rate accounting, impairment of loans and receivables, capitalisation and impairment of intangible assets and fair value measurement. There have been no significant changes in the basis upon which these critical estimates and judgements have been determined, compared to those applied at 31 December 2016. Recognition of deferred tax assets is no longer considered to be a significant judgement in the preparation of these condensed consolidated half-year financial statements.

Note 1: Basis of preparation (continued)

Effective interest rate accounting for unsecured lending remains an area of critical judgement and estimate for the Group. Management model future expected cash flows over the expected customer life, up to a maximum of seven years from origination. In determining the future expected cash flows management estimate future customer behaviour including card balance, transaction activity and post-promotional retention rates. In the circumstances that management revise its estimate of future cash flows, for example where actual cash flows vary from initial estimation, the balance sheet effective interest rate adjustment is recalculated to reflect the revised estimated future cash flows. The recalculated value is the present value of the revised future cash flows discounted at the original effective interest rate, with the movement recognised in profit and loss.

At 30 June 2017, the effective interest rate method gave rise to an adjustment of £123.7 million (31 December 2016: £81.8 million) to the balance sheet carrying value of unsecured loans and advances. The net movement in the unsecured lending effective interest rate accrual accounted for £41.9 million of interest income in the period.

Management consider the expected life used for modelling purposes, capped at seven years, to be a significant estimate in the unsecured effective interest rate calculation. If the modelled period had been restricted to five years at origination, the balance sheet effective interest rate adjustment would have been approximately £32 million lower as at 30 June 2017 and the interest income recognised in the period would have been reduced by approximately £11 million.

Separately, management consider the estimation of future customer behaviour to be a significant estimate in the unsecured effective interest rate calculation. Should management's current estimation of future cash flows be inaccurate to the extent that the original effective interest rates on unsecured lending cohorts were all reduced by 0.1%, the present value adjustment to interest income, in relation to the revised future cash flows, would be approximately £8 million as at 30 June 2017.

Note 2: Segmental analysis

The Group falls within the scope of IFRS 8 'Operating Segments'. The Group's chief operating decision maker (which has been determined to be the Executive Committee) assesses performance and makes decisions based on the performance of the Group as a whole. The Group has therefore determined that it has one reportable operating segment and is therefore not required to produce additional segmental disclosure.

The Group operates in a single geographic segment, being the UK. The Group is not reliant on a single customer.

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. The tables below reconcile the statutory results to the underlying basis.

		Adjusted for				
	Statutory results	IPO share based payments	Strategic items	Simplification costs	Fair value gains on financial instruments	Underlying basis
Half-year to 30 June 2017	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Net interest income	**288.5**	**-**	**-**	**-**	**-**	**288.5**
Other income	**40.0**	**-**	**-**	**-**	**(1.3)**	**38.7**
Total income	**328.5**	**-**	**-**	**-**	**(1.3)**	**327.2**
Operating expenses	**(182.5)**	**0.6**	**5.5**	**-**	**-**	**(176.4)**
Profit before tax from operating activities	**146.0**	**0.6**	**5.5**	**-**	**(1.3)**	**150.8**
Impairment	**(22.2)**	**-**	**-**	**-**	**-**	**(22.2)**
Profit before tax	**123.8**	**0.6**	**5.5**	**-**	**(1.3)**	**128.6**

Note 2: Segmental analysis (continued)

		Adjusted for				
	Statutory results	IPO share based payments	Strategic items	Simplification costs	Fair value losses on financial instruments	Underlying basis
Half-year to 30 June 2016	£m	£m	£m	£m	£m	£m
Net interest income	255.6	-	(3.4)	-	-	252.2
Other income	32.4	-	(0.1)	-	5.1	37.4
Total income	288.0	-	(3.5)	-	5.1	289.6
Operating expenses	(176.9)	1.4	1.8	3.3	-	(170.4)
Profit before tax from operating activities	111.1	1.4	(1.7)	3.3	5.1	119.2
Impairment	(17.4)	-	-	-	-	(17.4)
Profit before tax	93.7	1.4	(1.7)	3.3	5.1	101.8

		Adjusted for				
	Statutory results	IPO share based payments	Strategic items	Simplification costs	Fair value losses on financial instruments	Underlying basis
Half-year to 31 December 2016	£m	£m	£m	£m	£m	£m
Net interest income	266.8	-	-	-	-	266.8
Other income	26.6	-	0.1	-	3.8	30.5
Total income	293.4	-	0.1	-	3.8	297.3
Operating expenses	(172.5)	0.6	4.0	2.3	-	(165.6)
Profit before tax from operating activities	120.9	0.6	4.1	2.3	3.8	131.7
Impairment	(20.2)	-	-	-	-	(20.2)
Profit before tax	100.7	0.6	4.1	2.3	3.8	111.5

Note 3: Net interest income

	Half-year to 30 Jun 2017 £m	Half-year to 30 Jun 2016 £m	Half-year to 31 Dec 2016 £m
Interest and similar income:			
Loans and advances to customers	**460.6**	464.0	469.1
Loans and advances to banks	**0.4**	1.3	1.0
Interest receivable on loans and receivables	**461.0**	465.3	470.1
Available-for-sale financial assets	**2.6**	6.3	2.6
Cash and balances at central banks	**1.8**	2.3	1.5
Total interest and similar income	**465.4**	473.9	474.2
Interest and similar expense:			
Deposits from banks	**(5.7)**	(3.7)	(3.9)
Customer deposits	**(152.9)**	(190.4)	(180.3)
Debt securities in issue	**(15.4)**	(20.7)	(19.9)
Other	**(2.9)**	(3.5)	(3.3)
Total interest and similar expense	**(176.9)**	(218.3)	(207.4)
Net interest income	**288.5**	255.6	266.8

Interest accrued on individually impaired assets for the half-year was £3.6 million (30 June 2016: £3.1 million, 31 December 2016: £2.7 million).

Note 4: Operating expenses

	Half-year to 30 Jun 2017 £m	Half-year to 30 Jun 2016 £m	Half-year to 31 Dec 2016 £m
Staff costs:			
Salaries	**71.1**	73.0	83.8
Social security costs	**7.5**	7.1	7.5
Other pension costs	**5.4**	5.4	5.3
Employee share schemes	**5.1**	6.4	6.4
	89.1	91.9	103.0
Premises and equipment:			
Hire of equipment	**2.3**	2.3	2.3
Rent and rates	**7.4**	6.9	7.4
	9.7	9.2	9.7
Other expenses:			
Marketing costs	**10.3**	10.7	10.3
FSCS levy	**4.7**	7.8	-
Professional fees	**6.4**	4.9	8.8
Other	**42.5**	43.3	28.8
	63.9	66.7	47.9
Depreciation, amortisation and impairment:			
Depreciation of tangible fixed assets	**4.3**	1.5	4.1
Amortisation of intangible assets	**10.7**	7.6	7.8
Impairment of intangible assets	**4.8**	-	-
	19.8	9.1	11.9
Total operating expenses	**182.5**	176.9	172.5

Note 5: Share based payments

All share based payment charges relate to equity settled schemes. Details of the existing share plans can be found in note 7 of the 2016 Annual Report and Accounts.

In the six months to 30 June 2017 the Group granted new awards under the Deferred Bonus Share Plan and the Long Term Incentive Plan.

Note 6: Allowance for impairment losses on loans and receivables

	Half-year to 30 Jun 2017 £m	Half-year to 30 Jun 2016 £m	Half-year to 31 Dec 2016 £m
Opening allowance	**50.1**	39.9	44.1
Advances written off	**(16.6)**	(13.2)	(14.2)
Charge to the income statement	**22.2**	17.4	20.2
Closing allowance	**55.7**	44.1	50.1
In respect of:			
Secured loans	**11.7**	9.5	10.6
Unsecured loans	**44.0**	34.6	39.5
Total closing allowance	**55.7**	44.1	50.1

Of the total allowance in respect of loans and advances to customers, £53.9 million was assessed on a collective basis (30 June 2016: £43.3 million, 31 December 2016: £49.4 million).

Note 7: Taxation

Analysis of the tax charge for the period:

	Half-year to 30 Jun 2017 £m	Half-year to 30 Jun 2016 £m	Half-year to 31 Dec 2016 £m
Profit before tax	**123.8**	93.7	100.7
Tax charge at standard tax rate of 19.25% (30 June 2016: 20%, 31 December 2016: 20%)	**(23.8)**	(18.7)	(20.2)
Factors affecting tax charge:			
Disallowed items	**(0.8)**	(1.2)	(0.6)
Bank corporation tax surcharge	**(8.4)**	(5.8)	(6.7)
UK corporation tax rate changes	**(0.1)**	(0.1)	(0.1)
Deferred tax charge in respect of share schemes	**-**	(0.8)	(0.3)
Adjustments in respect of prior periods	**(0.1)**	0.2	-
Other	**(0.1)**	0.2	(0.2)
Total tax charge	**(33.3)**	(26.2)	(28.1)

A 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.

In accordance with IAS 34 '*Interim Financial Reporting'*, the Group's tax charge for the half-year to 30 June 2017 is based on the best estimate of the weighted-average annual corporation tax rate expected for the full financial year. The tax effects of one-off items are not included in the weighted-average annual corporation tax rate, but are recognised in the relevant period.

Note 8: Earnings per share

	Half-year to 30 Jun 2017 £m	Half-year to 30 Jun 2016 £m	Half-year to 31 Dec 2016 £m
Profit attributable to equity shareholders – basic and diluted	**90.5**	67.5	72.6
Distributions to Additional Tier 1 security holders (net of tax)	**(12.4)**	(5.0)	(5.1)
Profit attributable to equity holders for the purposes of basic and diluted EPS	**78.1**	62.5	67.5

	30 Jun 2017 Number of shares (million)	30 Jun 2016 Number of shares (million)	31 Dec 2016 Number of shares (million)
Weighted-average number of ordinary shares in issue – basic	**442.2**	442.6	443.0
Adjustment for share options and awards	**4.2**	3.4	3.8
Weighted-average number of ordinary shares in issue – diluted	**446.4**	446.0	446.8
Basic earnings per share (pence)	**17.7**	14.1	15.2
Diluted earnings per share (pence)	**17.5**	14.0	15.1

Basic earnings per share has been calculated after deducting 2.8 million (30 June 2016: 1.7 million; 31 December 2016: 1.7 million) ordinary shares representing the weighted-average of 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 30 June 2017 none were anti-dilutive (2016: nil).

Note 9: Dividends

An interim dividend for 2017 of 1.9 pence per ordinary share was declared on 24 July 2017 and will be paid on 22 September 2017 to shareholders on the share register at close of business on 11 August 2017.

An interim dividend for 2016 of 1.6 pence per ordinary share, amounting to £7.1 million, was paid in September 2016. A final dividend in respect of the year ended 31 December 2016 of 3.5 pence per ordinary share, amounting to £15.5 million, was paid in May 2017.

Note 10: Loans and advances to customers

	At 30 Jun 2017 £m	At 31 Dec 2016 £m
Advances secured on residential property not subject to securitisation	**21,323.1**	19,375.2
Advances secured on residential property subject to securitisation	**4,579.6**	4,907.8
	25,902.7	24,283.0
Residential buy-to-let loans not subject to securitisation	**5,935.3**	5,468.4
Total loans and advances to customers secured on residential property	**31,838.0**	29,751.4
Unsecured receivables not subject to securitisation	**2,800.4**	2,486.6
Total loans and advances to customers before allowance for impairment losses	**34,638.4**	32,238.0
Impairment allowance (refer note 6)	**(55.7)**	(50.1)
Total loans and advances to customers excluding portfolio hedging	**34,582.7**	32,187.9
Fair value of portfolio hedging	**101.2**	179.2
Total loans and advances to customers	**34,683.9**	32,367.1

Note 11: Intangible assets

	Core deposit intangible £m	**Software £m**	**Core banking platforms £m**	**Total £m**
Cost:				
At 1 January 2017	4.8	114.6	21.5	140.9
Additions	**-**	**14.2**	**20.4**	**34.6**
At 30 June 2017	**4.8**	**128.8**	**41.9**	**175.5**
Accumulated amortisation and impairment:				
At 1 January 2017	4.8	49.0	6.5	60.3
Charge for the year	**-**	**8.9**	**1.8**	**10.7**
Impairment	**-**	**4.8**	**-**	**4.8**
At 30 June 2017	**4.8**	**62.7**	**8.3**	**75.8**
Balance sheet amount at 30 June 2017	**-**	**66.1**	**33.6**	**99.7**
Balance sheet amount at 31 December 2016	-	65.6	15.0	80.6

The impairment charge of £4.8 million in the period represents previous software development which has been discontinued in light of the strategic decision to consolidate activities within the digital banking program.

Note 12: Customer deposits

	At 30 Jun 2017 £m	At 31 Dec 2016 £m
Savings and investment accounts	**29,181.2**	27,762.7
Personal current accounts	**383.0**	343.6
Total customer deposits	**29,564.2**	28,106.3

Note 13: Debt securities in issue

	Secured £m	Unsecured £m	Total £m
At 1 January 2017	2,294.2	305.8	2,600.0
Repayments	**(302.7)**	**-**	**(302.7)**
Revaluation	**1.5**	**-**	**1.5**
Other movements	**1.7**	**(1.7)**	**-**
At 30 June 2017	**1,994.7**	**304.1**	**2,298.8**

Other movements comprise unamortised issue costs and hedge accounting adjustments.

Note 14: Provisions

	FSCS £m	Other £m	Total £m
At 1 January 2017	7.7	0.8	8.5
Provisions applied	**-**	**(0.7)**	**(0.7)**
Charge for the year	**4.7**	**0.7**	**5.4**
At 30 June 2017	**12.4**	**0.8**	**13.2**

In accordance with IFRIC 21 'Levies' the Group recognises a provision for the Financial Services Compensation Scheme (FSCS) levy in the scheme year (from 1 April to 31 March) based on its share of total protected deposits on 31 December of the year preceding the scheme year.

Note 15: Contingent liabilities and commitments

Contingent liabilities

The Board was not aware of any significant contingent liabilities as at 30 June 2017 (31 December 2016: none).

The Group 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 Group 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.

	At 30 Jun 2017 £m	At 31 Dec 2016 £m
Not later than 1 year	**5,627.9**	4,854.3
Later than 1 year and not later than 5 years	**91.4**	88.2
Later than 5 years	**315.3**	346.6
Total loan commitments	**6,034.6**	5,289.1

Note 16: 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 the 31 December 2016 Annual Report and Accounts 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 30 June 2017					
Cash and balances at central banks	**-**	**3,677.0**	**-**	**3,677.0**	**3,677.0**
Loans and advances to banks	**-**	**522.3**	**-**	**522.3**	**522.3**
Loans and advances to customers	**-**	**-**	**34,988.4**	**34,988.4**	**34,683.9**
Debt securities classified as loans and receivables	**0.4**	**-**	**-**	**0.4**	**0.5**
Available-for-sale financial assets	**-**	**-**	**0.3**	**0.3**	**0.3**
Other assets	**-**	**48.6**	**-**	**48.6**	**48.6**
Total financial assets at fair value	**0.4**	**4,247.9**	**34,988.7**	**39,237.0**	**38,932.6**
Deposits from banks	**-**	**6,124.7**	**-**	**6,124.7**	**6,124.7**
Customer deposits	**-**	**29,614.5**	**-**	**29,614.5**	**29,564.2**
Debt securities in issue	**2,309.0**	**-**	**-**	**2,309.0**	**2,298.8**
Other liabilities	**-**	**274.9**	**-**	**274.9**	**274.9**
Total financial liabilities at fair value	**2,309.0**	**36,014.1**	**-**	**38,323.1**	**38,262.6**

	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

Note 16: Fair value of financial assets and financial liabilities (continued)

Fair value hierarchy

The tables above summarise 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).

There is no significant change to what was disclosed in the 31 December 2016 Annual Report and Accounts in respect of the valuation methodology (techniques and inputs) applied for calculations of fair values in the tables above.

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 the 31 December 2016 Annual Report and Accounts sets out the key principles for estimating the fair values of financial instruments.

30 June 2017	**Level 1 £m**	**Level 2 £m**	**Level 3 £m**	**Total £m**
Financial assets				
Derivative financial instruments	**-**	**89.2**	**-**	**89.2**
Available-for-sale financial assets	**898.1**	**143.2**	**5.1**	**1,046.4**
Financial liabilities				
Derivative financial instruments	**-**	**142.0**	**-**	**142.0**

31 December 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

Level 1 Valuations

The fair value of debt securities categorised as available-for-sale financial assets are 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 unlisted preferred stock. The valuations take into account relevant information on the individual investments, with discounts applied to reflect their illiquid nature and, in respect of the preferred stock, risks of reduction in conversion rights. The discounts applied are the most significant unobservable valuation inputs.

The Group's shares in VocaLink Holdings Limited (Vocalink) were included within this category at 31 December 2016. The shares were sold in April 2017 following regulatory approval of Mastercard's acquisition of Vocalink, resulting in recognition of a gain on disposal of £6.1 million, included within Other Operating Income in the period.

Note 17: Related party transactions

Full details of the Group's related party transactions for the year to 31 December 2016 can be found in note 36 of the 2016 Annual Report and Accounts.

Related party transactions for the half-year to 30 June 2017 are similar in nature to those for the year to 31 December 2016.

In June 2017 an agreement was signed with Virgin Atlantic Airways (VAA) which will give rise to related party transactions in future periods.

There are no other changes to related party transactions that have had a material effect on the financial position or performance of the Group.

Note 18: Events after the balance sheet date

There have been no significant events between 30 June 2017 and the date of approval of the condensed consolidated half-year financial statements which would require a change to or additional disclosure in the financial statements apart from the declaration of the interim dividend as disclosed in note 9.

Note 19: Future accounting developments

IFRS 9 *'Financial Instruments'* (Effective 1 January 2018, EU endorsed on 22 November 2016)

Background

IFRS 9 *'Financial Instruments'* replaces IAS 39 *'Financial Instruments: Recognition and Measurement'* and has three core areas of change: Impairment (Expected Credit Loss), Classification and Measurement; and Hedge Accounting. An update is provided on each of these three areas below:

Impairment (Expected Credit Loss)

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.

IFRS 9 implementation programme

The Group has an established IFRS 9 programme to ensure a high-quality implementation in compliance with the accounting and regulatory guidance. The Audit Committee has oversight responsibility for the implementation of IFRS 9. The Group has built expected credit loss models for the key retail portfolios (secured and unsecured). The Group will run these models for the remainder of 2017 in a period of parallel run which will ensure full readiness in advance of implementation on 1 January 2018.

The Group continues to monitor the wider market developments in relation to IFRS 9, including evolving disclosure requirements and regulatory developments such as potential capital transitionary rules.

Key accounting judgments

The Group has completed technical assessment, which has highlighted certain significant accounting policies and judgements. These areas include the selection of quantitative and qualitative criteria for the determination of significant increase in credit risk and the application of forward-looking data into the expected credit loss calculations, including multiple economic scenarios.

Note 19: Future accounting developments (continued)

Significant Increase in Credit Risk (SICR)

The Group has identified a series of quantitative, qualitative and backstop criteria that will be used to determine if an account has demonstrated a significant increase in credit risk. The quantitative measures consider the increase in an accounts remaining lifetime PD compared to the expected residual lifetime PD when the account was originated. The Group will segment its credit portfolios into PD bands and has determined a relevant threshold for each PD band, where a movement in excess of threshold is considered to be significant. These thresholds have been determined separately for each portfolio based on historical evidence of delinquency. Qualitative measures include the observation of a specific event such as short-term forbearance, payment cancellation, historical arrears or extension to customer terms. The Group considers 30 days past due to be an appropriate backstop measure.

Application of forward-looking economic scenarios

The assessment of SICR and the ECL calculation both incorporate forward-looking information. The Group has identified the most significant macroeconomic factors include house price inflation, unemployment rate and Bank Base Rate. These variables and their associated impact on PD, EAD and LGD have been factored into the ECL models. The Group has determined an approach to running multiple scenarios.

Expected impact of IFRS 9

The implementation of IFRS 9 is expected to result in a material increase in the Group's total balance sheet allowance for loan loss. The extent of any increase will depend upon, amongst other things, the portfolio and forecast economic conditions at the date of implementation. The factors affecting the transition of accounts between stages, including the impact of changes in forecast economic conditions, is likely to result in impairment charges being more volatile when compared to IAS 39.

The initial outputs of the Group's IFRS 9 models indicate that the change in balance sheet allowance for loan loss for the unsecured credit card portfolio is material. In relation to the secured and wholesale portfolios, the initial outputs indicate that the change in balance sheet allowance for loan loss may be insignificant. This reflects the low LTVs and high credit quality of the mortgage portfolio and the high credit ratings of the wholesale book.

The implementation of IFRS 9 will result in a negative impact on the Group's regulatory capital position, although the capital transitional arrangements are not yet defined. At this stage the Group has reflected the full impact in forecast CET 1 resources and will allow for transitional arrangements once determined by the relevant authorities.

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. For financial assets 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. IFRS 9 retains most of the existing classification requirements for financial liabilities.

In relation to Classification and Measurement, IFRS 9 will not result in a significant change to current asset and liability measurement bases.

Hedge Accounting

The hedge accounting requirements of IFRS 9 are more closely aligned with risk management practices and follow a more principle-based approach. However, there is an option to maintain existing IAS 39 hedge accounting rules until the IASB completes its project on macro hedging.

In relation to Hedge Accounting, the Group will continue applying IAS 39 hedge accounting.

Transition to IFRS 9

The Group has undertaken an assessment to determine the impact of adoption of IFRS 9. The changes in relation to impairment, as noted above, will have the most significant impact on the Group. The final impact of IFRS 9 on the Group is dependent upon the circumstances in place as at 1 January 2018, the effective date, and the Group does not expect to restate prior periods on implementation.

DIRECTORS' RESPONSIBILITY STATEMENT

The Directors confirm that these condensed consolidated half-year financial statements have been prepared in accordance with International Accounting Standard 34, *Interim Financial Reporting*, as adopted by the European Union and that the interim management report includes a fair review of the information required by DTR 4.2.7 and DTR 4.2.8, namely:

- an indication of important events that have occurred during the first six months and their impact on the condensed set of financial statements, and a description of the principal risks and uncertainties for the remaining six months of the financial year; and
- material related party transactions in the first six months and any material changes in the related party transactions described in the last annual report.

By order of the Board,

Jayne-Anne Gadhia CBE
Chief Executive
24 July 2017

INDEPENDENT AUDITORS' REVIEW REPORT TO VIRGIN MONEY HOLDINGS (UK) PLC

Report on the Virgin Money Holdings (UK) plc condensed consolidated half-year financial statements

Our conclusion

We have reviewed Virgin Money Holdings (UK) plc's condensed consolidated half-year financial statements (the "interim financial statements") in the 2017 half-year results of Virgin Money Holdings (UK) plc for the 6 month period ended 30 June 2017. Based on our review, nothing has come to our attention that causes us to believe that the interim financial statements are not prepared, in all material respects, in accordance with International Accounting Standard 34, 'Interim Financial Reporting', as adopted by the European Union and the Disclosure Guidance and Transparency Rules sourcebook of the United Kingdom's Financial Conduct Authority.

What we have reviewed

The interim financial statements comprise:

- the condensed consolidated balance sheet as at 30 June 2017;
- the condensed consolidated income statement and condensed consolidated statement of comprehensive income for the period then ended;
- the condensed consolidated cash flow statement for the period then ended;
- the condensed consolidated statement of changes in equity for the period then ended; and
- the explanatory notes to the interim financial statements.

The interim financial statements included in the 2017 half-year results have been prepared in accordance with International Accounting Standard 34, 'Interim Financial Reporting', as adopted by the European Union and the Disclosure Guidance and Transparency Rules sourcebook of the United Kingdom's Financial Conduct Authority.

As disclosed in note 1 to the interim financial statements, the financial reporting framework that has been applied in the preparation of the full annual financial statements of the Group is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

Responsibilities for the interim financial statements and the review

Our responsibilities and those of the directors [1, 2]

The 2017 half-year results, including the interim financial statements, is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the 2017 half-year results in accordance with the Disclosure Guidance and Transparency Rules sourcebook of the United Kingdom's Financial Conduct Authority.

Our responsibility is to express a conclusion on the interim financial statements in the 2017 half-year results based on our review. This report, including the conclusion, has been prepared for and only for the company for the purpose of complying with the Disclosure Guidance and Transparency Rules sourcebook of the United Kingdom's Financial Conduct Authority and for no other purpose. We do not, in giving this conclusion, 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 a review of interim financial statements involves

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410, 'Review of Interim Financial Information Performed by the Independent Auditor of the Entity', issued by the Auditing Practices Board for use in the United Kingdom. A review of interim financial information consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures.

A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK) and, consequently, does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

INDEPENDENT AUDITORS' REVIEW REPORT TO VIRGIN MONEY HOLDINGS (UK) PLC (continued)

We have read the other information contained in the 2017 half-year results and considered whether it contains any apparent misstatements or material inconsistencies with the information in the interim financial statements.

PricewaterhouseCoopers LLP
Chartered Accountants
Edinburgh
24 July 2017

1 The maintenance and integrity of the Virgin Money Holdings (UK) plc website is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the interim financial statements since they were initially presented on the website.

2 Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdiction.

ALTERNATIVE PERFORMANCE MEASURES

The Group analyses its performance on an underlying basis, as described in the basis of presentation, and reconciled to the statutory results in note 2 to the condensed consolidated half-year 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 half-year 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 net interest income	Statutory net interest income adjusted for a subset of certain items as detailed on pages 10 to 11 and note 2 to the condensed consolidated half-year financial statements.
Underlying profit/(loss) before tax	Statutory profit/(loss) before tax adjusted for certain items as detailed on pages 10 to 11 and note 2 to the condensed consolidated half-year financial statements.
Underlying total costs	Statutory total costs adjusted for a subset of certain items as detailed on pages 10 to 11 and note 2 to the condensed consolidated half-year financial statements.
Underlying total income	Statutory total income adjusted for a subset of certain items as detailed on pages 10 to 11 and note 2 to the condensed consolidated half-year 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 of the 2016 Annual Report and Accounts.

Capital metrics disclosed in this News Release have been calculated inclusive of verified profit for the half-year to 30 June 2017.

Analyst and investor call

An analyst and investor call will be held as follows:

Date: Tuesday 25 July 2017

Time: 9.30am

Dial: +44 20 3059 8125

Webcast: **www.virginmoney.com/results**

An operator will assist you in joining the call.

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NOTES TO EDITORS

About Virgin Money

- Virgin Money offers savings, mortgages, credit cards, current accounts, currency services, pensions, investments and protection products to customers across the UK.
- Virgin Money's business ambition is to make "everyone better off" – this philosophy underpins our approach to business by offering good value to customers, treating employees well, making a positive contribution to society and delivering a profit to shareholders.
- More than 13,000 charities have registered with Virgin Money Giving and by the end of June 2017, over £560 million had been donated to charities through the service since its launch in 2009, resulting in an estimated £17.9 million more donated to charities because of its not-for-profit model.

Note: all figures in this News Release are unaudited.

Virgin Money Holdings (UK) plc - Registered in England and Wales (Company No. 03087587).
Registered Office - Jubilee House, Gosforth, Newcastle upon Tyne NE3 4PL.