

Annual report & consolidated financial statements.

Clydesdale Bank PLC.

For the year ended 30 September 2012.

Company Number: SC001111.

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For the year ended 30 September 2012.

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Overview

Clydesdale Bank PLC (the "Bank"), together with its subsidiary undertakings (which together comprise the "Group"), is the United Kingdom retail and commercial banking business of National Australia Bank Limited. Its immediate parent is National Australia Group Europe Limited ("NAGE"). The Group operates under both the Clydesdale Bank and Yorkshire Bank brands. It offers a range of banking services for both personal and business customers through retail branches, business centres, direct banking and brokers.

Forward looking statements

This document contains certain forward looking statements with respect to the expectations, plans and aims of the Group relating to future performance, financial position and results. The Group considers the expectations these forward looking statements reflect are reasonable, however, we can give no assurance that these expectations will not differ materially from actual outcomes. All forward looking statements involve risk and uncertainty because they relate to future events and circumstances that are beyond the Group's control. Factors beyond the Group's control include, amongst others, domestic UK and global economic and business conditions, the policies and actions of Governments and other regulatory bodies, changes in the tax regimes or other legislation in the jurisdictions the Group and its parent operate, market related risks such as interest or exchange rate movements, inflation, changes in customer preferences and the actions of competitors, the effect, timing and other uncertainties around future acquisitions or other combinations within relevant industries, delays in implementing proposals and risks affecting borrower credit quality. As a result, the Group recommends that readers of this document do not place undue reliance on such forward looking statements.

The Group undertakes no obligation to update any forward looking statements in light of any future events, new information or otherwise.

Officers and professional advisers

Directors **Executive Chairman** Cameron Clyne (appointed as Chairman 23 July 2012)

Non-executive David Allvey (appointed 18 May 2012) * #
David Browne (appointed 2 May 2012) * #
Richard Gregory OBE * # ^
James Pettigrew (appointed 25 September 2012) *
Barbara Ridpath (appointed 9 May 2012) #
Alexander Shapland (appointed 23 May 2012) #

Executive David Thorburn, Chief Executive Officer #
John Hooper
Mark Joiner (appointed 14 June 2012)
Richard Sawers (appointed 14 June 2012) #

* Member of the European Boards' Audit Committee
Member of the European Boards' Risk Committee
^ Appointed Senior Independent Director on 18 September 2012

UK Executive Committee David Thorburn, Chief Executive Officer
John Hooper, Executive Director
Scott Butterworth, Chief Financial Officer
Debbie Crosbie, Operations and IT Director
Jennifer Darbyshire, General Counsel (appointed 31 August 2012)
Eric Gunn, Chief Risk Officer
Lynn McManus, People and Communications Director
Kevin Page, Transformation Director
Andrew Pearce, Retail Banking Director (appointed 24 September 2012)
Steve Reid, Chief Data Officer
Paul Shephard, Business and Private Bank Director (appointed 20 April 2012)

Joint Company Secretary Jennifer Darbyshire (appointed 18 September 2012)
Lorna McMillan

Registered Office 30 St Vincent Place
Glasgow, G1 2HL

Bankers National Australia Bank Limited

Auditor Ernst & Young LLP
1 More London Place
London, SE1 2AF

Chairman's statement

Cameron Clyne.



During the year, the Clydesdale Bank Group faced some exceptional challenges and made some significant changes.

The UK economy contracted for most of the financial year and commercial property values receded.

These factors combined to weaken demand for credit and to increase the charge for bad and doubtful debts associated with commercial real estate loans.

In addition to these pressures, the business also faced increased funding and liquidity costs as a result of uncertainty in the Eurozone.

Although disappointing, it is therefore not unexpected that the Clydesdale Bank Group incurred a statutory loss in the year.

In light of these trading conditions, the Board is taking action to reform and refocus the business and to significantly reduce balance sheet risk. The end result will be a stronger and more sustainable business that generates better returns and has an improved balance sheet structure. The action we are taking is set out within this Annual Report.

The Board has also reviewed and refreshed its own membership and introduced a new risk and control framework to strengthen the overall corporate governance of the Bank.

A number of non-executive Directors had remained on the Board beyond their intended retirement dates to support the reviews that we were undertaking and they stood down during the year as new Directors were appointed. I very much appreciate their contribution to the Board, particularly Sir Malcolm Williamson who retired as Chairman during the year.

I would also like to thank the Bank's employees for their continuing support and commitment, particularly during the difficult changes that we are making.

The uncertainty in the UK economy and in the sector as a whole will undoubtedly continue for the foreseeable future as the regulatory and bank reform agenda in Europe settles. I am confident however that the changes that we continue to make will ensure that the Clydesdale Bank is stronger, better placed to challenge other UK banks, and more able to support our customers in the years ahead.

A handwritten signature in black ink that reads "Cameron Clyne". The signature is written in a cursive, flowing style.

Cameron Clyne
Executive Chairman
16 November 2012

Chief Executive's statement

David Thorburn.



In the year under review, the Group faced exceptionally challenging economic and operating conditions.

Financial performance was significantly affected by elevated funding and liquidity costs together with higher bad and doubtful debt charges, mainly from commercial real estate exposures.

In light of this, the Group undertook a Strategic Review and agreed a package of measures to strengthen the business, improve shareholder returns and reduce the Group's risk profile.

As a result of the Review, we are focusing on services for personal customers and for small and medium sized businesses in our heartlands. This has involved closing a number of Financial Solutions Centres, predominantly in the south of the UK, and operating from a reduced network of Business & Private Banking Centres together with new regional administrative hubs in our heartlands. We are also streamlining our back office operations and consolidating them into Glasgow, while maintaining our important operations centre in Leeds.

In addition to simplifying the Bank's business model, the Review outcomes will also lead to an improved balance sheet structure

and a significantly improved funding position. We made arrangements to transfer the vast majority of our commercial real estate assets (£5.6bn) to NAB to be managed separately and run-off. This transfer took place on 5 October 2012.

Implementing these proposals is impacting our employee numbers. In the year, some 400 employees left the Group and another 200 employees transferred to NAB to assist in the on-going management of the transferred commercial property portfolio. We anticipate that, by the end of 2015, there will be a further reduction of 800 employees relative to September 2011.

Despite the very difficult economic environment, our average gross loans and acceptances increased, largely as a result of strong growth in mortgage lending. Average retail customer deposits also grew strongly in a highly competitive market and, while our business lending balances decreased, we still outperformed the wider market.

Nevertheless, the impact of the bad and doubtful debt charges and the increased funding and liquidity costs, combined with a new provision for the Strategic Review restructuring costs and an increased provision for Payment Protection Insurance redress, have resulted in the business making a loss for the year.

Next year will remain challenging for the Group given the outlook for the economy. However, the action that we are taking following the Strategic Review is putting the business on a much firmer financial footing and will deliver a more competitive and sustainable business.

A handwritten signature in black ink that reads "D Thorburn". The signature is written in a cursive, slightly stylized font.

David Thorburn
Chief Executive Officer
16 November 2012

Business review

Key points

- The Group incurred a pro forma loss after tax of £351m for the year ended 30 September 2012 compared to a pro forma profit after tax of £117m in the prior year. The statutory loss was £470m, compared to a statutory profit of £18m in the prior year.
- The results in these Financial Statements reflect the current structure for the Group. On 5 October 2012, the Group transferred the majority of its commercial real estate lending to NAB as part of its response to the Strategic Review.
- The pro forma loss for the year is due in the main to two key factors. The most material was a substantial increase in bad and doubtful debt charges arising mainly from elevated provisioning for commercial real estate exposures. The second was the impact of the credit rating downgrade which has driven increased funding costs and a reduction in the net interest margin as wholesale funding was replaced by retail deposits.
- The year's result includes £149m of restructuring costs and £120m of additional provision raised for Payment Protection Insurance following higher than expected claims experience in the first half of the year. The impact of these matters was offset by a £130m payment from NAB as a result of reforms to the Group's defined benefit pension scheme.
- The Group has continued to actively manage its balance sheet during the year. Provisioning coverage (total provisions to gross loans and acceptances) has increased to 2.78% (30 September 2011: 1.58%). The total Tier 1 capital ratio reduced to 9.6% at the end of the year (from 9.9% at 30 September 2011) driven by the losses in the year. The ratio is significantly improved as a result of the transfer of the commercial property portfolio to NAB in October 2012. The Customer Funding Index (CFI)[†] and Stable Funding Index (SFI)[†] have strengthened in the period under review (CFI to 78.0% from 74.0% at September 2011 and SFI to 92.3% from 87.0% at September 2011). This is a result of the funding issuances and term deposits raised during the year.
- Reflecting underlying franchise strength, the business achieved mortgage growth of 10.3% over the prior year compared to system growth of 0.6%** . Retail deposits grew by 5.1% over the prior year compared to system growth of 3.2%** , reflecting the impact of a successful term deposit campaign.

	Year ended 30 Sep 2012	Year ended 30 Sep 2011
Pro forma (loss)/profit after tax (£m)	(351)	117
Statutory (loss)/profit after tax (£m)	(470)	18
Operating (loss)/profit after tax on average assets ⁽¹⁾	(0.78)%	0.26%
Net interest margin ⁽¹⁾	2.07%	2.37%
Cost to income ratio ⁽¹⁾	72.1%	61.3%
Operating (loss)/profit after tax per FTE (£'000) ⁽¹⁾	(67)	21

(1) On a pro forma basis.

* Note that the ratios for the reporting periods have been calculated in accordance with the redefined Group methodology.

** Source: Bank of England – September 2012.

Business review (continued)

Our business

Overview

The Group operates a UK-focused retail and commercial banking business under the brand names “Clydesdale Bank” and “Yorkshire Bank”, primarily in the north of England and in Scotland. The Bank currently has 333 retail branches, 71 Business & Private Banking Centres, and employs 5,247* staff.

Operating environment

The UK economy emerged from recession in the third quarter of 2012, growing by 1.0%, following two successive quarters of contraction. This growth was helped by the Olympic Games, with the Office for National Statistics estimating that ticket sales had added 0.2% to the figures. The Q3 GDP figures were also enhanced by comparison with the previous quarter, with the extra public holiday resulting in lower output. Despite these positive impacts in the last quarter underlying growth remains weak and the immediate outlook remains uncertain. The challenging conditions continue to be reflected in most leading economic indicators and in the Group's performance.

Despite the challenging economic conditions the UK's unemployment rate fell to 7.8% in the quarter to September, with the overall number of people in employment hitting a record high of almost 30 million.

The financial markets have been impacted by the uncertainty in the Eurozone. The Bank of England Base Rate remained at 0.5% throughout the year, whilst the rolling average of three month LIBOR in the last 12 months has increased by 18 basis points over the prior year. Basis risk hedging has mitigated the impact of this change, which would otherwise have had a further negative impact on net interest margins. In line with the overall economy, the commercial property market has also experienced a “double dip” in values. This has been exacerbated by banks accelerating the reduction in their CRE exposures.

The regulatory and legislative landscape for financial services in the UK continues to change rapidly. This reflects the ongoing reorganisation in UK regulatory bodies and developments within Europe. There are multiple concurrent initiatives in the areas of prudential and conduct risk. Additionally, in October 2012, the Government issued the draft Financial Services (Banking Reform) Bill recommending ring-fencing of vital banking services and increasing banks' loss absorbency.

* This is the Clydesdale Bank PLC full time equivalent. The proposed employee reductions referred to on page 3 relate to the UK Region figure of 7,883 which includes employees working within other National Australia Group Europe Limited subsidiaries who provide support services to the Group.

Business review (continued)

Pro forma financial analysis

For the year to	Sep 12 £m	Sep 11 £m	Sep 12 v Sep 11 %
Net interest income	877	987	(11.1)%
Non interest income	118	184	(35.9)%
Total operating income	995	1,171	(15.0)%
Total operating expenses	(717)	(719)	0.3%
Operating profit before impairment losses	278	452	(38.5)%
Impairment losses on credit exposures ⁽¹⁾	(737)	(297)	(large)
(Loss)/profit before tax	(459)	155	(large)
Tax credit/(expense)	108	(38)	large
Pro forma operating (loss)/profit after tax	(351)	117	(large)
Significant items after tax	(119)	(99)	(20.2)%
(Loss)/profit attributable to equity holders ⁽²⁾	(470)	18	(large)

Year to 30 September 2012	Statutory results £m	FSCS and Bank levies £m	PPI redress £m	Pension Scheme Reforms Benefit ⁽³⁾ £m	Restructuring expenses £m	Other items £m	Pro forma results £m
Net interest income	869	8	-	-	-	-	877
Non interest income	128	-	120	(130)	-	-	118
Total operating income	997	8	120	(130)	-	-	995
Total operating expenses	(874)	2	-	-	149	6	(717)
Operating profit before impairment losses	123	10	120	(130)	149	6	278
Impairment losses on credit exposures ⁽¹⁾	(737)	-	-	-	-	-	(737)
Loss before tax	(614)	10	120	(130)	149	6	(459)
Tax credit	144	(2)	(29)	33	(36)	(2)	108
Loss after tax	(470)	8	91	(97)	113	4	(351)

Business review (continued)

Pro forma financial analysis (continued)

Year to 30 September 2011	Statutory results £m	FSCS and Bank levies ⁽⁴⁾ £m	PPI redress £m	Pension Scheme Reforms Benefit ⁽³⁾ £m	Restructuring expenses £m	Other items £m	Pro forma results £m
Net interest income	983	4	-	-	-	-	987
Non interest income	68	-	116	-	-	-	184
Total operating income	1,051	4	116	-	-	-	1,171
Total operating expenses	(733)	3	-	-	-	11	(719)
Operating profit before impairment losses	318	7	116	-	-	11	452
Impairment losses on credit exposures ⁽¹⁾	(297)	-	-	-	-	-	(297)
Profit before tax	21	7	116	-	-	11	155
Tax expense	(3)	(2)	(30)	-	-	(3)	(38)
Profit after tax	18	5	86	-	-	8	117

- (1) Impairment provisions and impairment losses on credit exposures relate solely to Loans and Advances to Customers (see notes 15 and 16 to the Financial Statements) and exclude the credit risk adjustments on loans at fair value through profit or loss which are incorporated in the movement in fair value assets within non-interest income.
- (2) (Loss)/profit attributable to equity holders is stated after tax. The statutory loss before tax for the year ended 30 September 2012 was £614m (year ended 30 September 2011: profit of £21m).
- (3) The table includes a significant item in respect of Pension Reforms. This reflects the withdrawal of NAB as a participating employer of the YCB Scheme that resulted in a one-off payment of £130m into the Scheme.
- (4) The treatment of the FSCS levy has been adjusted to conform to the current year presentation.

Key balance sheet measures

Average volumes for the year to	Sep 12 £bn	Sep 11 £bn	Sep 12 v Sep 11 %
Gross loans and acceptances ⁽⁵⁾	33.6	32.9	2.1%
Interest earning assets	42.4	41.5	2.2%
Total assets	45.2	44.4	1.8%
Retail deposits ⁽⁶⁾	24.6	23.4	5.1%

- (5) Gross loans and acceptances include gross loans and advances to customers, loans designated at fair value through profit or loss and due from customers on acceptances.
- (6) Retail deposits include current accounts, savings accounts, term deposits and business retail deposits.

Business review (continued)

Pro forma financial analysis (continued)

September 2012 v September 2011

A loss after tax of £470m was incurred in the year compared to a profit of £18m in the prior year. This reflected an increase in impairment charges and deterioration in net interest income due to increased funding and liquidity costs. Excluding the charge for PPI redress, the gain from pension reforms, other items and the restructuring costs associated with the Strategic Review, the pro forma loss of £351m was £468m adverse to the prior year.

Net interest income decreased by £110m (11.1%). The credit rating downgrade in December 2011 resulted in lower margin money market and retail deposits being replaced by more expensive longer term wholesale funding and retail term deposits. This resulted in higher funding costs, coupled with higher liquidity costs from the increase in average 3 month LIBOR over the year. This was partially offset by higher lending income. The net interest margin declined by 30 basis points to 2.07%.

Non interest income decreased by £66m (35.9%), largely driven by lower fees and commissions as a result of economic conditions and the subdued demand for credit. There were also adverse movements in hedge ineffectiveness.

Operating expenses decreased by £2m (0.3%) over the prior year. The underlying cost improvement was driven by lower personnel costs resulting from a reduction in FTEs and lower performance related remuneration.

Impairment losses on credit exposures have increased by £440m (148.1%) over the prior year. This increase was driven by business lending losses, as a result of prolonged economic and market uncertainty that affected all sectors, but particularly the commercial real estate market. This was partially offset by continued improvement in unsecured retail portfolio delinquency, driving lower unsecured retail lending losses and a reduction in mortgage lending losses.

Average gross loans and acceptances, which incorporate assets held for sale and loans accounted for at fair value, increased by £0.7bn (2.1%) to £33.6bn, primarily due to growth in mortgages. Mortgage growth of 9.8% was substantially higher than system growth of 0.6%*, however system growth levels were impacted by the reduction in the number of mortgage portfolios by lenders who have left the active market. Business lending balances declined by 2.4%, compared to business lending system decline of 5.1%*, with the unsecured personal lending book 16.1% down on the prior year.

Average retail deposits increased by £1.2bn (5.1% compared to system growth of 3.2%*), reflecting the impacts of our term deposit campaign designed to provide a stable source of retail funding.

Six months to	Sep 12	Mar 12	Sep 12 v Mar 12 %
	£m	£m	
Net interest income	418	459	(8.9)%
Non interest income	47	71	(33.8)%
Total operating income	465	530	(12.3)%
Total operating expenses	(365)	(352)	(3.7)%
Operating profit before impairment losses	100	178	(43.8)%
Impairment losses on credit exposures ⁽¹⁾	(321)	(416)	22.8%
Loss before tax	(221)	(238)	(7.1)%
Tax credit	46	62	25.8%
Pro forma operating loss after tax	(175)	(176)	(0.6)%
Significant items after tax	(109)	(10)	(large)
Loss attributable to equity holders ⁽²⁾	(284)	(186)	(large)

* Source: Bank of England – September 2012.

Business review (continued)

Pro forma financial analysis (continued)

Six months to 30 September 2012	Statutory results £m	FSCS and Bank levies £m	PPI redress £m	Pension Scheme Reforms Benefit £m	Restructuring expenses £m	Other items £m	Pro forma results £m
Net interest income	417	1	-	-	-	-	418
Non interest income	47	-	-	-	-	-	47
Total operating income	464	1	-	-	-	-	465
Total operating expenses	(507)	2	-	-	139	1	(365)
Operating profit before impairment losses	(43)	3	-	-	139	1	100
Impairment losses on credit exposures ⁽¹⁾	(321)	-	-	-	-	-	(321)
Loss before tax	(364)	3	-	-	139	1	(221)
Tax credit/(expense)	80	-	-	-	(33)	(1)	46
Loss after tax	(284)	3	-	-	106	-	(175)

Six months to 31 March 2012	Statutory results £m	FSCS and Bank levies ⁽⁴⁾ £m	PPI redress £m	Pension Scheme Reforms Benefit ⁽³⁾ £m	Restructuring expenses £m	Other items £m	Pro forma results £m
Net interest income	452	7	-	-	-	-	459
Non interest income	81	-	120	(130)	-	-	71
Total operating income	533	7	120	(130)	-	-	530
Total operating expenses	(367)	-	-	-	10	5	(352)
Operating profit before impairment losses	166	7	120	(130)	10	5	178
Impairment losses on credit exposures ⁽¹⁾	(416)	-	-	-	-	-	(416)
Loss before tax	(250)	7	120	(130)	10	5	(238)
Tax credit	64	(2)	(29)	33	(3)	(1)	62
Loss after tax	(186)	5	91	(97)	7	4	(176)

- 1) Impairment provisions and impairment losses on credit exposures relate solely to Loans and Advances to Customers (see notes 15 and 16 to the Financial Statements) and exclude the credit risk adjustments on loans at fair value through profit or loss which are incorporated in the movement in fair value assets within non-interest income.
- 2) Loss attributable to equity holders is stated after tax. The loss before tax for the six months ended 30 September 2012 was £364m (six months ended 31 March 2012: £250m).
- 3) The table includes a significant item in respect of Pension Reforms. This reflects the withdrawal of NAB as a participating employer of the YCB Scheme that resulted in a one-off payment of £130m into the Scheme.
- 4) The treatment of the FSCS levy has been adjusted to conform to the current year presentation.

Business review (continued)

Pro forma financial analysis (continued)

Key balance sheet measures

Average volumes for the six months to	Sep 12 £bn	Mar 12 £bn	Sep 12 v Mar 12 %
Gross loans and acceptances ⁽⁵⁾	33.4	33.7	(0.9)%
Interest earning assets	41.9	42.8	(2.1)%
Total assets	44.5	45.9	(3.1)%
Retail deposits ⁽⁶⁾	25.1	24.2	3.7%

5) Gross loans and acceptances include gross loans and advances to customers, loans designated at fair value through profit or loss and due from customers on acceptances.

6) Retail deposits include current accounts, savings accounts, term deposits and business retail deposits.

Six month period to September 2012 v six month period to March 2012

The pro forma loss after tax for the period of £175m was £1m lower than in the six month period to March 2012. This reflected a reduction in income, an increase in expenses and lower impairment losses on credit exposures.

Net interest income decreased by £41m (8.9%), driven by higher wholesale and retail funding costs. This was partially offset by higher lending income. The net interest margin reduced by 16bps to 1.99%.

Non interest income decreased by £24m (33.8%), driven by lower fees and commissions and adverse movements in hedge ineffectiveness. These reductions were partially offset by the benefits of one-off income received in the second half.

Operating expenses increased by £13m (3.7%) including the cost of the UK banking levy. On an underlying basis, expenses fell by 4.0% largely driven by lower personnel costs.

Impairment losses on credit exposures decreased by £95m (22.8%) when compared to the March 2012 half. The first half charge included an economic cycle adjustment of £150m for increased coverage on the commercial property portfolio. Excluding this impact, underlying losses increased by £55m in the September half. This was largely the result of further losses in business lending as the weakness in the economy continued to impact all sectors, in particular the commercial real estate market.

Average gross loans and acceptances, which incorporate assets held for sale and loans accounted for at fair value, decreased by £0.3bn (0.9%). This was driven by a reduction in business lending (5.1%) which was partially offset by above system growth in mortgages (5.2%). Unsecured personal lending volumes continued to fall and were down by 7.0% on the prior half, reflecting the subdued demand for credit in the current challenging economic environment. Unsecured lending balances were stable in the last 3 months of the year.

Average retail deposits increased by £0.9bn (3.7%) driven by our term deposit campaign.

Investment spend

The Group continues to maintain its investment in the business at a similar level to that of prior years. This spend is focused on regulatory and compliance, efficiency and simplification and revenue generation categories.

Key achievements during the year included the completion of the outsourcing of the technical infrastructure and operational management of our ATM and debit card channels as well as enhancing our Direct Banking offering by implementing an on-line personal loans capability.

In addition, we completed our Personal Current Account Fee project, mobilised further projects that will enable effective current account switching and commenced the upgrade of our mortgage processing platform.

Business review (continued)

Asset quality

	As at		
	30 Sep 2012	31 Mar 2012	30 Sep 2011
Impairment provisions on loans and advances (£m)			
Specific provision for doubtful debts	404	218	131
Collective provision for doubtful debts	354	383	243
Credit risk adjustments on loans at fair value (£m)			
Individually assessed credit risk adjustments on loans at fair value	42	25	15
Collectively assessed credit risk adjustments on loans at fair value	126	133	142
Past due and impaired assets (£m)			
90+ Days Past Due (DPD) assets	322	265	199
Gross impaired assets ⁽¹⁾⁽⁴⁾	1,294	1,006	890
Asset quality measures (%)			
90 DPD plus gross impaired assets to gross loans and acceptances ⁽¹⁾	4.86%	3.79%	3.23%
Specific provision to gross impaired assets ⁽¹⁾	34.4%	24.2%	16.5%
Net write-offs to gross loans and acceptances (annualised)	1.05%	1.11%	0.84%
Total provision as a percentage of net write-offs ⁽²⁾	265%	201%	187%
Total provision to gross loans and acceptances ⁽²⁾	2.78%	2.26%	1.58%
Bad and doubtful debt charge to credit risk weighted assets	2.62%	3.31%	1.14%
Impairment provisions on loans and advances (£m) ⁽³⁾			
Business lending	698	538	300
Retail lending	60	63	74
	758	601	374

	Year ended		Six months ended	
	30 Sep 2012	30 Sep 2011	30 Sep 2012	31 Mar 2012
	£m	£m	£m	£m
Impairment losses on loans and advances				
Business lending	698	243	306	392
Retail lending	39	54	15	24
	737	297	321	416
Of which:				
Specific	627	341	350	277
Collective	110	(44)	(29)	139
	737	297	321	416

- (1) Gross impaired assets for September 2012, March 2012 and September 2011 include £109m, £52m and £22m gross impaired fair value assets respectively.
- (2) Total provision to gross loans and acceptances includes the credit risk adjustments on loans at fair value through profit or loss.
- (3) Impairment provisions on loans and advances include provisions in respect of assets held for sale (note 24).
- (4) The amount at September 2012 includes £842m in respect of assets held for sale (note 24).

Continued weakness in economic and market conditions resulted in deteriorating asset quality in the business lending portfolio over the year to September 2012. This was particularly evident within the commercial property sector which experienced a further decline in commercial property values.

Business review (continued)

Asset quality (continued)

The total 90+ DPD balances have increased through the year to September 2012 to £322m, compared with £199m at September 2011. This increase was in the business portfolio, with the commercial property book accounting for the majority of the increase. However, there was also an increase in the trading book 90+ DPD balance, reflecting the prolonged weakness of the UK economy. There were continued improvements in the home loan and unsecured portfolios.

The level of impaired assets increased to £1,294m in the year to September 2012. Commercial real estate lending remains the largest component of the impaired asset portfolio, which is as a result of the continued weak market conditions in this sector. The vast majority of the Group's commercial real estate assets were transferred to NAB on 5 October 2012. The overall collective provision for doubtful debts increased over the year due to deteriorating conditions in the business lending portfolio. However, there was a continued reduction in the personal lending collective provision driven by improvements in the delinquency profile and a reduction in unsecured personal lending balances.

The ratio of total provisions to gross loans and acceptances increased to 2.78% in September 2012. The majority of the provisions growth was on commercial property related exposures.

Capital position

The Group undertook active capital management during the year, including issuing £500m of ordinary share capital. Despite this, the Group's Tier 1 ratio reduced to 9.6%, compared to 9.9% in September 2011 reflecting the losses incurred in the year largely due to high impairment charges, margin compression and the restructuring costs associated with the Strategic Review. The Core Tier 1 capital ratio fell to 8.4%, from 8.9% in September 2011, again driven by the losses in the year.

Regulatory capital

	As at	
	30 Sep 2012 £m	30 Sep 2011 £m
Tier 1 capital		
Permanent share capital	1,442	942
Profit and loss and other reserves ⁽¹⁾	475	1,236
Share premium account	243	243
Pension fund regulatory adjustments ⁽²⁾	73	104
Perpetual non-cumulative preference shares	300	300
Deductions from Tier 1 capital	(2)	(2)
Total Tier 1 capital after deductions	2,531	2,823
Tier 2 capital		
Upper Tier 2 capital		
Revaluation reserves	1	2
General/collective provisions ^{(1) (3)}	330	243
	331	245
Lower Tier 2 capital		
Long term subordinated debt	1,076	1,276
Deductions from Tier 2 capital	(2)	(2)
Total Tier 2 capital after deductions	1,405	1,519
Total capital after deductions ⁽⁴⁾	3,936	4,342

Business review (continued)

Capital position (continued)

	As at	
	30 Sep 2012 £m	30 Sep 2011 £m
Risk weighted assets ⁽⁵⁾		
Retail mortgages	6,139	5,696
Business lending	15,758	17,794
Other retail lending	1,104	1,285
Other lending	1,133	1,113
Operational risk	1,872	2,075
Counterparty risk	370	443
Market risk	1	-
	26,377	28,406

Capital ratios

Core Tier 1 ratio ⁽⁶⁾	8.4%	8.9%
Tier 1 ratio	9.6%	9.9%
Total capital ratio	14.9%	15.3%

(1) Includes the results for the year.

(2) For regulatory capital purposes, the pension fund deficit is added back to regulatory capital and substituted with an estimate of additional pension fund contributions to be made over the next five years, adjusted for deferred tax.

(3) The collective provision add back is limited for regulatory capital purposes.

(4) There is no Tier 3 capital.

(5) Risk weighted assets are calculated under the standardised approach.

(6) Core Tier 1 capital is Tier 1 capital excluding perpetual non-cumulative preference shares.

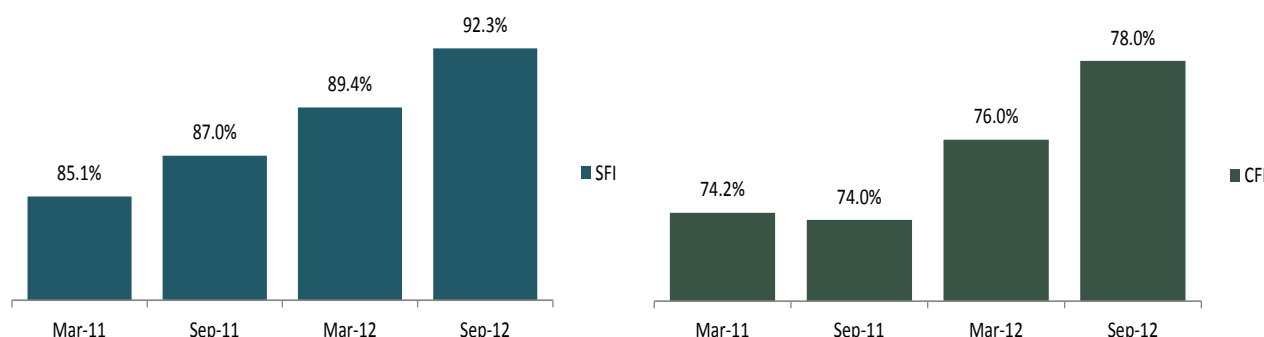
Regulatory capital to statutory equity reconciliation

	As at	
	30 Sep 2012 £m	30 Sep 2011 £m
Regulatory Tier 1 capital	2,531	2,823
Reverse pension regulatory adjustments	(73)	(104)
Reverse deductions from capital	2	2
Revaluation reserves	1	2
Available for sale reserve	12	16
Cash flow hedge reserve	124	120
Share option reserve	5	14
SPE reserves	2	4
Other	-	2
Total equity	2,604	2,879

Business review (continued)

Funding

Stable funding and customer funding indices



The growth of the Group's retail deposits has strengthened both the CFI and overall SFI. The SFI (customer funding plus term debt) remains robust.

The Group continued to focus on enhancing its ability to raise term funding. This included restructuring of the Covered Bond and Securitisation programmes which enabled the programmes to retain AAA ratings. This platform enabled Clydesdale to issue debt from the Lanark owner occupier mortgage securitisation programme and the Regulated Covered Bond programme.

The Group remains diversified in terms of the type of instrument, product, currency, counterparty, term structure and markets that make up its wholesale funding base.

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

	Outlook as at	As at	
	13 November 2012	30 Sep 2012	30 Sep 2011
Fitch	Stable	A	AA-
Moody's	Stable	A2	A1
Standard & Poor's	Positive	BBB+	A+

Liquid assets

	As at	
	30 Sep 2012	30 Sep 2011
	£bn	£bn
UK Government Treasury Bills and Gilts	0.9	5.1
Cash and cash at central bank	6.1	4.5
Note cover *	1.8	1.6
Government guaranteed assets	-	0.3
Interbank lending	0.1	0.1
Treasury bills	-	0.4
Liquid assets	8.9	12.0

* Note cover is excluded from FSA regulatory liquidity.

The Group has reduced its holding of highly liquid assets during the year due to reduced reliance on short-term wholesale funding.

Business review (continued)

Liquid assets (continued)

The Group continues to hold £100m of Floating Rate Notes issued by the European Investment Bank and has no direct exposure to any European Sovereigns as part of its liquidity portfolio.

Customers, employees and community

The Group continues to support customers and the communities in which it operates and a range of charitable causes.

The Yorkshire and Clydesdale Bank Foundation provides financial support to several charities across the UK and has distributed over £0.6m during the last twelve months. The charity partnership with Help the Hospices is now in its fifth year and over £2.4m has been raised in this time. In addition, over 26% of employees currently donate to their chosen charities through Payroll Giving and the Group's Employee Volunteering Policy offers all employees the opportunity to take two days paid leave to work in the local community.

The Group has continued its sponsorship of the Clydesdale Bank Scottish Premier Football League and the England and Wales Cricket Board's domestic "40-over" competition during the year.

The Group is committed to high standards of customer service, adding value and supporting customers and employees. Customer acquisition levels have increased in the year, driven by market leading Term Deposit and Cash ISA campaigns.

During the year, the Group won two "Your Mortgage" Awards, with Yorkshire Bank named "Best Regional Mortgage Lender" and Clydesdale Bank named "Best Mortgage Lender in Scotland" for the eighth consecutive year.

Report of the Directors

The Directors of the Bank with its subsidiary undertakings (which together comprise the "Group") submit their report and consolidated Financial Statements for the year ended 30 September 2012.

Activities

The Bank is an "authorised person" under the Financial Services and Markets Act 2000 and is regulated by the Financial Services Authority (FSA).

The Group and its subsidiaries offer access to a comprehensive range of banking and other related financial services through 71 Business and Private Banking Centres and 333 retail branches primarily in the north of England and in Scotland. Developments in the Group's existing business and future prospects are discussed below.

Profits and appropriations

The Group loss before tax for the year ended 30 September 2012 was £614m (2011: profit of £21m). The loss attributable to the shareholders for the year ended 30 September 2012 amounted to £470m (2011: profit of £18m). Preference share dividends of £15m (2011: £21m) were paid during the year. The Directors do not recommend the payment of a final dividend on the ordinary shares in respect of this financial year (2011: £Nil).

The Group's strategic highlights and business developments are set out in the Business Review on pages 4 to 15.

Financial instruments

The Group's risk management objectives and policies are discussed in note 40.

Directors and Directors' interests

The current Directors are shown on page 1. Directors who are not full-time employees of the Group or a related body corporate are appointed in accordance with the Articles of Association and may be eligible for reappointment thereafter. No Directors retired by rotation during the year.

Changes to the composition of the Board

Sir Malcolm Williamson retired as Chairman and Director of the Group on 23 July 2012, having held these roles since 2004. Cameron Clyne was appointed as Executive Chairman of the Group upon Sir Malcolm's retirement. The change was part of an on-going renewal process that the UK Boards have undertaken which included the appointment of the following new Directors to the Board of the Group:

- David Browne, Non-executive, 2 May 2012
- Barbara Ridpath, Non-executive, 9 May 2012
- David Allvey, Non-executive, 18 May 2012
- Alexander Shapland, Non-executive, 23 May 2012
- Mark Joiner, Executive, 14 June 2012
- Richard Sawers, Executive, 14 June 2012
- James Pettigrew, Non-executive, 25 September 2012

The following Directors retired during the year:

- Peter Wood, Non-executive, 21 October 2011
- Jonathan Dawson, Non-executive, 31 May 2012
- Roy Nicolson, Non-executive, 31 May 2012
- Elizabeth Padmore, Non-executive, 31 May 2012
- Sir David Fell, Non-executive, 23 July 2012

Report of the Directors (continued)

Directors and Directors' interests (continued)

Directors' interests

No Director had any interest in the shares of the Group or its subsidiaries at any time during the year. As the Group is a wholly-owned subsidiary of NAB, which is incorporated in the State of Victoria in Australia, any interest which the Directors may have in NAB does not need to be notified to the Group, and therefore is not disclosed in this report.

Directors' liabilities

During the year, the NAB Group paid a premium for a contract insuring the Directors and Officers of NAB, its subsidiaries and controlled entities against personal liabilities which may arise in the course of the performance of their duties, as well as protecting the Group itself to the extent that it is obligated to indemnify Directors and Officers for such liability.

Employee involvement

The Group carries out an information programme to keep staff informed of business objectives and results. This is achieved through regular meetings, conference calls, circulars, bulletins and specially commissioned communications as well as training courses for staff.

Under the UK National Share Incentive Plan, employees are entitled to purchase up to £1,500 worth of NAB shares each year. Participants contribute each month and the trustee uses the contributions to purchase shares on market which are then held in trust for the participants. Participants are entitled to receive dividends and exercise voting rights in respect of these shares whilst they are members of the plan and there is no risk of forfeiture. In addition, up to £3,000 of free shares per employee may be gifted per annum through the plan.

During the year, under the UK National Share Incentive Plan, NAB gifted ordinary shares of A\$1,000 in total to each eligible employee based on Group performance in respect of the 2011 financial year. Any award of ordinary shares in respect of the financial year 2012 would be based on Group performance for 2012.

Equality of employment opportunities

It is the policy of the Group to promote equality of employment opportunities by giving full and fair consideration to applications from people with disabilities. If existing employees become disabled, every effort is made to retain them within the workforce wherever reasonable and practicable. The Group also endeavours to provide equal opportunities in the training, promotion and general career development of disabled employees.

The Group is authorised as a "two tick" symbol user by Jobcentre Plus. The disability symbol is a recognition given by Jobcentre Plus to employers who have agreed to take action to meet five commitments regarding the employment, retention, training and career development of disabled employees, and to continually review progress and improve on what they do. Employers who wish to become a symbol user have to evidence they can achieve those commitments in their application.

The introduction of a staff network group and membership of the Business Disability Forum provides an ongoing opportunity for progress by identifying and implementing improvements.

Charitable and political donations

The total amount given for charitable purposes by the Group during the year ended 30 September 2012 was £659,000 (2011: £816,000). The Group channels its charitable donations through the Yorkshire and Clydesdale Foundation, which was established during 2008. The Foundation has made donations to many charities, including £271,000 during the year to Help the Hospices, the Group's charity partner (2011: £265,000). During the past four years and together with staff led initiatives, over £2.4m has been raised and donated to Help the Hospices and 112 local hospices.

No political donations were made during the year (2011: £Nil).

Report of the Directors (continued)

Corporate governance

It is the Group's policy not to include all of the disclosures in respect of voluntary corporate governance Codes of Practice as it is a wholly owned subsidiary of NAB. The NAB Group's Annual Financial Report details the Corporate Governance framework applicable to the Group and its subsidiaries. These disclosures are made after consideration of authoritative pronouncements on Audit Committees and associated disclosures in Australia, the USA, and the UK. Remuneration policy is not the responsibility of the Board. The remuneration policy that applies to employees and Directors of the Group is decided at the NAB Group level.

Management of risk

The Group has a well established European Boards' Risk Committee for the consideration of risks (note 40). The membership is shown on the list of Directors on page 1 and the Committee meets at quarterly intervals. The NAB Group publishes an annual and half-yearly "Risk and Capital Report" which provides extensive and rigorous coverage of all aspects of risk considered relevant including the position in the UK.

Going concern

The Group's Directors have made an assessment of the Group's ability to continue as a going concern and are satisfied that the Group has the resources to continue in business for the foreseeable future.

The Group's use of the going concern basis for preparation of the accounts is discussed in note 1.

Events after the balance sheet date

On 5 October 2012, the Group successfully completed the transfer of the vast majority of its commercial real estate lending portfolio to NAB. Further detail is provided in notes 24 and 44.

Auditors

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

Directors' statement as to disclosure of information to the auditor

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

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

By order of the Board



Lorna McMillan
Joint Company Secretary
16 November 2012

Statement of Directors' responsibilities

The Directors are responsible for preparing the Directors' Report and the Financial Statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare Financial Statements for each financial year. Under that law the Directors have elected to prepare the Financial Statements in accordance with International Financial Reporting Standards (IFRSs) and applicable law. Under company law the Directors must not approve the Financial Statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and Bank and of the profit or loss of the Group and Bank for that period. In preparing these Financial Statements the Directors are required to:

- select suitable accounting policies in accordance with International Accounting Standard 8: Accounting Policies, Changes in Accounting Estimates and Errors and then apply them consistently;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the financial performance; and
- state that the Group and Bank have complied with IFRSs, subject to any material departures disclosed and explained in the Financial Statements.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Group and Bank's transactions and disclose with reasonable accuracy at any time the financial position of the Group and Bank and enable them to ensure that the Financial Statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Group and Bank and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.



Lorna McMillan
Joint Company Secretary
16 November 2012

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

We have audited the Financial Statements of Clydesdale Bank PLC for the year ended 30 September 2012 which comprise the Consolidated Income Statement, the Group and Bank Statements of Comprehensive Income, the Group and Bank Balance Sheets, the Group and Bank Statements of Changes in Equity, the Group and Bank Statements of Cash Flow and the related notes 1 to 44. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

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

Respective responsibilities of Directors and Auditor

As explained more fully in the Directors' Responsibilities Statement set out on page 19, the Directors are responsible for the preparation of the Financial Statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the Financial Statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the Financial Statements

An audit involves obtaining evidence about the amounts and disclosures in the Financial Statements sufficient to give reasonable assurance that the Financial Statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's and Bank's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the Financial Statements. In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited Financial Statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on Financial Statements

In our opinion:

- the Financial Statements give a true and fair view of the state of the Group and Bank's affairs as at 30 September 2012 and of the Group's loss for the year then ended;
- the Group and Bank's Financial Statements have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- the Group and Bank's Financial Statements have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial year for which the Financial Statements are prepared is consistent with the Financial Statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the Group and Bank, or returns adequate for our audit have not been received from branches not visited by us; or
- the Group and Bank's Financial Statements are not in agreement with the accounting records and returns; or
- certain disclosures of Directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

A handwritten signature in black ink, appearing to read 'Peter Wallace'.

Peter Wallace (Senior statutory auditor)
For and on behalf of Ernst & Young LLP
Statutory Auditor, London
16 November 2012

Notes:

1. The maintenance and integrity of the Clydesdale Bank plc web site 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 financial statements since they were initially presented on the web site.
2. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Consolidated financial statements

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Consolidated income statement for the year ended 30 September 2012

	Note	2012 £m	2011 £m
Interest income and similar income		1,461	1,425
Interest expense and similar charges		(592)	(442)
Net interest income	5	869	983
Gains less losses on financial instruments at fair value		(123)	(89)
Other operating income		251	157
Non interest income	6	128	68
Total operating income		997	1,051
Personnel expenses		(225)	(265)
Depreciation expense		(19)	(15)
Other operating expenses		(481)	(442)
Restructuring and Efficiency, quality and service initiatives		(149)	(11)
Total operating expenses before impairment losses	7	(874)	(733)
Operating profit before impairment losses		123	318
Impairment losses on credit exposures	16	(737)	(297)
(Loss)/profit on ordinary activities before tax		(614)	21
Analysed as:			
(Loss)/profit before tax, pension scheme reforms benefit, PPI redress expense, FSCS levy and Bank levy		(614)	144
Pension scheme reforms benefit	29	130	-
Payment Protection Insurance redress expense	27	(120)	(116)
Financial Services Compensation Scheme levy	33	(8)	(4)
Bank levy		(2)	(3)
(Loss)/profit on ordinary activities before tax		(614)	21
Tax credit/(expense)	8	144	(3)
(Loss)/profit for the year attributable to the equity holders of the parent		(470)	18

The notes on pages 29 to 112 form an integral part of these Financial Statements.

Statements of comprehensive income for the year ended 30 September 2012

	Note	Group		Bank	
		2012 £m	2011 £m	2012 £m	2011 £m
(Loss)/profit for the year		(470)	18	(406)	38
Other comprehensive (losses)/income					
<i>Change in asset revaluation reserve</i>					
Transfers to the income statement		(1)	-	(1)	-
Taxation thereon		-	-	-	-
		(1)	-	(1)	-
<i>Change in available for sale investments reserve</i>					
(Losses)/gains during the year		(1)	20	(1)	20
Transfers to the income statement		(4)	(5)	(2)	(6)
Taxation thereon		1	(5)	1	(5)
		(4)	10	(2)	9
<i>Change in cash flow hedge reserve</i>					
Gains/(losses) during the year		2	(23)	(4)	(41)
Transfers to the income statement		(1)	4	13	48
Taxation thereon		3	9	1	1
		4	(10)	10	8
Actuarial (losses)/gains on defined benefit pension plans	29	(344)	49	(344)	49
Taxation thereon		64	(27)	64	(27)
		(280)	22	(280)	22
Taxation on employee share compensation		-	(2)	-	(2)
Other comprehensive (losses)/income net of tax		(281)	20	(273)	37
Total comprehensive (losses)/income for the year net of tax		(751)	38	(679)	75
Attributable to equity holders of the parent		(751)	38	(679)	75

The notes on pages 29 to 112 form an integral part of these Financial Statements.

Balance sheets as at 30 September 2012

	Note	Group		Bank	
		2012 £m	2011 £m	2012 £m	2011 £m
Assets					
Cash and balances with central banks	10	7,923	6,022	7,923	6,022
Due from related entities	11	1,256	4,950	5,782	9,803
Due from other banks		14	12	13	12
Investments – available for sale	12	1,039	1,110	1,039	1,109
– held to maturity	12	-	-	709	701
Other financial assets at fair value	13	2,791	4,846	2,791	4,846
Derivative financial instruments	14	600	1,018	600	1,009
Loans and advances to customers	15	24,346	28,238	19,704	23,585
Due from customers on acceptances		7	7	7	7
Current tax assets		55	14	70	40
Property, plant and equipment	18	128	151	128	151
Investment properties	19	77	81	77	78
Property inventory	20	9	27	7	11
Investments in controlled entities and associates	21	3	3	613	637
Deferred tax assets	22	249	112	244	106
Other assets	23	499	661	499	646
Assets held for sale	24	5,225	-	5,225	-
Total assets		44,221	47,252	45,431	48,763
Liabilities					
Due to other banks	25	557	1,507	557	1,507
Other financial liabilities at fair value	13	147	155	147	155
Derivative financial instruments	14	952	931	881	1,174
Due to customers	26	26,381	28,170	26,381	28,279
Liabilities on acceptances		7	7	7	7
Provisions	27	292	108	290	108
Due to related entities	11	7,527	7,758	11,008	10,480
Bonds, notes and subordinated debt	28	3,163	3,553	1,084	2,108
Retirement benefit obligations	29	306	185	306	185
Deferred tax liabilities	22	21	32	20	29
Other liabilities	30	2,122	1,967	2,118	2,038
Liabilities associated with assets held for sale	24	142	-	142	-
Total liabilities		41,617	44,373	42,941	46,070
Equity (parent entity interest)					
Share capital	31	1,742	1,242	1,742	1,242
Share premium	32	243	243	243	243
Other reserves	32	480	490	481	483
Retained earnings	32	139	904	24	725
Total equity		2,604	2,879	2,490	2,693
Total liabilities and equity		44,221	47,252	45,431	48,763

The notes on pages 29 to 112 form an integral part of these Financial Statements.

These Financial Statements were approved by the Board of Directors on 16 November 2012 and were signed on its behalf by:



David Thorburn
Chief Executive Officer

Statements of changes in equity for the year ended 30 September 2012

Group	Note	Share capital £m	Share premium account £m	Merger reserve £m	Share option reserve £m	Asset revaluation reserve £m	Available for sale investments reserve £m	Cash flow hedge reserve £m	Retained earnings £m	Total equity £m
As at 1 October 2010		942	243	338	1	2	6	130	885	2,547
Profit for the year		-	-	-	-	-	-	-	18	18
Other comprehensive income/(losses)		-	-	-	(2)	-	10	(10)	22	20
Total Comprehensive income/(losses) for the year		-	-	-	(2)	-	10	(10)	40	38
Dividends paid – preference shares		-	-	-	-	-	-	-	(21)	(21)
Shares issued – ordinary	31	100	-	-	-	-	-	-	-	100
Shares issued – preference	31	200	-	-	-	-	-	-	-	200
Share options granted		-	-	-	15	-	-	-	-	15
As at 30 September 2011	31,32	1,242	243	338	14	2	16	120	904	2,879
Loss for the year		-	-	-	-	-	-	-	(470)	(470)
Other comprehensive income/(losses)		-	-	-	-	(1)	(4)	4	(280)	(281)
Total Comprehensive income/(losses) for the year		-	-	-	-	(1)	(4)	4	(750)	(751)
Dividends paid – preference shares	9	-	-	-	-	-	-	-	(15)	(15)
Shares issued – ordinary	31	500	-	-	-	-	-	-	-	500
Share options granted		-	-	-	11	-	-	-	-	11
Share options settled		-	-	-	(20)	-	-	-	-	(20)
As at 30 September 2012	31,32	1,742	243	338	5	1	12	124	139	2,604

The notes on pages 29 to 112 form an integral part of these Financial Statements.

**Statements of changes in equity (continued)
for the year ended 30 September 2012**

Bank	Note	Share capital £m	Share premium account £m	Merger reserve £m	Share option reserve £m	Asset revaluation reserve £m	Available for sale investments reserve £m	Cash flow hedge reserve £m	Retained earnings £m	Total equity £m
As at 1 October 2010		942	243	338	1	2	6	106	686	2,324
Profit for the year		-	-	-	-	-	-	-	38	38
Other comprehensive income/(losses)		-	-	-	(2)	-	9	8	22	37
Total Comprehensive income/(losses) for the year		-	-	-	(2)	-	9	8	60	75
Dividends paid – preference shares	9	-	-	-	-	-	-	-	(21)	(21)
Shares issued – ordinary	31	100	-	-	-	-	-	-	-	100
Shares issued – preference	31	200	-	-	-	-	-	-	-	200
Share options granted		-	-	-	15	-	-	-	-	15
As at 30 September 2011	31,32	1,242	243	338	14	2	15	114	725	2,693
Loss for the year		-	-	-	-	-	-	-	(406)	(406)
Other comprehensive income/(losses)		-	-	-	-	(1)	(2)	10	(280)	(273)
Total Comprehensive income/(losses) for the year		-	-	-	-	(1)	(2)	10	(686)	(679)
Dividends paid – preference shares	9	-	-	-	-	-	-	-	(15)	(15)
Shares issued – ordinary	31	500	-	-	-	-	-	-	-	500
Share options granted		-	-	-	11	-	-	-	-	11
Share options settled		-	-	-	(20)	-	-	-	-	(20)
As at 30 September 2012	31,32	1,742	243	338	5	1	13	124	24	2,490

The notes on pages 29 to 112 form an integral part of these Financial Statements.

Statements of cash flows for the year ended 30 September 2012

	Note	Group		Bank	
		2012 £m	2011 £m	2012 £m	2011 £m
Operating activities					
(Loss)/profit on ordinary activities before tax		(614)	21	(586)	-
<i>Adjustments for:</i>					
Non cash or non operating items included in loss before tax	34	(136)	(630)	(137)	(560)
Changes in operating assets	34	463	(1,304)	409	(2,204)
Changes in operating liabilities	34	(2,172)	32	(2,573)	875
Interest received		1,563	1,649	1,531	1,640
Interest paid		(451)	(553)	(556)	(825)
Tax received /(paid)		4	(13)	51	58
Net cash (used in) operating activities		(1,343)	(798)	(1,861)	(1,016)
Cash flows from investing activities					
Dividends received		-	-	167	137
Interest received		12	25	13	25
Proceeds from sale or maturity of investments		71	1,174	206	1,173
Return of subsidiary company capital		-	-	24	-
Proceeds from sale of tangible fixed assets *		38	33	28	9
Purchase of tangible fixed assets *		(13)	(41)	(15)	(105)
Purchase of held to maturity investments**		-	-	(144)	(289)
Investment in joint ventures		-	(1)	-	-
Net cash provided by investing activities		108	1,190	279	950
Cash flows from financing activities					
Interest received		13	22	19	51
Interest paid		(229)	(141)	(238)	(132)
Proceeds from ordinary shares issued	31	500	100	500	100
Proceeds from preference shares issued	31	-	200	-	200
Redemption of subordinated debt	28	(200)	(250)	(200)	(250)
Maturity of medium term notes	28	(1,898)	(350)	(1,898)	(350)
Other movements in bonds and notes		(936)	(256)	(22)	(19)
Issuance of residential mortgage backed securities and covered bonds	28	2,644	-	1,096	-
Net decrease/(increase) in amount due from related entities		3,694	(2,111)	4,021	(2,026)
Net increase in amounts due to related entities		(233)	4,368	527	4,465
Dividends paid		(15)	(21)	(15)	(21)
Net cash provided by financing activities		3,340	1,561	3,790	2,018
Net increase in cash and cash equivalents		2,105	1,953	2,208	1,952
Cash and cash equivalents at the beginning of the year		5,844	3,891	5,834	3,882
Cash and cash equivalents at the end of the year	34	7,949	5,844	8,042	5,834

The notes on pages 29 to 112 form an integral part of these Financial Statements.

* Tangible fixed assets include property, plant and equipment, investment properties and property inventory.

** The prior year comparative figure for Bank has been restated to conform to current year presentation.

Notes to the consolidated financial statements

1. Basis of preparation

Reporting entity

The Bank is incorporated in the UK and registered in Scotland. The consolidated Financial Statements comprise the Bank and its controlled entities (together the "Group"). The Group's principal controlled entities are listed in note 21.

The ultimate parent undertaking, and ultimate controlling party is NAB, a company incorporated in the State of Victoria, Australia. NAB also heads the largest group in which the results of the Group are consolidated. The smallest group in which the results of the Group are consolidated is that headed by the Group's immediate parent, NAGE, which is incorporated and registered in England and Wales.

Statement of compliance

The consolidated Financial Statements of the Group have been prepared in accordance with IFRS as adopted by the European Union (EU) as applied in accordance with the provisions of the Companies Act 2006. As permitted by section 408 of the Companies Act 2006, no income statement is presented for the Bank.

The consolidated Financial Statements of the Group for the year ended 30 September 2012 were authorised for issue by the Board of Directors on 16 November 2012.

Basis of measurement

The financial information has been prepared under the historical cost convention, as modified by the revaluation of land and buildings, investment properties, available-for-sale financial assets and certain other financial assets and liabilities at fair value through profit or loss and all derivative contracts.

Going concern

The Group's business activities, together with the factors likely to affect its future development, performance and position are set out in the Business Review. In addition, note 40 to the Financial Statements includes the Group's risk management objectives and note 41 to the Financial Statements includes the Group's objectives, policies and processes for managing its capital.

The Group's ultimate parent, NAB, provides funding to the Group in the ordinary course of business. As a consequence, the Directors have a reasonable expectation that the Bank and the Group have adequate resources to continue in operational existence for the foreseeable future and therefore believe that the Group is well placed to manage its business risks successfully despite the current uncertain economic outlook. Accordingly, they continue to adopt the going concern basis in preparing the consolidated Financial Statements.

Notes to the consolidated financial statements (continued)

2. Accounting policies

Basis of consolidation

Controlled entities are all entities (including special purpose entities ("SPEs")) over which the Group has the power to govern the financial and operating policies so as to obtain economic benefits from their activities. The Group sponsors the formation of SPEs, primarily for the purpose of facilitation of asset securitisation and covered bond transactions to accomplish certain narrow and well defined objectives. SPEs require consolidation in circumstances such as those where the Group in substance has control over them through access to the majority of the residual income or is exposed to the majority of the residual risk associated with the SPE.

Controlled entities are consolidated from the date on which control is established by the Bank until the date that control ceases. The purchase method of accounting is used to account for the acquisition of controlled entities. Balances and transactions between entities within the Group and any unrealised gains and losses arising from those transactions are eliminated in full upon consolidation. The consolidated Financial Statements have been prepared using uniform accounting policies and are based on the same accounting period as NAB.

Foreign currency

Functional and presentation currency

Items included in the Financial Statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the "functional currency"). The consolidated Financial Statements are presented in pounds sterling (GBP), which is the Group's functional and presentation currency, rounded to the nearest million pounds (£m) unless otherwise stated.

Transactions and balances

Initially, at the date of a foreign currency transaction, the Group records an asset, liability, expense or revenue arising from a transaction using the end of day spot exchange rate between the functional and foreign currency on the transaction date.

Subsequently, at each reporting date, the Group translates foreign currency monetary items at the closing rate. Foreign exchange differences arising on translation or settlement of monetary items are recognised in the income statement during the year in which the gains or losses arise. Foreign currency non-monetary items measured at historical cost are translated at the date of the transaction. Foreign currency non-monetary items measured at fair value will be translated at the date when the fair value is determined. Foreign exchange differences are recognised directly in equity for non-monetary items where any component of associated gains or losses is recognised directly in equity. Foreign exchange differences arising from non-monetary items, whereby any portion of associated gains or losses is recognised in the income statement, are also recognised in the income statement.

Fair value measurement

Fair value is defined as the amount for which an asset could be exchanged or a liability transferred, between willing parties in an arm's length transaction.

When available, the Group measures the fair value of an instrument using quoted prices in an active market for that instrument. A market is regarded as active if quoted prices are readily and regularly available and represent actual and regularly occurring market transactions on an arm's length basis. Assets are measured at a bid price, liabilities are measured at an asking price.

Notes to the consolidated financial statements (continued)

2. Accounting policies (continued)

Fair value measurement (continued)

Where no such active market exists for the particular asset or liability, the Group uses a valuation technique to arrive at the fair value, including the use of transaction prices obtained in recent arm's length transactions where possible, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants. In doing so, fair value is estimated using a valuation technique that makes maximum possible use of market inputs and that places minimal possible reliance upon entity-specific inputs.

The best evidence of the fair value of a financial instrument at initial recognition is the transaction price (i.e. the fair value of the consideration given or received) unless the fair value of that instrument is evidenced by comparison with other observable current market transactions in the same instrument (i.e. without modification or repackaging) or based on a valuation technique whose variables include only data from observable markets. When such evidence exists, the Group recognises profits or losses on day one.

The carrying value of financial assets at fair value through profit or loss reflects the credit risk attributable to the counterparty. Changes in the credit profile of the counterparty are reflected in the fair value of the asset and recognised in the income statement.

Assets and liabilities classified as held for sale

On 30 April 2012, the Group announced its intention to transfer the vast majority of its commercial property assets to NAB.

IFRS requires that groups of assets and liabilities are classified as held for sale when:

- their carrying amounts will be recovered principally through sale;
- they are available for sale in their present condition; and
- their sale is highly probable.

Accordingly, the Group has reclassified certain of its assets and liabilities on this basis (note 24). These assets and liabilities are being transferred at their carrying value and also fall within the scope of IAS 39 and as such continue to be measured in accordance with that Standard.

Income earned and expenses incurred on assets and liabilities classified as held for sale continue to be recognised in the appropriate line items in the income statement until the transaction is complete.

Items classified as fair value through profit or loss

Purchases and sales of financial assets classified within fair value through profit or loss are recognised on trade date, being the date that the Group is committed to purchase or sell a financial asset.

Financial assets held for trading

A financial asset is classified as held for trading if it is acquired principally for the purpose of selling in the near term, or forms part of a portfolio of financial instruments that are managed together and for which there is evidence of short-term profit taking, or it is a derivative not in a qualifying hedge relationship.

Notes to the consolidated financial statements (continued)

2. Accounting policies (continued)

Items classified as fair value through profit or loss (continued)

Financial instruments designated at fair value through profit or loss

Upon initial recognition, financial assets may be designated as held at fair value through profit or loss. Financial assets classified as fair value through profit or loss are initially recognised at fair value, with transaction costs being recognised in the income statement immediately. Subsequently, they are measured at fair value with gains and losses recognised in the income statement as they arise.

Restrictions are placed on the use of the designated fair value option and the classification can only be used in the following circumstances:

- if a host contract contains one or more embedded derivatives, the Group may designate the entire contract as being held at fair value;
- designating the instruments will eliminate or significantly reduce measurement or recognition inconsistencies (i.e. eliminate an accounting mismatch) that would otherwise arise from measuring assets or liabilities on a different basis; or
- assets and liabilities are both managed and their performance is evaluated on a fair value basis in accordance with documented risk management and investment strategies.

Derivative financial instruments and hedge accounting

All derivatives are recognised on the balance sheet at fair value on trade date and are classified as trading except where they are designated as part of an effective hedge relationship. The carrying value of a derivative is measured at fair value throughout the life of the contract. Derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative.

The method of recognising the resulting fair value gain or loss on a derivative depends on whether the derivative is designated as a hedging instrument and, if so, the nature of the item being hedged. The Group designates certain derivatives as either hedges of the fair value of recognised assets or liabilities or firm commitments (a fair value hedge); or hedges of highly probable future cash flows attributable to a recognised asset or liability, or a highly probable forecast transaction (a cash flow hedge). Hedge accounting is used for derivatives designated in this way provided certain criteria are met.

The Group makes use of derivative instruments to manage exposures to interest rates and foreign currency, including exposures arising from forecast transactions and firm commitments. In order to manage particular risks, the Group applies hedge accounting for transactions which meet the specified criteria.

The Group documents, at the inception of a transaction, the relationship between hedging instruments and the hedged items, and the Group's risk management objective and strategy for undertaking these hedge transactions. The Group documents how effectiveness will be measured throughout the life of the hedge relationship and its assessment, both at hedge inception and on an on-going basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items. A hedge is expected to be highly effective if the changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated are expected to offset in a range of 80% to 125%.

Fair value hedge

The carrying value of the hedged item on initial designation is adjusted for the fair value attributable to the hedged risk. Subsequent to initial designation, changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the income statement, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. The movement in the fair value of the hedged item attributable to the hedged risk is made as an adjustment to the carrying value of the hedged asset or liability. Where the hedged item is derecognised from the balance sheet, the adjustment to the carrying amount of the asset or liability is immediately transferred to the income statement.

Notes to the consolidated financial statements (continued)

2. Accounting policies (continued)

Derivative financial instruments and hedge accounting (continued)

Fair value hedge (continued)

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of a hedged item is amortised to the income statement on an effective yield basis over the remaining period of the original hedge relationship.

Cash flow hedge

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges are recognised in equity, while the gain or loss relating to the ineffective portion is recognised immediately in the income statement. The carrying value of the hedged item is not adjusted.

Amounts accumulated in equity are transferred to the income statement in the year in which the hedged item will affect profit or loss.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised when the forecast transaction is ultimately recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the income statement.

Derivatives that do not qualify for hedge accounting

Certain derivative instruments do not qualify for hedge accounting. This could occur for two reasons:

- the derivative is held for purposes of short-term profit taking; or
- the derivative is held to economically hedge an exposure but does not meet the accounting criteria for hedge accounting.

In both these cases, the derivative is classified as a trading derivative and changes in the value of the derivative are immediately taken to the income statement.

Certain derivatives embedded in financial instruments are treated as separate derivatives when their economic characteristics and risks are not clearly and closely related to those of the host contract and the host contract is not carried at fair value. These embedded derivatives are separately measured at fair value with changes in fair value recognised in the income statement.

Available for sale investments

Available for sale investments are non-derivative financial assets that are designated as available for sale and are not categorised into any of the categories of (i) fair value through profit or loss (ii) loans and receivables or (iii) held to maturity.

Consistent with financial assets classified as fair value through profit or loss the Group applies trade date accounting to purchases and sales of available for sale investments.

Available for sale investments are initially recognised at fair value including direct and incremental transaction costs. They are subsequently held at fair value. Gains and losses arising from changes in fair value are included as a separate component of equity until sale or impairment when the cumulative gain or loss is transferred to the income statement.

Interest income is determined using the effective interest method. Impairment losses and translation differences on monetary items are recognised in the income statement within the year in which they arise. Available for sale investments are derecognised when the rights to receive cash flows have expired or the Group has transferred substantially all the risks and rewards of ownership. Available for sale investments consist primarily of debt securities and an immaterial investment in equity securities.

Notes to the consolidated financial statements (continued)

2. Accounting policies (continued)

Held to maturity financial assets

Held to maturity investments are non derivative financial assets with fixed or determinable payments that the Group has the intention and ability to hold to maturity. Held to maturity assets are initially recognised at fair value and subsequently recorded at amortised cost using the effective interest method.

Loans and advances

Loans and advances are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and which are not classified as available for sale or designated at fair value through profit or loss. They arise when the Group provides money or services directly to a customer with no intention of trading the loan. Loans and advances include overdrafts, credit card lending, market rate advances, bill financing, mortgages, lease finance and term lending.

Loans and advances are initially recognised at fair value including direct and incremental transaction costs. They are subsequently recorded at amortised cost, using the effective interest method, adjusted for impairment losses and unearned income. They are derecognised when the rights to receive cash flows have expired or the Group has transferred substantially all the risks and rewards of ownership.

As noted above, in certain limited circumstances the Group applies the fair value measurement option to financial assets. This option is applied to loans and advances where there is an embedded derivative within the loan contract and the Group has entered into a derivative to offset the risk introduced by the embedded derivative. The loan is designated as being carried at fair value through profit or loss to offset the movements in the fair value of the derivative within the income statement. When this option is applied the asset is included within other financial assets at fair value, and not within loans and advances. When a loan is held at fair value, a statistical-based calculation is used to estimate expected losses attributable to adverse movements in credit risk on the assets held. This adjustment to the credit quality of the asset is then applied to the carrying amount of the loan to arrive at fair value.

Repurchase and reverse repurchase agreements

Securities sold subject to repurchase agreements (“repos”) are retained in their respective balance sheet categories. The counterparty liability is included in amounts due to other banks, deposits from banks, other deposits or deposits due to customers, as appropriate based upon the counterparty to the transaction.

Securities purchased under agreements to resell (“reverse repos”) are accounted for as collateralised loans. The difference between the sale and repurchase price is treated as interest and accrued over the life of the agreements using the effective interest method. Such amounts are normally classified as deposits with other banks or cash and cash equivalents. Securities lent to counterparties are also retained in the Financial Statements. Securities borrowed are not recognised in the Financial Statements unless they are sold to third parties in which case the purchase and sale are recorded with the gain or loss included in trading income. The obligation to return securities borrowed is recorded at fair value as a trading liability.

Impairment of financial assets other than fair value loans

The Group assesses at each balance sheet date whether there is evidence that a financial asset or a portfolio of financial assets that is not carried at fair value through profit or loss is impaired. A financial asset or portfolio of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more loss events that occurred after the initial recognition of the asset and prior to the balance sheet date (“a loss event”), and that loss event or events has had an impact on the estimated future cash flows of the financial asset or the portfolio that can be reliably estimated.

Notes to the consolidated financial statements (continued)

2. Accounting policies (continued)

Impairment of financial assets other than fair value loans (continued)

The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

For loans and advances and held to maturity investments, the amount of impairment loss is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows discounted at the asset's original effective interest rate. The amount of the loss is recognised using an allowance account and the amount of the loss is included in the income statement.

The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure and any costs for obtaining and selling the collateral, whether or not foreclosure is probable.

For the purposes of a collective evaluation of impairment, financial assets are grouped on the basis of similar risk characteristics, taking into account asset type, industry, geographical location, collateral type, past-due status and other relevant factors. These characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the counterparty's ability to pay all amounts due according to the contractual terms of the assets being evaluated.

Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets in the group and historical loss experience for assets with credit risk characteristics similar to those in the group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not currently exist. In addition, the Group uses its experienced judgement to estimate the amount of an impairment loss. This incorporates amounts calculated to overcome model deficiencies and systemic risks where appropriate and supported by historic loss experience data. The use of such judgements and reasonable estimates is considered by management to be an essential part of the process.

The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

Following impairment, interest income is recognised using the original effective rate of interest which was used to discount the future cash flows for the purpose of measuring the impairment loss.

When a loan is uncollectible, it is written off against the related provision. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off reduce the amount of the expense in the income statement.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognised in the income statement.

If the originally contracted terms of loans and advances are amended, the amounts are classified as restructured. Such accounts accrue interest as long as the loan performs in accordance with the restructured terms.

Notes to the consolidated financial statements (continued)

2. Accounting policies (continued)

Impairment of financial assets other than fair value loans (continued)

Equity and debt instruments

In the case of equity instruments classified as available for sale, the Group seeks evidence of a significant or prolonged decline in the fair value of the security below its cost to determine whether impairment exists. Where such evidence exists, the cumulative net loss that has been previously recognised directly in equity is removed from equity and recognised in the income statement.

Reversals of impairment of equity shares classified as available for sale are not recognised in the income statement. Increases in the fair value of equity shares classified as available for sale after impairment are recognised directly in equity.

In the case of debt instruments classified as available for sale, impairment is assessed based on the same criteria as all other financial assets. Reversals of impairment of debt securities classified as available for sale are recognised in the income statement.

Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition. This includes: cash and liquid assets, amounts due from other banks (to the extent less than 90 days) and short-term government securities (which have the same characteristics as cash).

Investments in controlled entities and associates

The Group's investments in controlled entities and associates are valued at cost or valuation less any provision for impairment. Such investments are reviewed annually for impairment, or more frequently when there are indications that impairment may have occurred. Losses relating to impairment in the value of shares in controlled entities and associates are recognised in the income statement.

Property, plant and equipment

All freehold and long-term leasehold land and buildings are revalued annually on an open market basis by the Directors to reflect current market values, based on advice received from independent valuers. In addition, full independent valuations are carried out on a three year cycle on an open market basis, including directly attributable acquisition costs but without deducting expected selling costs. For properties that are vacant, valuations are carried out on an open market basis. Revaluation increments are credited to the asset revaluation reserve, unless these reverse deficits on revaluations charged to the income statement in prior years. To the extent that they reverse previous revaluation gains, revaluation losses are charged against the asset revaluation reserve. This policy is applied to assets individually. Revaluation increases and decreases are not offset, even within a class of assets, unless they relate to the same asset.

All other items of property, plant and equipment are carried at cost, less accumulated depreciation and impairment losses. Historical cost includes expenditure that is directly attributable to acquisition.

Property, plant and equipment carrying amounts are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount. The recoverable amount is the higher of (i) the asset's fair value less costs to sell and (ii) the asset's value in use.

Where a group of assets working together supports the generation of cash inflows largely independent of cash inflows from other assets or groups of assets, the recoverable amount is assessed in relation to that group of assets (a cash-generating unit).

Notes to the consolidated financial statements (continued)

2. Accounting policies (continued)

Property, plant and equipment (continued)

With the exception of freehold land, all items of property, plant and equipment are depreciated or amortised using the straight-line method, at rates appropriate to their estimated useful life to the Group. For major classes of property, plant and equipment, the annual rates of depreciation or amortisation are:

- buildings - 2%;
- leases (leasehold improvements) - the lower of the expected lease term and the assets useful life; and
- motor vehicles, fixtures and equipment - 10% to 33.33%.

Assets residual values and useful lives are reviewed, and adjusted if appropriate, at each reporting date.

Gains or losses on the disposal of property, plant and equipment, which are determined as the difference between the net sale proceeds and the carrying amount at the time of sale are included in the income statement.

Any realised amounts in the asset revaluation reserve are transferred directly to retained earnings.

Investment properties

Investment property is property (land or building, or part of a building, or both) held by the owner or by the lessee under a finance lease to earn rentals or for capital appreciation or both, rather than for:

- use in the production or supply of goods or services or for administrative purposes; or
- sale in the ordinary course of business.

Investment property assets are carried at fair value, with fair value increments and decrements taken to the income statement in the period in which they arise. Investment property assets are revalued annually by Directors to reflect fair values. Directors' valuations are based on advice received from independent valuers. Such valuations are performed on an open market basis being the amounts for which the assets could be exchanged between a knowledgeable, willing buyer and a knowledgeable willing seller in an arm's length transaction at the valuation date. Newly acquired investment property assets are held at cost (i.e. equivalent to fair value due to their recent acquisition) until the time of the next annual review, a period not exceeding twelve months.

Property inventory

Property acquired or being constructed for sale in the ordinary course of business, rather than to be held for rental or capital appreciation, is held as inventory and is measured at the lower of cost and net realisable value.

Leases

The determination of whether an arrangement is, or contains, a lease is based on the substance of the arrangement and requires an assessment of whether:

- fulfilment of the arrangement is dependent on the use of a specific asset or assets; and
- the arrangement conveys a right to use the asset.

As lessee

The leases entered into by the Group as lessee are primarily operating leases. Operating lease rentals are charged to the income statement on a straight-line basis over the period of the lease.

When an operating lease is terminated before the end of the lease period, any payment made to the lessor by way of penalty is recognised as an expense in the period of termination.

Notes to the consolidated financial statements (continued)

2. Accounting policies (continued)

Leases (continued)

As lessee (continued)

Sale and leaseback transactions entered into by the Group as lessee are primarily operating leases. Where an operating lease is established at fair value, any excess of sales proceeds over the carrying amount is recognised immediately in the income statement.

As lessor

Leases entered into by the Group as lessor, where the Group transfers substantially all the risks and rewards of ownership to the lessee, are classified as finance leases. The net investment in the lease, which is comprised of the present value of the lease payments including any guaranteed residual value and initial direct costs, is recognised as a receivable. The difference between the gross receivable and the present value of the receivable is unearned income. Income is recognised over the term of the lease using the net investment method (before tax) reflecting a constant periodic rate of return.

Assets under operating leases are included within property, plant and equipment at cost and depreciated over the useful life of the lease after taking into account anticipated residual values. Operating lease rental income is recognised within other operating income in the income statement on a straight line basis over the life of the lease. Depreciation is recognised within depreciation expense in the income statement consistent with the nature of the asset (refer to note 18, property plant and equipment).

Financial liabilities

Financial liabilities comprise items such as due to other banks, due to customers, liabilities on acceptances, trading liabilities and deposits and other borrowings.

Financial liabilities may be held at fair value through profit or loss or at amortised cost. Items held at fair value through profit or loss comprise both items held for trading and items specifically designated as fair value through profit or loss at initial recognition.

Financial liabilities held at fair value through profit or loss are initially recognised at fair value with transaction costs being recognised immediately in the income statement. Subsequently they are measured at fair value and any gains and losses are recognised in the income statement as they arise.

Liabilities may be designated as fair value through profit or loss if they meet the following criteria:

- designating instruments will eliminate or significantly reduce measurement or recognition inconsistencies (eliminate an accounting mismatch) that would otherwise arise from measuring assets or liabilities on a different basis; or
- if a host contract contains one or more embedded derivatives the Group may designate the entire contract as being held at fair value; or
- assets and liabilities are both arranged and their performance evaluated on a fair value basis in accordance with documented risk management and investment strategies.

A financial liability is classified as held-for-trading if it is incurred principally for the purpose of selling in the near term, or forms part of a portfolio of financial instruments that are managed together and for which there is evidence of short-term profit taking, or it is a derivative not in a qualifying hedge relationship.

All other financial liabilities are measured at amortised cost using the effective interest method. A financial liability is derecognised from the balance sheet when the Group has discharged its obligation, the contract is cancelled or expires.

Notes to the consolidated financial statements (continued)

2. Accounting policies (continued)

Provisions

Provisions are recognised when a legal or constructive obligation exists as a result of past events, it is probable that an outflow of economic benefits will be necessary to settle the obligation, and the obligation can be reliably estimated. Provisions are not discounted to the present value of their expected net future cash flows except where the time value of money is considered material.

Contingent liabilities

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

Dividends on ordinary and preference shares

Dividends on ordinary and preference shares classified as equity instruments are recognised as a liability and deducted from equity when they are approved by the Bank's Directors. Interim dividends are deducted from equity when they are declared and no longer at the discretion of the Bank.

Dividends for the year that are approved after the balance sheet date are disclosed as an event after the balance sheet date.

Financial guarantees

The Group provides guarantees in the normal course of business on behalf of its customers. Guarantees written are conditional commitments issued by the Group to guarantee the performance of a customer to a third party. Guarantees are primarily issued to support direct financial obligations such as commercial bills or other debt instruments issued by a counterparty. It is the rating of the Group as a guarantee provider that enhances the marketability of the paper issued by the counterparty in these circumstances.

The financial guarantee contract is initially recorded at fair value which is equal to the premium received, unless there is evidence to the contrary. Subsequently, the Group records and measures the financial guarantee contract at the higher of:

- where it is likely the Group will incur a loss as a result of issuing the contract, a liability is recognised for the estimated amount of the loss payable; and
- the amount initially recognised less, when appropriate, amortisation of the fee which is recognised over the life of the guarantee.

Pension and post retirement costs

Employees of the Group are entitled to benefits on retirement, disability or death from the Group's pension plans. The Group operates both defined benefit and defined contribution pension schemes.

Defined contribution pension scheme

The defined contribution scheme receives fixed contributions from Group companies and the Group's obligation for contributions to these plans is recognised as an expense in the income statement as incurred. Prepaid contributions are recognised as an asset to the extent that a cash refund or a reduction in the future payment is available.

Notes to the consolidated financial statements (continued)

2. Accounting policies (continued)

Pension and post retirement costs (continued)

Defined benefit pension scheme

The defined benefit scheme provides defined benefits based on years of service and career averaged revalued earnings. A liability or asset in respect of the defined benefit scheme is recognised in the balance sheet. The present value of the defined benefit obligation for the scheme is discounted by high quality corporate bond rates that have maturity dates approximating to the terms of the Group's defined benefit obligation.

Pension expense attributable to the Group's defined benefit scheme comprises current service cost, interest cost, expected return on plan assets, curtailment gains and past service cost. The Group's policy where actuarial gains and losses arise as a result of actual experience is to fully recognise such amounts directly in retained earnings through the statement of comprehensive income.

The Group also provides post retirement health care for certain retired employees. The calculation of the post retirement health care liability is calculated in the same manner as the defined benefit pension obligation.

Securitisation

Through its loan securitisation programme, the Group packages and sells loans (principally housing mortgage loans) as securities to investors through a securitisation vehicle. All such financial instruments continue to be held on the Group balance sheet, and a liability recognised for the proceeds of the funding transaction as the Group retains substantially all the risks and rewards.

Preference shares

Preference shares are classified as an equity instrument if and only if both of the following conditions are met:

- The instrument includes no contractual obligation:
 - to deliver cash or another financial asset to another entity; or
 - to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the issuer.
- If the instrument will or may be settled in the issuer's own equity instruments and it is:
 - a non-derivative that includes no contractual obligation for the issuer to deliver a variable number of its own equity instruments; or
 - a derivative that will be settled only by the issuer exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instruments. For this purpose the issuer's own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the issuer's own equity instruments.

Where preference shares do not satisfy the above conditions, then they are classified as a financial liability. The Bank's preference shares currently issued meet the criteria for classification as equity.

Income tax

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

Income tax expense or revenue is the tax payable (or receivable) on the current year's taxable income based on the applicable tax rate adjusted by changes in deferred tax assets and liabilities.

Notes to the consolidated financial statements (continued)

2. Accounting policies (continued)

Income tax (continued)

Current tax

Current tax is the expected tax payable (or recoverable) on the taxable income for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax

Deferred tax assets and liabilities are recognised on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated Financial Statements. Deferred tax is determined using tax rates and laws that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred tax asset is realised or the deferred tax liability is settled.

Deferred tax assets are only recognised for temporary differences, unused tax losses and unused tax credits if it is probable that future taxable amounts will arise to utilise those temporary differences and losses.

Deferred tax liabilities are not recognised for temporary differences arising from investments in subsidiaries and associates where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the difference will not reverse in the foreseeable future. Deferred tax assets are not recognised for temporary differences arising from investments in subsidiaries and associates where it is probable that the difference will not reverse in the foreseeable future, and it is not probable that taxable profit will be available against which the temporary difference can be utilised.

The effects of income taxes arising from asset revaluation adjustments are recognised directly in the asset revaluation reserve where relevant.

Deferred tax assets and liabilities related to fair value re-measurement of cash flow hedges, which are charged or credited directly to equity, are also credited or charged directly to equity. The tax associated with these transactions will be recognised in the income statement at the same time as the underlying transaction.

Subordinated liability and related entity balances

Subordinated liabilities and related entity balances are recorded at amortised cost. Subordinated liabilities comprise undated and dated loan capital which is provided to the Bank by NAGE and NAB. Subordinated liabilities are included within amounts due to related entities on the balance sheet.

Debt issues

Debt issues are short and long term debt issued by the Group including commercial paper, notes, term loans, medium term notes and residential mortgage backed securities. Debt issues are typically recorded at amortised cost using the effective interest method. Premiums, discounts and associated issue expenses are recognised using the effective interest method through the income statement from the date of issue to accrete the carrying value of securities to redemption values by maturity date. Interest is charged to the income statement using the effective interest method.

Where debt issues are classified as held at fair value through profit or loss they are initially recognised at fair value with transaction costs being recognised immediately in the income statement. Subsequently, they are measured at fair value and any gains or losses are recognised in the income statement as they arise.

Notes to the consolidated financial statements (continued)

2. Accounting policies (continued)

Equity

Share option reserve

The share option reserve records the outstanding balance payable to NAB for equity benefits provided to employees and Directors as part of their remuneration including deferred tax.

Cash flow hedge reserve

The cash flow hedge reserve records the effective portion of the fair value revaluation of derivatives designated as cash flow hedging instruments.

Offsetting financial instruments

A financial asset and a financial liability shall be offset and the net amount presented in the balance sheet if, and only if, the Bank has a legally enforceable right to set off the recognised amounts and it intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

Net interest income

Interest income is reflected in the income statement using the effective interest method.

The effective interest method is a method of calculating amortisation using the effective interest rate of a financial asset or financial liability. The effective interest rate is the rate that exactly discounts the estimated stream of future cash payments or receipts over the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or liability.

When calculating the effective interest rate, the cash flows are estimated considering all contractual terms of the financial instrument (e.g. prepayment, call and similar options) excluding future credit losses.

The calculation of the effective interest rate includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs, and all other premiums or discounts. Where it is not possible to estimate reliably the cash flows or the expected life of a financial instrument (or group of financial instruments), the contractual cash flows over the full contractual term of the financial instrument (or group of financial instruments) are used.

Loan origination and commitment fees are recognised as revenue within the effective interest rate calculation. When the non-utilisation of a commitment fee occurs, this is taken as revenue upon expiry of the agreed commitment period. Loan related administration and service fees are recognised as revenue over the period of service.

Direct loan origination costs are netted against loan origination fees and the net amount recognised as revenue over the life of the loan as an adjustment of yield. All other loan related costs are expensed as incurred.

Fees and commissions

Unless included in the effective interest calculation, fees and commissions are recognised on an accruals basis when the service has been provided. Fees and commissions not integral to the effective interest rate arising from services provided to customers and third parties are recognised once the service has been provided.

Notes to the consolidated financial statements (continued)

2. Accounting policies (continued)

Gains less losses on financial instruments at fair value through profit or loss (continued)

Gains less losses on financial instruments at fair value through profit or loss comprises fair value gains and losses from three distinct activities:

- trading financial instruments;
- hedging assets, liabilities and derivatives designated in hedge relationships; and
- financial assets and liabilities designated at fair value through profit or loss.

Trading financial instruments recognises fair value movements on all trading financial instruments. For trading derivatives, a full fair value is determined inclusive of interest income and expense arising on those derivatives.

Hedging assets, liabilities and derivatives designated in hedge relationships result in the recognition of fair value movements on both the hedged item and hedging derivative in a fair value hedge relationship, and hedge ineffectiveness for both fair value and cash flow hedge relationships.

Financial instruments designated at fair value through profit or loss recognise fair value movements (excluding interest) on those items designated as fair value through profit or loss at inception.

Interest income and interest expense on hedging assets, liabilities and derivatives and financial assets and liabilities designated as fair value through profit or loss at initial recognition are recognised in net interest income.

Equity based compensation

The Group engages in share-based payment transactions in respect of services received from certain of its employees and to provide long term incentives. The fair value of the services received is measured by reference to the fair value of the NAB shares or share options granted, on the date of the grant. This is recognised as an expense in the income statement over the relevant vesting period and results in an increase in the share option reserve which is reduced on repayment to the ultimate parent company.

The grant date fair value of shares is generally determined by reference to the weighted average price of the NAB shares in the week up to, and including, the date on which the shares are granted. Employee share plans are linked to internal performance, market performance and/or service conditions. The fair value of shares with a market performance condition is determined using a Monte Carlo simulation. The grant date fair value of the performance options and performance rights is determined using a simulated version of the Black-Scholes model. The key assumptions and inputs used in the valuation model are the exercise price of the performance options or performance rights, the expected volatility of the share price, the risk-free interest rate and the expected dividend yield on the shares for the life of the performance options and performance rights. The simulation takes into account both the probability of achieving market performance conditions and the potential for early exercise of vested performance options or performance rights.

While market performance conditions are incorporated into the grant date fair values, non-market conditions are not taken into account when determining the fair value and expected time to vesting of shares, performance options and performance rights. Instead, non-market conditions are taken into account by adjusting the number of shares, performance options and performance rights included in the measurement of the expense so that the amount recognised in the income statement reflects the number of shares, performance options or performance rights that actually vest.

Accounting developments

The following Standards and amendments have been adopted in the current financial year. None of these Standards or amendments have had a material impact on the Group's Financial Statements.

- *Revision to IAS 24 Related Party Disclosures*, issued 4 November 2009 and effective for financial years beginning on or after 1 January 2011. The revision provided clarification of the definition of related parties to enhance consistency; it also introduced a partial exemption for government related entities.

Notes to the consolidated financial statements (continued)

2. Accounting policies (continued)

Accounting developments (continued)

- *Amendment to IFRIC 14 Prepayment of a Minimum Funding Requirement*, issued 26 November 2009 and effective for financial years beginning on or after 1 January 2011. The amendment permits early payments of minimum funding requirements into defined benefit pension schemes to be treated as an asset.
- *Amendment to IFRS 7 Financial Instruments: Disclosures*, issued 7 October 2010 and effective for financial years beginning on or after 1 July 2011. The amendment sets out enhanced disclosure requirements around transfers of financial assets.
- *Improvements to IFRSs 2010*, issued 6 May 2010 and effective for financial years beginning on or after 1 January 2011. This sets out minor amendments to IFRS Standards as part of the IASB's annual improvement process.

The following amendments are relevant to the Group and were available for adoption in the European Union, but are not mandatory and have not been applied by the Group in the 30 September 2012 reporting year:

- *Amendments to IAS 1*, issued 16 June 2011 and effective for financial years beginning on or after 1 July 2012. The amendment sets out enhanced presentation requirements of items of other comprehensive income.
- *Amendments to IAS 19*, issued 16 June 2011 and effective for financial years beginning on or after 1 January 2013. The amendment sets out enhanced disclosures around post-employment benefit plans and removes the option to defer the recognition of gains and losses on these. The Group currently recognises all gains and losses on post-employment benefit plans as they arise.

The following Standards, revisions and amendments are relevant to the Group but were not available for adoption in the European Union and have not been applied by the Group in the 30 September 2012 reporting year:

- *IFRS 9 Financial Instruments*, issued 12 November 2009, amended 16 December 2011 and effective for financial years beginning on or after 1 January 2015. The new Standard will gradually replace IAS 39: Financial Instruments: Recognition and Measurement. IFRS 9 requires financial assets to be classified at either amortised cost, fair value through profit or loss (FVTPL) or fair value through other comprehensive income (FVTOCI) thus removing the available for sale category, which is currently used by the Group. There are however certain similarities between available for sale and the new FVTOCI category. IFRS 9 retains IAS 39's treatment of financial liabilities except for fair value movements due to own credit risk, which would be recognised in other comprehensive income. IFRS 9 will also provide guidance on other areas such as impairments and hedge accounting. The impact of IFRS 9 is likely to be material to the Group and while a detailed assessment has commenced, the final results of this remain uncertain and will remain so until the standard's changing scope has ultimately been resolved.
- *IFRS 10 Consolidated Financial Statements, IFRS 11 Joint Arrangements, IFRS 12 Disclosure of Interests in Other Entities*, issued 12 May 2011 and effective for financial years beginning on or after 1 January 2013 (with the application date for EU entities being financial years beginning on or after 1 January 2014). The Group will look to early adopt these standards to align with the ultimate parent company provided the Standards are adopted by the EU. These are part of a suite of Standards covering the amended accounting requirements for consolidations and joint arrangements and their related disclosures. The impact of these Standards is not considered to be material to the Group.
- *IFRS 13 Fair Value Measurement*, issued 12 May 2011 and effective for financial years beginning on or after 1 January 2013. The standard brings together the measurement and disclosures for fair values under the one standard. The standard does not alter the requirements for what should be fair valued but does require some enhanced disclosures. The impact of this Standard is not considered to be material to the Group.
- *Amendments to IAS 12 Income Taxes*, issued 20 December 2010 and effective for financial years beginning on or after 1 January 2012. This amendment enhances the methodology for measuring the effect of deferred tax relating to the recovery of an entity's investment property assets. The impact of this Amendment is not considered to be material to the Group.
- *Amendments to IFRS 7 Financial Instruments: Disclosures*, issued 16 December 2011 and effective for financial years beginning on or after 1 January 2013. This amendment places further disclosure requirements on netting arrangements of financial assets and liabilities. The impact of this Amendment is not considered to be material to the Group.

Notes to the consolidated financial statements (continued)

2. Accounting policies (continued)

Accounting developments (continued)

- *Amendments to IAS 32 Financial Instruments: Presentation*, issued 16 December 2011 and effective for financial years beginning on or after 1 January 2014. This amendment provides clarification on the criteria that already exist for offsetting. The impact of this Amendment is not considered to be material to the Group.
- *Improvements to IFRSs 2009 – 2011 cycle*, issued 17 May 2012 and effective for financial years beginning on or after 1 January 2013. As part of the IASB's annual improvement process, this makes numerous non-essential changes to accounting standards which are necessary to maintain the overall integrity of Financial Statements. The impact of these Improvements is not considered to be material to the Group.

3. Critical accounting estimates and judgements

The preparation of Financial Statements requires the use of certain critical accounting estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and the disclosed amount of contingent liabilities. Assumptions made at each balance sheet date are based on best estimates at that date. Although the Group has internal control systems in place to ensure that estimates can be reliably measured, actual amounts may differ from those estimates. The most significant use of judgements and estimates are as follows:

Equity based compensation

The Group's ultimate parent, NAB, grants shares and share options to the Group's employees as a part of employee remuneration which is recharged to the Group. IFRS 2 requires recognition of an expense for those shares and share options at the fair value on the grant date. For shares granted to employees, the fair value is measured directly at the market price of NAB Group's shares, adjusted to take into account the terms and conditions upon which the shares were granted. For share options granted to employees, the fair value of the equity instruments granted is estimated using a valuation technique consistent with generally accepted valuation methodologies. Further details are given in note 36.

Fair value of financial instruments

Where the fair values of financial assets and financial liabilities recorded on the balance sheet cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The inputs to these models are derived from observable market data where possible, but where observable market data is not available, judgement is required to establish fair values. The judgements include considerations of liquidity and model inputs such as volatility for longer dated derivatives and discount rates, prepayment rates and default rate assumptions for asset backed securities. The most significant judgement is in relation to the Group's fair value loan portfolio.

The most significant inputs impacting the carrying value of the loans other than interest rates are future expectations of credit losses and the expected repayment profile of the loans. If the loans were to be repaid six months earlier than currently predicted the value would decline by £9m. Similarly, if the level of prepayment is less than expected the loan value would increase by up to £51m. If lifetime expected losses were 20% greater than predicted, the carrying value of the loans would decrease by £14m, and vice versa. There are inter-dependencies between several of the key assumptions which add to the complexity of the judgements the Group has to make and which mean that no single factor is likely to move independent of others; however, the sensitivities disclosed above assume all other assumptions remain unchanged.

The valuation of these financial instruments is described in more detail in note 13.

Notes to the consolidated financial statements (continued)

3. Critical accounting estimates and judgements (continued)

Impairment losses on loans and advances (continued)

The Group reviews its individually significant loans and advances at each balance sheet date to assess whether an impairment loss should be recorded in the income statement. In particular, judgement by management is required in the estimation of the amount and timing of future cash flows when determining the impairment loss. In estimating these cash flows, the Group makes judgements about the borrower's financial situation and the net realisable value of collateral. These estimates are based on assumptions about a number of factors and actual results may differ, resulting in future changes to the impairment allowance.

Loans and advances that have been assessed individually and found not to be impaired and all not individually significant loans and advances are then assessed collectively, in groups of assets with similar risk characteristics, to determine whether provision should be made due to incurred loss events for which there is objective evidence but whose effects are not yet evident. The collective assessment takes account of data from the loan portfolio (such as credit quality, levels of arrears, credit utilisation, loan to collateral ratios etc.), concentrations of risk and economic data (including levels of unemployment, real estate prices indices, country risk and the performance of different individual groups). To the extent that recovery rates improve from those presently used within each of the Group's provisioning models by 5%, the impairment provision on loans and advances would decrease by £14m. Alternatively, if recovery rates deteriorate by 5%, the impairment provision on loans and advances would increase by £24m.

The impairment loss on loans and advances is disclosed in more detail in note 16.

Payment Protection Insurance redress provision

The Group held a provision for this matter of £108m at 30 September 2012 (2011: £102m). Significant judgement by management is required in determining the assumptions used to estimate the quantum of the provision, including the level of complaint volumes, uphold rates and redress costs. The provision is therefore subject to inherent uncertainties as a result of the subjective nature of the assumptions used in quantifying the overall likely position at 30 September 2012. Consequently, the provision calculated at 30 September 2012 may be subject to change in future years as a result of the emergence of new trends in relation to the judgements and assumptions which differ to those currently used. The most significant of the individual assumptions are the level of complaints and average pay-out per complaint. If the number of complaints were to be 5% higher or lower than that originally estimated, the provision would have increased / decreased by approximately £3m. If the average redress cost was to be 5% higher or lower than that originally estimated, the provision would have increased / decreased by approximately £4m. There are inter-dependencies between several of the key assumptions which add to the complexity of the judgements the Group has to make and which mean that no single factor is likely to move independent of others; however, the sensitivities disclosed above assume all other assumptions remain unchanged.

Retirement benefit obligations

The cost of the defined benefit pension plan is determined using an actuarial valuation. The actuarial valuation involves making assumptions about discount rates, expected rates of return on assets, future salary increases, mortality rates and future pension increases. Due to the long term nature of these plans, such estimates are subject to significant uncertainty. Refer to note 29 for the assumptions used.

Notes to the consolidated financial statements (continued)

4. Segment information

The Group's operating and reportable segments are operating units engaged in providing different products or services and whose operating results are regularly reviewed by the entity's chief operating decision maker.

The Group's business is organised into two principal operating segments: Business and Private Banking (including business centres and small business customers) and Retail Banking. Business and Private Banking, Retail Banking and Central Functions together represent UK Banking. The Group's central functions are Finance, Risk, Operations & IT, Legal, CEO Office Support, Funding and Treasury, Human Resources, and other functions which are not considered to be separate reportable operating segments.

Business and Private Banking

The Business and Private Banking operating segment provides a range of banking products and services including loans and finance, day to day banking, wealth management, international services, treasury solutions and corporate and structured finance.

All of the assets held for sale (note 24) are included within the Business and Private Banking segment at 30 September 2012.

Retail Banking

Retail Banking provides a range of banking products and services including current accounts, mortgages, overdrafts, personal loans, savings accounts, insurances and financial planning.

The Group evaluates each operating segment's performance on the basis of cash earnings. Cash earnings represents the net profit attributable to members of the Group, adjusted for certain non-cash items, primarily fair value adjustments and significant items that are one off or idiosyncratic in nature.

Revenues, expenses and tax directly associated with each operating segment are included in determining their result. Transactions between operating segments are based on agreed recharges between segments.

Segment revenue represents revenue directly attributable to a segment and a portion of the Banking Group's revenue that can be allocated to a segment on a reasonable basis. Segment revenue includes net interest income and other operating income, and includes transfer pricing adjustments to reflect inter-segment funding arrangements. Segment profit represents operating profit before unrealised fair value gains or losses on financial instruments and income or expenses which are one-off in nature or are not part of the Banking Group's core business operations. Lending assets and deposit liabilities represent additional key metrics that are regularly provided to the UK Executive Committee.

The segment information below has been prepared on the same basis. The accounting policies of the operating segments are consistent with those described in note 2.

Major Customers

Revenues from no one single customer amount to greater than 10% of the Group's revenues.

Geographical areas

The Group has no material operations outside the UK and therefore no secondary geographical area information is presented.

Notes to the consolidated financial statements (continued)

4. Segment information (continued)

Operating Segments 2012	Business and Private £m	Retail £m	Central and other functions £m	UK Banking £m
Net interest income	399	392	73	864
Other operating income	176	145	(40)	281
Net operating income	575	537	33	1,145
Operating expenses	(139)	(155)	(403)	(697)
Impairment losses on credit exposures	(629)	(35)	33	(631)
Segment operating (loss)/profit	(193)	347	(337)	(183)
Tax credit/(expense)	48	(86)	82	44
Segment cash earnings after tax	(145)	261	(255)	(139)
Average assets	20,080	12,736	12,815	45,631
Operating Segments 2011	Business and Private £m	Retail £m	Central and other functions £m	UK Banking £m
Net interest income	444	416	112	972
Other operating income	218	154	(85)	287
Net operating income	662	570	27	1,259
Operating expenses	(153)	(154)	(419)	(726)
Impairment losses on credit exposures	(254)	(42)	-	(296)
Segment operating profit/(loss)	255	374	(392)	237
Tax (expense)/credit	(66)	(97)	109	(54)
Segment cash earnings after tax	189	277	(283)	183
Average assets	21,004	11,316	12,626	44,946
Reconciliation between segment and statutory results 2012	UK Banking £m	Non-cash earnings items £m	Other segments and adjustments £m	Clydesdale Bank PLC £m
Net interest income	864	-	5	869
Other operating income	281	(79)	(74)	128
Net operating income	1,145	(79)	(69)	997
Operating expenses	(697)	(165)	(12)	(874)
Impairment losses on credit exposures	(631)	(150)	44	(737)
Operating loss	(183)	(394)	(37)	(614)
Tax credit	44	90	10	144
Cash earnings after tax	(139)	(304)	(27)	(470)
Items outside of UK Banking cash earnings after tax:				
Fair value and hedge ineffectiveness	(67)	67	-	-
Payment Protection Insurance redress	(92)	92	-	-
Impairment losses on credit exposures	(113)	113	-	-
Pension contribution from ultimate parent	98	(98)	-	-
Reorganisation and other costs	(130)	130	-	-
Loss after tax	(443)	-	(27)	(470)
Average assets	45,631	-	(425)	45,206

Notes to the consolidated financial statements (continued)

4. Segment information (continued)

Reconciliation between segment and statutory results 2011	UK Banking £m	Non-cash earnings items £m	Other segments and adjustments £m	Clydesdale Bank PLC £m
Net interest income	972	-	11	983
Other operating income	287	(209)	(10)	68
Net operating income	1,259	(209)	1	1,051
Operating expenses	(726)	-	(7)	(733)
Impairment losses on credit exposures	(296)	-	(1)	(297)
Operating profit/(loss)	237	(209)	(7)	21
Tax (expense)/credit	(54)	55	(4)	(3)
Cash earnings after tax	183	(154)	(11)	18
Items outside of UK Banking cash earnings after tax:				
Fair value and hedge ineffectiveness	(79)	79	-	-
Payment Protection Insurance redress	(75)	75	-	-
Profit/(loss) after tax	29	-	(11)	18
Average assets	44,946	-	(521)	44,425

In 2012, the fair value and hedge ineffectiveness, PPI redress and pension contribution from NAB are all adjusted against other operating income in order to reach the Clydesdale Bank PLC result. Reorganisation and other costs are adjusted against other operating expenses.

With effect from 1 October 2011 the small business channel was reclassified from Retail to Business and Private Banking, and third party introduced mortgages and the Clydesdale Bank International branch were re-pointed from Business and Private Banking to Retail. The prior year comparatives have been re-presented to show the impact on the comparative years.

Other segments and adjustments include deductions for the Wealth Management business and certain mid corporate lending on the NAB Group Wholesale Banking balance sheet, which are not part of the Group. Also included are adjustments to bring in the Wholesale Banking business written on the Group balance sheet which is not included within UK Banking and reallocations of income statement items for statutory purposes. Wholesale Banking by virtue of its size, is not considered a reportable segment for the purposes of this note.

In addition, as noted in the Strategic Review announcement dated 30 April 2012, there are adjustments outside of cash earnings which impact the Group's immediate parent NAGE.

NAB Group publishes segmental financial results of which UK Banking forms one segment. The segmentation is based on geographical lines, the exception being the Wholesale Banking business which is treated as a global business segment in its own right. Certain lines of the Wholesale Banking business are written on the Group balance sheet and this business is not included in the UK Banking results. The UK Wealth Management business, which operates through separate legal entities, is included in the UK Banking results but is not part of the Group.

The UK Banking division of NAB Group result excludes fair value and hedge ineffectiveness income and significant items in determining cash earnings.

Notes to the consolidated financial statements (continued)

5. Net interest income

	2012 £m	2011 £m
Interest income		
Loans and advances to other banks	27	19
Available for sale investments	13	25
Loans and advances to customers	1,271	1,238
Due from related entities (note 11)	14	22
Other interest income	7	2
	<u>1,332</u>	<u>1,306</u>
Financial assets at fair value through profit or loss	129	119
Total interest income	<u>1,461</u>	<u>1,425</u>
Interest expense		
Due to other banks	6	13
Financial liabilities at fair value through profit or loss	2	2
Due to customers	347	286
Bonds and notes	53	63
Due to related entities (note 11)	176	78
Other interest expense	8	-
Total interest expense	<u>592</u>	<u>442</u>
Net interest income	<u>869</u>	<u>983</u>

Included in interest income is income received from assets classified as held for sale.

6. Non interest income

	2012 £m	2011 £m
Gains less losses on financial instruments at fair value		
Movement in fair value of assets	(121)	(109)
Interest rate derivatives	(12)	9
Foreign exchange derivatives	21	21
Ineffectiveness arising from cash flow hedges (note 14)	1	(4)
Ineffectiveness arising from fair value hedges (note 14)	(12)	(6)
	<u>(123)</u>	<u>(89)</u>
Other operating income		
Fees and commission	106	139
Net fair value movement on investment properties	(7)	1
Gain on disposal of tangible fixed assets*	10	2
Other income	142	15
	<u>251</u>	<u>157</u>
Total non interest income	<u>128</u>	<u>68</u>

Included in non interest income is income received from assets classified as held for sale.

Fees and commission income includes £5m (2011: £9m) in relation to financial instruments at fair value through profit or loss and is reported net of charges of £120m (2011: £116m) for Payment Protection Insurance redress costs. Other income includes a one-off contribution of £130m (2011: £Nil) to the defined benefit pension scheme from the parent company, NAB (note 29).

* Tangible fixed assets include property, plant and equipment, investment properties and property inventory.

Notes to the consolidated financial statements (continued)

6. Non interest income (continued)

The movement in the fair value of assets incorporates valuation movements for certain financial assets which are designated at inception as fair value through profit or loss. These assets are predominantly fixed interest rate loans which are individually hedged. They are fair valued with the movements in fair value taken through the income statement as part of non interest income. The fair value of the loan is derived from the future loan cash flows using appropriate discount rates and includes adjustments for credit risk and credit losses. This valuation technique is regularly reviewed to ensure that it captures the continued economic uncertainty and volatility being experienced.

As interest rates fall, the carrying value of the loan increases. Similarly, as interest rates increase, the carrying value of the loan decreases. To the extent that the fair value of the loan reflects movements in interest rates there will be an offsetting movement in the underlying derivative. Movements in the fair value of loans that relate to changes in the creditworthiness of the loan counterparty and the margin earned on the loan are not offset with a movement in the hedging derivative valuation. The difference in the fair value movement between the loan and derivative is the net present value of the credit margin.

7. Operating expenses

	2012 £m	2011 £m
Personnel expenses		
Salaries, wages and non cash benefits	164	192
Related personnel expenses	14	17
Defined contribution pension expense	10	10
Defined benefit pension expense (note 29)	19	24
Equity-based compensation	11	15
Other personnel expenses	7	7
	<u>225</u>	<u>265</u>
Depreciation expense		
Depreciation of property, plant and equipment (note 18)	19	15
Other operating expenses		
Operating lease rental	38	42
Other occupancy charges	41	41
Related entity recharges (note 11)	273	264
Other operating expenses	129	95
	<u>481</u>	<u>442</u>
Restructuring and Efficiency, quality and service initiatives		
Other personnel expenses	96	10
Other occupancy	32	-
Other expenses	21	1
	<u>149</u>	<u>11</u>
Total operating expenses	<u><u>874</u></u>	<u><u>733</u></u>

Other operating expenses include £2m (2011: £3m) in respect of the Bank levy.

Auditors' remuneration

	2012 £'000	2011 £'000
Included within other operating expenses:		
Audit of the Financial Statements	1,134	895
Other fees to auditors:		
Audit of the Group pension scheme	58	89
Local statutory audits for subsidiaries	200	150
Other assurance including regulatory compliance based work	262	30
	<u>1,654</u>	<u>1,164</u>

Notes to the consolidated financial statements (continued)

8. Taxation

	2012 £m	2011 £m
Current tax		
UK corporation tax		
Current year	(46)	3
Adjustment in respect of prior years	5	(4)
Other overseas taxation	3	10
	<u>(38)</u>	<u>9</u>
Deferred tax (note 22)		
Current year	(100)	(8)
Adjustment in respect of prior years	(6)	2
	<u>(106)</u>	<u>(6)</u>
Tax (credit)/expense	<u>(144)</u>	<u>3</u>

The tax assessed for the year differs from the standard rate of corporation tax in the UK (25%). A reconciliation from the expense implied by the standard rate to the actual tax expense is as follows:

	2012 £m	2011 £m
(Loss)/profit on ordinary activities before tax	<u>(614)</u>	<u>21</u>
Tax (credit)/expense based on the standard rate of Corporation Tax in the UK of 25% (September 2011: 27%)	<u>(154)</u>	<u>6</u>
<i>Effects of:</i>		
Expenses not deductible for tax purposes	5	2
Bank levy	1	1
Rate differences	3	(5)
Adjustments in respect of prior years	(1)	(2)
Other	2	1
Actual tax (credit)/expense for the year	<u>(144)</u>	<u>3</u>

9. Dividends paid

	2012 £m	2011 £m
Preference dividends paid – 12% per annum payable semi-annually (6p per share)	6	12
Preference dividends paid – 6 month LIBOR plus a margin of 779bps per annum payable semi-annually (4.5p per share)	9	9
	<u>15</u>	<u>21</u>

Notes to the consolidated financial statements (continued)

10. Cash and balances with central banks

	Group		Bank	
	2012 £m	2011 £m	2012 £m	2011 £m
Cash assets	1,123	951	1,123	951
Balances with central banks	6,800	5,071	6,800	5,071
	<u>7,923</u>	<u>6,022</u>	<u>7,923</u>	<u>6,022</u>
Less mandatory deposits with central banks	(31)	(29)	(31)	(29)
Included in cash and cash equivalents (note 34)	<u>7,892</u>	<u>5,993</u>	<u>7,892</u>	<u>5,993</u>

Mandatory deposits are not available for use in the Group or Bank's day to day business and are non-interest bearing.

11. Related party transactions

During the year there have been transactions between the Group, its ultimate parent, controlled entities of the ultimate parent, controlled entities of the Group, and other related parties.

The Group provides a range of services to related parties, including the provision of banking facilities and standby financing arrangements. Other dealings include granting loans and accepting deposits, and the provision of finance, forward exchange and interest cover.

The Group receives a range of services from the parent and related parties, including loans and deposits, forward exchange and interest rate cover and various administrative services. Fees may be charged for these services.

The assets held for sale, as referred to in notes 24 and 44, have been sold to NAB subsequent to the year end.

Amounts due from related entities	Group		Bank	
	2012 £m	2011 £m	2012 £m	2011 £m
				As restated
Loans				
Ultimate parent	1,215	4,921	1,215	4,921
Controlled entities of the ultimate parent	-	-	4,526	4,853
	<u>1,215</u>	<u>4,921</u>	<u>5,741</u>	<u>9,774</u>
Other receivables				
Ultimate parent	34	13	34	13
Controlled entities of the ultimate parent	7	16	7	16
	<u>41</u>	<u>29</u>	<u>41</u>	<u>29</u>
Total amounts due from related entities	<u>1,256</u>	<u>4,950</u>	<u>5,782</u>	<u>9,803</u>
Interest income on the above amounts was as follows:				
Ultimate parent (note 5)	14	22	22	40
Controlled entities of the ultimate parent	-	-	40	57
	<u>14</u>	<u>22</u>	<u>62</u>	<u>97</u>

Comparative disclosures have been restated to conform with current year presentation.

Notes to the consolidated financial statements (continued)

11. Related party transactions (continued)

Reverse repurchase agreements

Included in amounts due from related entities is £Nil (2011: £4,284m) for securities purchased under agreements to resell. As part of these reverse repurchase agreements, the Group received securities that it is allowed to sell or re-pledge. The fair value of the securities accepted under these terms as at 30 September 2012 amounts to £Nil (2011: £4,343m) for the Group, of which £Nil (2011: £204m) has been sold or re-pledged to third parties in connection with financing activities or to comply with commitments under short sale transactions.

Amounts due to related entities	Group		Bank	
	2012 £m	2011 £m	2012 £m	2011 £m
Deposits				
Ultimate parent	6,392	6,606	6,392	6,606
Controlled entities of the Bank	-	-	3,481	2,722
	<u>6,392</u>	<u>6,606</u>	<u>9,873</u>	<u>9,328</u>
Subordinated liabilities				
Ultimate parent	550	550	550	550
Controlled entities of the ultimate parent	526	526	526	526
	<u>1,076</u>	<u>1,076</u>	<u>1,076</u>	<u>1,076</u>
Other payables				
Ultimate parent	20	21	20	21
Controlled entities of the ultimate parent	39	55	39	55
	<u>59</u>	<u>76</u>	<u>59</u>	<u>76</u>
Total amounts due to related entities	<u><u>7,527</u></u>	<u><u>7,758</u></u>	<u><u>11,008</u></u>	<u><u>10,480</u></u>
Interest expense on the above amounts was as follows (note 5):				
Ultimate parent	163	68	163	68
Controlled entities of the ultimate parent	13	10	13	10
Controlled entities of the Bank	-	-	61	82
	<u>176</u>	<u>78</u>	<u>237</u>	<u>160</u>

Subordinated liabilities

Subordinated liabilities comprises undated and dated loan capital which is provided to the Bank by NAGE and NAB. Interest on the loans is payable at rates related to the London Interbank Offered Rate ("LIBOR"). The undated loans are subject to five years and one day's notice of redemption by the lenders and are repayable at par. Early repayment is at the option of the borrower, subject to the prior consent of the Financial Services Authority. The loans are subordinated to the claims of other creditors and are unsecured. The loans are employed in the general business of the Bank.

Details of subordinated liabilities in excess of 10% of the total balance of the subordinated loans are disclosed below:

The rates of interest stated below apply at 30 September 2012:	2012 £m	2011 £m
6.40438% (2011: 6.55219%) 10 year, non-call with a final maturity of 15 February 2019	300	300
5.17900% (2011: 5.25281%) 10 year, non-call with a final maturity of 25 January 2021	250	250
	<u>550</u>	<u>550</u>
Other subordinated notes	526	526
Total subordinated liabilities	<u><u>1,076</u></u>	<u><u>1,076</u></u>

Securitisation

The Group has securitised part of its residential mortgage portfolio and the cash raised through the issue of residential mortgage backed securities ("RMBS") through special purpose entities forms part of the Group's medium term funding. A portfolio of Buy to Let mortgages has been securitised via the Lannraig Master Trust Issuer programme and a total of £474m (2011: £500m) of the securities issued have been purchased by the Group's ultimate parent.

Notes to the consolidated financial statements (continued)

11. Related party transactions (continued)

Other transactions with related entities

	Group		Bank	
	2012 £m	2011 £m	2012 £m	2011 £m
Non interest income received				
Controlled entities of the ultimate parent	<u>9</u>	<u>9</u>	<u>9</u>	<u>9</u>
Administrative expenses (note 7)				
Ultimate parent	8	8	8	8
Controlled entities of the ultimate parent	<u>265</u>	<u>256</u>	<u>263</u>	<u>254</u>
	<u>273</u>	<u>264</u>	<u>271</u>	<u>262</u>

Compensation of key management personnel (KMP)

For the purposes of IAS 24 "Related Party Disclosures" key management personnel comprise Directors of the Bank, members of the UK Executive Committee and FSA approved persons with a control function of 1 to 29.

Group	2012 £m	2011 £m
Salaries and other short-term benefits	11	13
Share based payments	3	4
	<u>14</u>	<u>17</u>

Directors' emoluments are analysed in note 37.

Transactions with key management personnel

KMPs, their close family members and any entities controlled or significantly influenced by the KMPs have undertaken the following transactions with the Group in the normal course of business. The transactions were made on the same terms and conditions as applicable to other Group employees, or on normal commercial terms.

Group	2012 £m	2011 £m
Loans and advances	<u>5</u>	<u>6</u>
Deposits	<u>1</u>	<u>4</u>

No provisions have been recognised in respect of loans provided to KMPs. There were no debts written off or forgiven during the year to 30 September 2012 (2011: £Nil). Included in the above are seven (2011: ten) loans totalling £1.6m (2011: £1.9m) made to Directors.

Other related party transactions

The Group incurred costs in relation to pension scheme administration. These costs, which amounted to £0.3m in the year ended 30 September 2012 (2011: £0.4m) were charged to the Group sponsored Scheme. The Group has deposits of £3.1m (2011: £2.8m) at the year end placed by the Scheme at market rates.

Pension contributions of £242m (2011: £107m) were made during the year to the Yorkshire and Clydesdale Bank Pension Scheme sponsored by the Bank (note 29).

Notes to the consolidated financial statements (continued)

11. Related party transactions (continued)

Other related party transactions (continued)

The following derivative positions are held with the ultimate parent:

	Group		Bank	
	2012 £m	2011 £m	2012 £m	2011 £m
Derivative financial assets (note 14)	<u>179</u>	<u>157</u>	<u>179</u>	<u>157</u>
Derivative financial liabilities (note 14)	<u>710</u>	<u>806</u>	<u>710</u>	<u>806</u>

12. Investments

	Group		Bank	
	2012 £m	2011 £m	2012 £m	2011 £m
Available for sale – listed	1,032	1,103	1,032	1,103
Available for sale – unlisted	<u>7</u>	<u>7</u>	<u>7</u>	<u>6</u>
	<u>1,039</u>	<u>1,110</u>	<u>1,039</u>	<u>1,109</u>
Held to maturity – listed	-	-	709	701
	<u>1,039</u>	<u>1,110</u>	<u>1,748</u>	<u>1,810</u>

Included in the available for sale (AFS) listed securities are £Nil (2011: £0.06bn) investments in other banks' debt securities, which are subject to a UK Government backed guarantee plus £0.8bn (2011: £0.9bn) in UK Government Gilts and £0.1bn (2011: £0.1bn) in other banks' debt securities.

The listed available for sale investments are classified as level 1 in the fair value hierarchy, with the unlisted available for sale investments classified as level 3 (see note 38).

Credit quality of investments

	Group		Bank	
	2012 £m	2011 £m	2012 £m	2011 £m
Available for sale				
Senior investment grade	1,032	1,103	1,032	1,103
Other	<u>7</u>	<u>7</u>	<u>7</u>	<u>6</u>
	<u>1,039</u>	<u>1,110</u>	<u>1,039</u>	<u>1,109</u>
Held to maturity				
Investment grade	-	-	218	542
Sub investment grade	<u>-</u>	<u>-</u>	<u>491</u>	<u>159</u>
	<u>-</u>	<u>-</u>	<u>709</u>	<u>701</u>

Notes to the consolidated financial statements (continued)

13. Other financial assets and liabilities at fair value

	Group		Bank	
	2012	2011	2012	2011
	£m	£m	£m	£m
Other financial assets at fair value through profit or loss				
Loans and advances	<u>2,791</u>	<u>4,846</u>	<u>2,791</u>	<u>4,846</u>
Not included in the above:				
Assets classified as held for sale (note 24)	<u>1,475</u>	<u>-</u>	<u>1,475</u>	<u>-</u>
Other financial liabilities at fair value through profit or loss				
Due to customers – term deposits	<u>147</u>	<u>155</u>	<u>147</u>	<u>155</u>

Derivatives which did not meet the requirements for hedge accounting and that are related to loans held at fair value through profit or loss are accounted for as derivative financial instruments (note 14).

Loans and advances at fair value

Included in other financial assets at fair value is a portfolio of loans which have embedded derivative characteristics. Interest rate risk associated with these loans is managed using interest rate derivative contracts, and the loans are recorded at fair value to avoid an accounting mismatch. The maximum credit exposure of the loans is £2,791m (2011: £4,846m). The cumulative reserves movement in the fair value of the loans attributable to changes in credit risk losses amounts to £82m (2011: £157m) and the change for the current year is a reduction of £75m (2011: increase of £26m), which incorporates an £86m reduction relating to the transfer into assets held for sale (see note 24).

The designated loans were historically classified as level 2 in the fair value hierarchy as their value was principally determined using directly observable inputs other than directly quoted prices. The expected changes in fair value of the designated loans attributable to credit risk are calculated using an established statistical based calculation to estimate expected losses attributable to adverse movements in credit risk. The Group ceased further sales of this suite of loan products with effect from 30 April 2012. This led to a reduction in the level of observable inputs resulting in the loans being reclassified at 30 September 2012 as level 3 in the fair value hierarchy (see note 38).

Due to customers - term deposits

Included in other financial liabilities at fair value are fixed rate deposits which have been hedged with interest rate derivative contracts with matching cash flows.

The change in fair value attributable to changes in the Bank credit risk is £Nil (2011: £Nil). The Bank is contractually obligated to pay £16m (2011: £17m) less than the carrying amount at maturity to the deposit holder.

The term deposits are classified as level 3 in the fair value hierarchy as their value is determined using valuation techniques where one or more significant inputs are unobservable (see note 38).

Notes to the consolidated financial statements (continued)

14. Derivative financial instruments

The Group uses derivatives for risk mitigation purposes and does not have a trading book. However, certain derivatives do not meet the hedging criteria within IAS 39 and are therefore accounted for as held for trading, though they are used for risk mitigation purposes. The tables below analyse derivatives between those held as hedging instruments and those that do not meet the hedging criteria within IAS 39.

	Group		Bank	
	2012 £m	2011 £m	2012 £m	2011 £m
Fair value of derivative financial assets				
Designated as hedging instruments	160	537	160	324
Designated as held for trading	261	324	261	528
Designated as held for trading – related entities (note 11)	179	157	179	157
	<u>600</u>	<u>1,018</u>	<u>600</u>	<u>1,009</u>
Not included in the above:				
Assets classified as held for sale (note 24)	<u>(4)</u>	<u>-</u>	<u>(4)</u>	<u>-</u>
Fair value of derivative financial liabilities				
Designated as hedging instruments	187	81	116	81
Designated as held for trading	55	44	55	287
Designated as held for trading – related entities (note 11)	710	806	710	806
	<u>952</u>	<u>931</u>	<u>881</u>	<u>1,174</u>
Not included in the above:				
Liabilities associated with assets held for sale (note 24)	<u>142</u>	<u>-</u>	<u>142</u>	<u>-</u>

The derivative financial instruments held by the Group are classified as level 2 in the fair value hierarchy as their value is determined using directly observable inputs other than directly quoted prices.

Group	Contract amount £m	Fair value of assets £m	Fair value of liabilities £m
Total derivative contracts as at 30 September 2012			
Derivatives designated as hedging instruments			
<i>Cash flow hedges</i>			
Interest rate swaps	8,970	160	2
<i>Fair value hedges</i>			
Interest rate swaps	1,458	-	133
Foreign exchange rate swaps	1,023	-	52
	<u>2,481</u>	<u>-</u>	<u>185</u>
Derivatives designated as held for trading			
<i>Foreign exchange rate related contracts</i>			
Spot, forward and futures contracts	3,785	43	48
Swaps	504	78	6
Options	542	6	6
	<u>4,831</u>	<u>127</u>	<u>60</u>
<i>Interest rate related contracts</i>			
Swaps	41,476	280	638
Swaptions	398	11	11
Options	1,350	20	54
	<u>43,224</u>	<u>311</u>	<u>703</u>
<i>Commodity related contracts</i>	75	2	2
Total derivative contracts	<u>59,581</u>	<u>600</u>	<u>952</u>

Notes to the consolidated financial statements (continued)

14. Derivative financial instruments (continued)

The contract amount is the amount from which the cash flows from the derivative contracts are derived and is not an indication of the amounts at risk relating to these contracts.

Certain derivative financial assets and liabilities have been booked in consolidated special purpose entities.

Derivative financial assets and liabilities held at fair value through profit or loss ("FVTPL") include the hedges for the Group securitisation programme, medium term note ("MTN") programmes and cash flow hedges.

The carrying value of the currency liabilities issued through securitisation and MTN programmes fluctuates as a result of foreign exchange movements. There is a corresponding movement in the value of the hedging derivative.

The carrying value of the cash flow hedge derivatives increases as LIBOR yield curves used to discount the future cash flows reduce.

Group	Contract amount	Fair value of assets	Fair value of liabilities
Total derivative contracts as at 30 September 2011	£m	£m	£m
Derivatives designated as hedging instruments			
<i>Cash flow hedges</i>			
Interest rate swaps	7,320	176	19
<i>Fair value hedges</i>			
Interest rate swaps	2,408	17	62
Foreign exchange rate swaps	1,167	344	-
	<u>3,575</u>	<u>361</u>	<u>62</u>
Derivatives designated as held for trading			
<i>Foreign exchange rate related contracts</i>			
Spot, forward and futures contracts	5,328	92	56
Swaps	563	86	1
Options	572	9	9
	<u>6,463</u>	<u>187</u>	<u>66</u>
<i>Interest rate related contracts</i>			
Swaps	32,924	268	719
Swaptions	539	12	13
Options	2,072	13	51
	<u>35,535</u>	<u>293</u>	<u>783</u>
<i>Commodity related contracts</i>	40	1	1
Total derivative contracts	<u><u>52,933</u></u>	<u><u>1,018</u></u>	<u><u>931</u></u>

Notes to the consolidated financial statements (continued)

14. Derivative financial instruments (continued)

Bank

Total derivative contracts as at 30 September 2012

	Contract amount £m	Fair value of assets £m	Fair value of liabilities £m
Derivatives designated as hedging instruments			
<i>Cash flow hedges</i>			
Interest rate swaps	8,970	160	2
<i>Fair value hedges</i>			
Interest rate swaps	758	-	114
Foreign exchange rate swaps	-	-	-
	<u>758</u>	<u>-</u>	<u>114</u>
Derivatives designated as held for trading			
<i>Foreign exchange rate related contracts</i>			
Spot, forward and futures contracts	3,785	43	48
Swaps	504	78	6
Options	542	6	6
	<u>4,831</u>	<u>127</u>	<u>60</u>
<i>Interest rate related contracts</i>			
Swaps	41,476	280	638
Swaptions	398	11	11
Options	1,350	20	54
	<u>43,224</u>	<u>311</u>	<u>703</u>
<i>Commodity related contracts</i>			
	75	2	2
Total derivative contracts	<u>57,858</u>	<u>600</u>	<u>881</u>

Bank

Total derivative contracts as at 30 September 2011

	Contract amount £m	Fair value of assets £m	Fair value of liabilities £m
Derivatives designated as hedging instruments			
<i>Cash flow hedges</i>			
Interest rate swaps	7,320	176	19
<i>Fair value hedges</i>			
Interest rate swaps	2,408	17	62
Foreign exchange rate swaps	387	101	-
	<u>2,795</u>	<u>118</u>	<u>62</u>
Derivatives designated as held for trading			
<i>Foreign exchange rate related contracts</i>			
Spot, forward and futures contracts	5,328	92	56
Swaps	564	329	244
Options	572	9	9
	<u>6,464</u>	<u>430</u>	<u>309</u>
<i>Interest rate related contracts</i>			
Swaps	32,423	259	719
Swaptions	539	12	13
Options	2,072	13	51
	<u>35,034</u>	<u>284</u>	<u>783</u>
<i>Commodity related contracts</i>			
	40	1	1
Total derivative contracts	<u>51,653</u>	<u>1,009</u>	<u>1,174</u>

Notes to the consolidated financial statements (continued)

14. Derivative financial instruments (continued)

The Group macro hedges its interest rate exposure using cash flow hedges. These are vanilla fixed rate interest rate swaps for which the Group has the following commitments in the time bands noted:

<i>Nominal values per time period</i>	2012 £m	2011 £m
0 to 6 months	2,810	2,795
6 to 12 months	995	1,440
1 to 2 years	2,145	800
2 to 5 years	3,020	2,285
	<u>8,970</u>	<u>7,320</u>

The Group has hedged the following forecast cash flows, which primarily vary with interest rates. These cash flows are expected to impact the income statement in the following periods, excluding any hedge adjustments that may be applied:

	Forecast receivable cash flows 2012 £m	Forecast payable cash flows 2012 £m	Forecast receivable cash flows 2011 £m	Forecast payable cash flows 2011 £m
within one year	-	132	6	143
between one and two years	-	80	-	78
between two and three years	-	45	-	54
between three and four years	-	17	-	32
between four and five years	-	5	-	8
	<u>-</u>	<u>279</u>	<u>6</u>	<u>315</u>

	2012 £m	2011 £m
Gain/(loss) from cash flow hedges recognised in income due to hedge ineffectiveness (note 6)	<u>1</u>	<u>(4)</u>

	2012 £m	2011 £m
<i>Gain/ (loss) arising from fair value hedges recognised in income (note 6)</i>		
Hedging instrument	(563)	(137)
Hedged item attributable to the hedged risk	551	131
	<u>(12)</u>	<u>(6)</u>

Notes to the consolidated financial statements (continued)

15. Loans and advances to customers

	Group		Bank	
	2012	2011	2012	2011
	£m	£m	£m	£m
Overdrafts	2,346	4,075	2,346	4,162
Credit cards	436	483	436	483
Lease finance	694	901	569	636
Mortgages	15,369	13,981	10,822	9,462
Other term lending – business	5,151	8,503	5,151	8,503
Other term lending – retail	730	858	730	858
Other lending	51	30	51	30
Gross loans and advances to customers	<u>24,777</u>	<u>28,831</u>	<u>20,105</u>	<u>24,134</u>
Unearned income	(78)	(150)	(67)	(129)
Deferred and unamortised fee income	(58)	(69)	(49)	(60)
Impairment provisions on credit exposures (note 16)	(295)	(374)	(285)	(360)
	<u>24,346</u>	<u>28,238</u>	<u>19,704</u>	<u>23,585</u>
Not included in the above:				
Assets classified as held for sale (note 24)	4,177	-	4,177	-
Impairment provisions on credit exposures in respect of assets held for sale (note 24)	(463)	-	(463)	-
	<u>3,714</u>	<u>-</u>	<u>3,714</u>	<u>-</u>

The Group and Bank has transferred £4,364m and £2,470m respectively (September 2011: £2,916m and £1,783m) of mortgages through securitisation arrangements that do not qualify for derecognition from the balance sheet (note 17). The mortgages do not qualify for derecognition because the Group and Bank remain exposed to the risks and rewards of ownership on an ongoing basis. Prior to any relevant hedging arrangements the Group and Bank continue to be exposed primarily to the credit risk, liquidity risk and interest rate risk of the mortgages. The Group and Bank are also exposed to the residual rewards of the mortgages as a result of their ability to benefit from the future performance of the mortgages through the receipt of deferred consideration. The carrying amount of the associated liabilities before transactional costs is £2,553m (2011: £1,939m).

Included within Group and Bank loans and advances to customers are £2,498m and £1,445m respectively (2011: £809m and £489m) of mortgages assigned to two bankruptcy remote special purpose entities, Clydesdale Covered Bonds LLP and Clydesdale Covered Bonds No 2 LLP (further information in note 17). These loans provide security for issues of covered bonds made by the Group. These transactions do not qualify for derecognition from the balance sheet. At 30 September 2012 there were £1,084m (September 2011: £Nil) of covered bonds in issue under the covered bond programmes.

Notes to the consolidated financial statements (continued)

15. Loans and advances to customers (continued)

Lease finance

The Group leases a variety of assets to third parties under operating and finance lease arrangements, including vehicles and general plant and machinery. The costs of assets acquired by the Group during the year for the purpose of letting under finance leases and hire purchase contracts amounted to £4m (2011: £24m) and £314m (2011: £480m) respectively. The total closing balances of finance leases and hire purchase contracts were £20m (2011: £38m) and £629m (2011: £802m) respectively.

Finance lease receivables

	Group	
	2012	2011
	£m	£m
Gross investment in finance lease receivables		
Due within one year	301	351
Due within one to five years	365	505
Due after more than five years	28	45
	<u>694</u>	<u>901</u>
Unearned income	(45)	(61)
Net investment in finance lease receivables	<u>649</u>	<u>840</u>

There are specific provisions of £5.8m (2011: £4.8m) in relation to finance lease receivables, with a collective provision of £0.6m (2011: £1.2m) as at 30 September 2012.

Maximum exposure to credit risk

The maximum exposure to credit risk is disclosed in note 39.

Distribution of loans and advances by credit quality

Group	Business lending		Retail lending	
	2012	2011	2012	2011
	£m	£m	£m	£m
Gross loans and advances:				
Neither past due nor impaired	7,677	12,245	16,070	14,988
Past due but not impaired	293	350	394	380
Impaired	272	797	71	71
	<u>8,242</u>	<u>13,392</u>	<u>16,535</u>	<u>15,439</u>
Bank				
	2012	2011	2012	2011
	£m	£m	£m	£m
Gross loans and advances:				
Neither past due nor impaired	7,577	12,189	11,721	10,552
Past due but not impaired	279	349	229	217
Impaired	261	793	38	34
	<u>8,117</u>	<u>13,331</u>	<u>11,988</u>	<u>10,803</u>

Notes to the consolidated financial statements (continued)

15. Loans and advances to customers (continued)

Distribution of loans and advances by credit quality (continued)

The distribution of loans and advances by credit quality is further analysed as follows:

Group							
As at 30 September 2012	Retail overdrafts	Credit cards	Lease finance	Mortgages	Business lending *	Other retail lending	Total
	£m	£m	£m	£m	£m	£m	£m
Gross loans and advances:							
Neither past due nor impaired	132	415	661	14,994	7,016	529	23,747
Past due but not impaired	12	21	19	304	274	57	687
Impaired	-	-	14	71	258	-	343
	144	436	694	15,369	7,548	586	24,777
Group							
As at 30 September 2011	Retail overdrafts	Credit cards	Lease finance	Mortgages	Business lending *	Other retail lending	Total
	£m	£m	£m	£m	£m	£m	£m
Gross loans and advances:							
Neither past due nor impaired	104	455	855	13,620	11,337	862	27,233
Past due but not impaired	13	28	28	300	335	26	730
Impaired	-	-	18	61	789	-	868
	117	483	901	13,981	12,461	888	28,831
Bank							
As at 30 September 2012	Retail overdrafts	Credit cards	Lease finance	Mortgages	Business lending *	Other retail lending	Total
	£m	£m	£m	£m	£m	£m	£m
Gross loans and advances:							
Neither past due nor impaired	132	415	560	10,645	7,017	529	19,298
Past due but not impaired	12	21	6	139	273	57	508
Impaired	-	-	3	38	258	-	299
	144	436	569	10,822	7,548	586	20,105
Bank							
As at 30 September 2011	Retail overdrafts	Credit cards	Lease finance	Mortgages	Business lending *	Other retail lending	Total
	£m	£m	£m	£m	£m	£m	£m
Gross loans and advances:							
Neither past due nor impaired	163	455	617	9,279	11,365	862	22,741
Past due but not impaired	13	28	14	150	335	26	566
Impaired	-	-	5	33	789	-	827
	176	483	636	9,462	12,489	888	24,134

* Business lending includes business overdrafts.

Credit quality of loans and advances

The Group has an internally developed credit rating system that uses data drawn from a number of sources to assess the potential risk in lending to the Group's customers. This system assigns an indication of the probability of default for each customer and can be broadly mapped to external agencies rating scales. Impaired assets consist of business lending and secured personal lending where current circumstances indicate that losses of loan principal and/or interest may be incurred.

Notes to the consolidated financial statements (continued)

15. Loans and advances to customers (continued)

Distribution of loans and advances neither past due nor impaired

The credit quality of the portfolio of loans and advances that were neither past due nor impaired can be assessed by reference to the Group's standard credit rating system. The credit rating system is supported by a variety of financial analytics, combined with processed market information to provide the main inputs for the measurement of counterparty risk. All internal risk ratings are tailored to the various categories of accounts and customer and are derived in accordance with the Group's ratings policy.

The table below presents the analysis of business lending credit quality of loans and advances that are neither past due nor impaired:

	Group		Bank	
	2012 £m	2011 £m	2012 £m	2011 £m
Senior investment grade	1,419	1,473	1,409	1,456
Investment grade	2,020	2,496	1,974	2,555
Sub-investment grade	4,238	8,276	4,194	8,178
	<u>7,677</u>	<u>12,245</u>	<u>7,577</u>	<u>12,189</u>

For the business lending analysis, investment grades are determined by the Customer Rating System (eCRS) as defined under the Credit Risk Management policy:

- senior investment grade is eCRS ratings 1 to 5;
- investment grade is eCRS ratings 6 to 11; and
- sub-investment grade is ratings 12 to 23.

The loan to value (LTV) of retail mortgage lending coupled with the relationship of the debt to customers income are key to the credit quality of the Group's mortgages. The table below sets out the indexed loan to value analysis of the Group's retail mortgages:

	2012 %	2011 %
Less than 50%	21	22
50% to 75%	40	36
76% to 80%	9	9
81% to 85%	7	7
86% to 90%	6	6
91% to 95%	5	6
96% to 100%	4	4
Greater than 100%	4	5
Unknown	4	5
	<u>100</u>	<u>100</u>

Notes to the consolidated financial statements (continued)

15. Loans and advances to customers (continued)

Loans and advances which were past due but not impaired

Loans and advances that are past due but are not impaired are classified as such for secured lending where the net current market value of supporting security is sufficient to cover all principal, interest and other amounts (including legal, enforcement, realisation costs etc.) due on the facility. The distribution of loans and advances that are past due but not impaired are analysed below:

Group 2012	Retail overdrafts £m	Credit cards £m	Lease finance £m	Mortgages £m	Business lending * £m	Other retail lending £m	Total £m
1 to 29 days past due	8	8	18	111	173	44	362
30 to 59 days past due	2	3	1	79	9	4	98
60 to 89 days past due	1	3	-	36	6	3	49
Past due 90 days and over	1	7	-	78	86	6	178
	<u>12</u>	<u>21</u>	<u>19</u>	<u>304</u>	<u>274</u>	<u>57</u>	<u>687</u>

Group 2011	Retail overdrafts £m	Credit cards £m	Lease finance £m	Mortgages £m	Business lending * £m	Other retail lending £m	Total £m
1 to 29 days past due	8	14	25	102	231	8	388
30 to 59 days past due	2	3	2	74	10	5	96
60 to 89 days past due	1	3	1	37	1	4	47
Past due 90 days and over	2	8	-	87	93	9	199
	<u>13</u>	<u>28</u>	<u>28</u>	<u>300</u>	<u>335</u>	<u>26</u>	<u>730</u>

Bank 2012	Retail overdrafts £m	Credit cards £m	Lease finance £m	Mortgages £m	Business lending * £m	Other retail lending £m	Total £m
1 to 29 days past due	8	8	5	43	172	44	280
30 to 59 days past due	2	3	1	38	9	4	57
60 to 89 days past due	1	3	-	19	6	3	32
Past due 90 days and over	1	7	-	39	86	6	139
	<u>12</u>	<u>21</u>	<u>6</u>	<u>139</u>	<u>273</u>	<u>57</u>	<u>508</u>

Bank 2011	Retail overdrafts £m	Credit cards £m	Lease finance £m	Mortgages £m	Business lending * £m	Other retail lending £m	Total £m
1 to 29 days past due	8	14	14	46	230	8	320
30 to 59 days past due	2	3	-	38	11	5	59
60 to 89 days past due	1	3	-	17	1	4	26
Past due 90 days and over	2	8	-	49	93	9	161
	<u>13</u>	<u>28</u>	<u>14</u>	<u>150</u>	<u>335</u>	<u>26</u>	<u>566</u>

* Business lending includes business overdrafts.

Notes to the consolidated financial statements (continued)

16. Impairment provisions on credit exposures

Group 2012	Business lending £m	Retail lending £m	Total £m
Opening balance	300	74	374
Charge for the year	698	39	737
Amounts written off	(314)	(68)	(382)
Recoveries of amounts written off in previous years	14	15	29
Transfer to assets held for sale (note 24)	(463)	-	(463)
Closing balance	235	60	295
Specific	112	14	126
Collective	123	46	169
	235	60	295
Not included in the above:			
Impairment provisions on credit exposures held for sale (note 24)	463	-	463
Specific	278	-	278
Collective	185	-	185
	463	-	463

Provisions are further analysed as follows:

Group 2012	Retail overdrafts £m	Credit cards £m	Lease finance £m	Mortgages £m	Business lending * £m	Other retail lending £m	Total £m
Opening balance	10	17	6	26	294	21	374
Charge for the year	7	13	7	10	691	9	737
Amounts written off	(10)	(22)	(6)	(14)	(308)	(22)	(382)
Recoveries of amounts written off in previous years	3	5	-	-	14	7	29
Transfer to assets held for sale (note 24)	-	-	-	-	(463)	-	(463)
Closing balance	10	13	7	22	228	15	295
Specific	-	-	6	14	106	-	126
Collective	10	13	1	8	122	15	169
	10	13	7	22	228	15	295

* Business lending includes business overdrafts.

Notes to the consolidated financial statements (continued)

16. Impairment provisions on credit exposures (continued)

Group 2011	Business lending £m	Retail lending £m	Total £m
Opening balance	282	80	362
Charge for the year	243	54	297
Amounts written off	(242)	(91)	(333)
Recoveries of amounts written off in previous years	17	31	48
Closing balance	<u>300</u>	<u>74</u>	<u>374</u>
Specific	112	19	131
Collective	188	55	243
	<u>300</u>	<u>74</u>	<u>374</u>
Bank 2012	Business lending £m	Retail lending £m	Total £m
Opening balance	296	64	360
Charge for the year	698	34	732
Amounts written off	(310)	(63)	(373)
Recoveries of amounts written off in previous years	14	15	29
Transfer to assets held for sale group (note 24)	(463)	-	(463)
Closing balance	<u>235</u>	<u>50</u>	<u>285</u>
Specific	112	8	120
Collective	123	42	165
	<u>235</u>	<u>50</u>	<u>285</u>
Impairment provisions on credit exposures held for sale (note 24)	<u>463</u>	<u>-</u>	<u>463</u>
Specific	278	-	278
Collective	185	-	185
	<u>463</u>	<u>-</u>	<u>463</u>

Provisions are further analysed as follows:

Bank 2012	Retail overdrafts £m	Credit cards £m	Lease finance £m	Mortgages £m	Business lending * £m	Other retail lending £m	Total £m
Opening balance	10	17	2	16	294	21	360
Charge for the year	7	13	7	5	691	9	732
Amounts written off	(10)	(22)	(2)	(9)	(308)	(22)	(373)
Recoveries of amounts written off in previous years	3	5	-	-	14	7	29
Transfer to assets held for sale (note 24)	-	-	-	-	(463)	-	(463)
Closing balance	<u>10</u>	<u>13</u>	<u>7</u>	<u>12</u>	<u>228</u>	<u>15</u>	<u>285</u>
Specific	-	-	6	8	106	-	120
Collective	10	13	1	4	122	15	165
	<u>10</u>	<u>13</u>	<u>7</u>	<u>12</u>	<u>228</u>	<u>15</u>	<u>285</u>

* Business lending includes business overdrafts.

Notes to the consolidated financial statements (continued)

16. Impairment provisions on credit exposures (continued)

Bank 2011	Business lending £m	Retail lending £m	Total £m
Opening balance	267	77	344
Charge for the year	239	47	286
Amounts written off	(226)	(91)	(317)
Recoveries of amounts written off in previous years	16	31	47
Closing balance	<u>296</u>	<u>64</u>	<u>360</u>
Specific	108	13	121
Collective	<u>188</u>	<u>51</u>	<u>239</u>
	<u>296</u>	<u>64</u>	<u>360</u>

	Group		Bank	
	2012 £m	2011 £m	2012 £m	2011 £m
Amounts included in				
Loans and advances to customers (note 15)	<u>295</u>	<u>374</u>	<u>285</u>	<u>360</u>
Non accrual loans				
Loans and advances to customers	343	868	299	827
Specific provisions	<u>(126)</u>	<u>(131)</u>	<u>(120)</u>	<u>(121)</u>
	<u>217</u>	<u>737</u>	<u>179</u>	<u>706</u>

17. Securitisations and covered bonds

Securitised advances are subject to non-recourse finance arrangements. These loans have been transferred at principal value to SPEs and have been funded through the issue of amortising mortgage backed securities to investors. The transfers do not meet the criteria for derecognition in IAS 39 as the Group has retained the risks and rewards of the assets. The Group consolidated Financial Statements include the results, assets and liabilities of the securitisation SPEs, on a line by line basis.

The balances of assets and liabilities in relation to securitisation notes in issue at 30 September 2012 within the Group and Bank balance sheets are as follows:

	Group		Bank	
	2012 £m	2011 £m	2012 £m	2011 £m
Assets				
Derivative financial assets	-	204	-	243
Loans and advances to customers (note 15)	4,364	2,916	2,470	1,783
Accrued interest receivable	28	14	16	8
Other assets	-	-	1,894	1,133
	<u>4,392</u>	<u>3,134</u>	<u>4,380</u>	<u>3,167</u>
Liabilities				
Derivative financial liabilities	52	-	-	243
Bonds and notes	2,079	1,439	-	-
Due to related entities (note 11)	474	500	2,523	1,704
Accrued interest payable	33	11	-	-
	<u>2,638</u>	<u>1,950</u>	<u>2,523</u>	<u>1,947</u>

At 30 September 2012, the SPEs had cash deposits with the Bank amounting to £Nil (2011: £67m). This balance is restricted in use to the repayment of the debt securities issued by the SPEs and other legal obligations.

Notes to the consolidated financial statements (continued)

17. Securitisations and covered bonds (continued)

The balances of assets and liabilities in relation to covered bonds notes in issue at 30 September 2012 within the Group and Bank balance sheets are as follows:

	Group		Bank	
	2012 £m	2011 £m	2012 £m	2011 £m
Assets				
Loans and advances to customers (note 15)	2,498	809	1,445	489
Accrued interest receivable	32	9	27	9
Other assets	-	-	1,052	319
	<u>2,530</u>	<u>818</u>	<u>2,524</u>	<u>818</u>
Liabilities				
Derivative financial liabilities	17	-	-	-
Bonds and notes	1,084	-	1,084	-
Accrued interest payable	25	-	25	-
	<u>1,126</u>	<u>-</u>	<u>1,109</u>	<u>-</u>

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

Group	2012		2011	
	Securitisation £m	Covered bonds £m	Securitisation £m	Covered bonds £m
Carrying amount of transferred assets	4,364	2,498	2,916	809
Carrying amount of associated liabilities	2,553	1,084	1,939	-

For those liabilities that have recourse only to the transferred assets:

Group	2012		2011	
	Securitisation £m	Covered bonds £m	Securitisation £m	Covered bonds £m
Fair value of transferred assets	4,364	-	2,916	-
Fair value of associated liabilities	2,553	-	1,939	-
	<u>1,811</u>	<u>-</u>	<u>977</u>	<u>-</u>

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

Securitisation

The loans do not qualify for derecognition because the Group and Bank remain exposed to the risks and rewards of ownership on an on-going basis. The Group and Bank continue to be exposed primarily to liquidity risk, interest rate risk and credit risk of the loans. The securitisation trusts are consolidated into the Group. The note holders have only recourse to the mortgage pool of assets.

Covered Bonds

The residential mortgages do not qualify for derecognition because the Group and Bank retain all of the risks and rewards associated with them and where derivatives have not been externalised, interest rate and foreign currency risks are held in the Group and Bank. The covered bonds SPEs are consolidated, the residual mortgages are retained on the Group and Bank balance sheets and the covered bonds issued are included within debt securities in issue. The covered bond holders have dual recourse to the Bank or the covered bond pool assets.

Notes to the consolidated financial statements (continued)

18. Property, plant and equipment

Group and Bank	Freehold land and buildings	Long-term Leasehold land and buildings	Short-term Leasehold land and buildings	Motor vehicles, fixtures and equipment	Total
	£m	£m	£m	£m	£m
Cost or valuation					
At 1 October 2010	36	3	141	139	319
Additions	-	-	11	5	16
Disposals	(1)	-	(14)	(35)	(50)
Transfers	(1)	1	-	-	-
At 30 September 2011	34	4	138	109	285
Additions	-	-	9	2	11
Disposals	(12)	-	(3)	(12)	(27)
On revaluation	(2)	(1)	-	-	(3)
At 30 September 2012	20	3	144	99	266
Accumulated depreciation					
At 1 October 2010	1	1	72	88	162
Charge for the year	-	1	7	7	15
Disposals	-	(1)	(11)	(31)	(43)
Transfers	-	(1)	1	-	-
At 30 September 2011	1	-	69	64	134
Charge for the year	-	-	11	8	19
Disposals	-	-	(2)	(13)	(15)
At 30 September 2012	1	-	78	59	138
Net book value					
At 30 September 2012	19	3	66	40	128
At 30 September 2011	33	4	69	45	151

Valuations

The Group's freehold and long-term leasehold land and buildings are carried at their fair value as determined by independent valuers and the Group's own Director valuations. Fair values are determined in accordance with guidance published by the Royal Institution of Chartered Surveyors. Valuations are performed annually in July. A comparison of the carrying value under the revaluation basis and if the historical cost basis had been used is shown below:

Group	2012 £m	2011 £m
Carrying value as included under the revaluation basis	22	37
Carrying value if the historical cost basis had been used	15	26

Notes to the consolidated financial statements (continued)

19. Investment properties

	Group		Bank	
	2012 £m	2011 £m	2012 £m	2011 £m
At 1 October	81	77	78	-
Additions	1	12	4	78
Disposals	(2)	(8)	(2)	-
Deficit on revaluation	(3)	-	(3)	-
	<u>77</u>	<u>81</u>	<u>77</u>	<u>78</u>

Investment properties are stated at fair value, which has been determined based on valuations performed by independent valuers and the Group's own Director valuations. The fair value represents the amount at which the assets could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's length transaction at the date of valuation, in accordance with International Valuation Standards.

During the year 99% (2011: 93%) of the investment properties generated total rental income of £3m (2011: £3m) and incurred operating expenses of £2m (2011: £2m). The operating expenses of the investment properties that did not generate rental income were £Nil (2011: £Nil).

On 25 September 2012, £3m (2011: £78m) of properties were transferred from St Vincent Investments Limited, a controlled entity, to the Bank.

20. Property inventory

	Group		Bank	
	2012 £m	2011 £m	2012 £m	2011 £m
At 1 October	27	31	11	-
Additions	1	12	-	11
Disposals	(14)	(16)	(4)	-
Write-down of property inventory	(5)	-	-	-
	<u>9</u>	<u>27</u>	<u>7</u>	<u>11</u>

Included within property inventory is property under construction of £2m (2011: £16m). The remaining property inventory is complete and available for sale.

Notes to the consolidated financial statements (continued)

21. Investments in controlled entities and associates

	Group		Bank	
	2012	2011	2012	2011
	£m	£m	£m	£m
At 30 September	3	3	613	637

The details of all subsidiary undertakings will be annexed to the next annual return of the Bank.

The Company's principal controlled entities are as follows:

Controlled entities as at 30 September 2012	Nature of business	Country of incorporation
Yorkshire Bank Home Loans Limited	Mortgage finance	England

The following companies are SPEs established in connection with the Group's securitisation and covered bond programmes (note 17). Although the Bank has no direct or indirect ownership interest in these entities, they are regarded as controlled entities as described in note 2 and are consolidated in the Group's Financial Statements.

Other controlled entities as at 30 September 2012	Nature of business	Country of incorporation
Clydesdale Covered Bonds LLP	Acquisition of mortgage loans	England
Clydesdale Covered Bonds No.2 LLP	Acquisition of mortgage loans	England
Lanark Trustees Limited	Mortgages trustee	Jersey
Lanark Funding Limited	Funding company	England
Lanark Master Issuer plc	Issuer of securitised notes	England
Lannraig Trustees Limited	Mortgages trustee	Jersey
Lannraig Funding Limited	Funding company	England
Lannraig Master Issuer plc	Issuer of securitised notes	England

All of the above controlled entities have a 30 September financial year end.

Associates

Associates are undertakings over which the Bank exerts significant influence but not control. Investments in associates are accounted for using the equity method. The attributable share of profit and reserves of the associated undertaking is based on the management accounts as at 30 September 2012. The associated undertaking is The Scottish Agricultural Securities Corporation PLC, its country of registration and operations being Scotland. The associated undertaking's principal activity is the provision of finance and the Group's interest of 33.33% in the issued equity capital of £2m is held by the Bank. The associated undertaking has a 31 March year end.

Notes to the consolidated financial statements (continued)

22. Deferred tax

Movement in net deferred tax asset	Group		Bank	
	2012 £m	2011 £m	2012 £m	2011 £m
At 1 October	80	101	77	107
Recognised in the income statement (note 8)	106	6	106	5
Recognised directly in equity	62	(26)	61	(35)
Transfer to assets held for sale (note 24)	(20)	-	(20)	-
Other	-	(1)	-	-
At 30 September	228	80	224	77

Not included in the above:

Deferred tax in respect of assets held for sale (note 24)	<u>20</u>	<u>-</u>	<u>20</u>	<u>-</u>
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The Group recognises deferred tax attributable to the following items:

	Group		Bank	
	2012 £m	2011 £m	2012 £m	2011 £m
Deferred tax assets				
Defined benefit pension liability	70	48	70	48
Impairment provision on credit exposures	14	24	14	24
Employee equity based compensation	4	4	4	4
Tax losses carried forward	92	-	92	-
Provisions	59	26	59	26
Other	10	10	5	4
	<u>249</u>	<u>112</u>	<u>244</u>	<u>106</u>
Deferred tax liabilities				
Accelerated capital allowances	(18)	(10)	(18)	(11)
Net gain on revaluation of properties	1	2	1	2
Cash flow hedge reserve	37	40	37	38
Other	1	-	-	-
	<u>21</u>	<u>32</u>	<u>20</u>	<u>29</u>
Net deferred tax asset	228	80	224	77

The Group considers it probable that sufficient future taxable profits will be available against which the underlying deductible temporary differences can be utilised. The largest deferred tax asset held within the Group relates to tax losses carried forward. The tax losses carried forward have been assessed for recoverability against the Group's 5 year forecast which includes adjustments for future strategic changes, the future economic outlook and regulatory change. Current UK tax legislation does not specify a maximum forecast horizon to utilise losses, despite this the losses are expected to be fully utilised within 3 to 5 years.

The Finance Bill 2012 was substantively enacted on 3 July 2012. The announced corporation tax rate of 23% will be effective from 1 April 2013. Accordingly this rate has been used to calculate the deferred tax asset held by the Group. A further reduction of 1% per annum is anticipated until the rate reaches 22% in 2014.

The maximum effect on deferred tax of the reduction in the UK corporation tax rate to 22% is expected to be £10m (equivalent to 1% of the closing gross deferred tax balance).

Notes to the consolidated financial statements (continued)

23. Other assets

	Group		Bank	
	2012 £m	2011 £m	2012 £m	2011 £m
Prepayments and accrued income	257	403	257	495
Other	242	258	242	151
	<u>499</u>	<u>661</u>	<u>499</u>	<u>646</u>
Not included in the above:				
Assets classified as held for sale (note 24)	<u>20</u>	<u>-</u>	<u>20</u>	<u>-</u>

24. Assets held for sale

	Group 2012 £m	Bank 2012 £m
Assets held for sale		
Other financial assets at fair value	1,475	1,475
Gross loans and advances to customers	4,177	4,177
	<u>5,652</u>	<u>5,652</u>
Impairment provisions on credit exposures	(463)	(463)
Derivative financial instruments	(4)	(4)
Deferred tax	20	20
Other assets	20	20
	<u>5,225</u>	<u>5,225</u>
Liabilities associated with assets held for sale		
Derivative financial instruments	<u>142</u>	<u>142</u>

Assets held for sale principally comprise assets with balances before provisions of approximately £5.6bn. The assets held for sale were transferred to NAB on 5 October 2012 following the Strategic Review undertaken by the Group.

As part of the transaction NAB has assumed the credit risk on certain customer derivatives. Accordingly, the carrying value of derivatives in the Group has increased by £4m as there is a reduction in the level of credit valuation adjustment. This reduction in risk is part of the settlement of the net transaction.

The credit quality of the loans and advances held for sale is as follows:

	Group 2012 £m	Bank 2012 £m
Gross loans and advances:		
Neither past due nor impaired	3,095	3,095
Past due but not impaired	240	240
Impaired	842	842
	<u>4,177</u>	<u>4,177</u>
Impairment provisions on credit exposures (note 16)	(463)	(463)
Loans and advances held for sale (note 15)	<u>3,714</u>	<u>3,714</u>

Notes to the consolidated financial statements (continued)

24. Assets held for sale (continued)

The table below presents the analysis of business lending credit quality of loans and advances for assets held for sale that are neither past due nor impaired:

	Group 2012 £m	Bank 2012 £m
Senior investment grade	25	25
Investment grade	622	622
Sub-investment grade	2,448	2,448
	<u>3,095</u>	<u>3,095</u>

The distribution of loans and advances held for sale that are past due but not impaired are analysed below:

	Group 2012 £m	Bank 2012 £m
1 to 29 days past due	83	83
30 to 59 days past due	12	12
60 to 89 days past due	1	1
Past due over 90 days	144	144
	<u>240</u>	<u>240</u>

The value of undrawn formal standby facilities, credit lines and other commitments to lend at call in respect of assets held for sale is disclosed in note 33.

25. Due to other banks

	Group		Bank	
	2012 £m	2011 £m	2012 £m	2011 £m
Transaction balances with other banks	9	8	9	8
Securities sold under agreements to repurchase	78	510	78	510
Deposits from other banks	470	989	470	989
	<u>557</u>	<u>1,507</u>	<u>557</u>	<u>1,507</u>

26. Due to customers

	Group		Bank	
	2012 £m	2011 £m	2012 £m	2011 £m
Non interest bearing demand deposits	1,637	1,370	1,637	1,434
Interest bearing demand deposits	16,141	16,816	16,141	16,861
Term deposits	7,979	6,586	7,979	6,586
Other wholesale deposits	624	3,398	624	3,398
	<u>26,381</u>	<u>28,170</u>	<u>26,381</u>	<u>28,279</u>

The £2,774m movement in other wholesale deposits was driven by wholesale counterparty action in response to the reduction in the Bank's credit rating. This was partially offset by an increase in term deposit flows.

Notes to the consolidated financial statements (continued)

27. Provisions

	Group		Bank	
	2012 £m	2011 £m	2012 £m	2011 £m
Payment Protection Insurance redress provision				
Opening balance	102	15	102	15
Charge to the income statement	120	116	120	116
Provision utilised	(114)	(29)	(114)	(29)
Closing balance	<u>108</u>	<u>102</u>	<u>108</u>	<u>102</u>
Customer redress and other provisions				
Opening balance	6	12	6	12
Charge to the income statement	57	3	55	3
Provision utilised	(5)	(9)	(5)	(9)
Closing balance	<u>58</u>	<u>6</u>	<u>56</u>	<u>6</u>
Restructuring provisions				
Opening balance	-	-	-	-
Charge to the income statement	149	-	149	-
Provision utilised	(23)	-	(23)	-
Closing balance	<u>126</u>	<u>-</u>	<u>126</u>	<u>-</u>
Total provisions	<u>292</u>	<u>108</u>	<u>290</u>	<u>108</u>

Payment Protection Insurance redress

As at 30 September 2012, the Group is carrying a provision of £108m (2011: £102m) to cover potential customer claims for refunds of premiums associated to the mis-selling of Payment Protection Insurance (PPI) policies. The provision is based upon known pipeline cases and expectations of future claims. It is management's current best estimate of expected costs. During the year to 30 September 2012, the provision was increased by an additional £120m. This reflected a marked increase in the level of complaints received and the impact on the estimate for future complaints that may ultimately be received.

The provision reflects an assessment of future PPI claims based upon estimates; statistical analysis and assumptions in relation to a wide range of uncertain factors, including how many PPI claims will be made against Clydesdale Bank PLC, for what value, and the prospect of the mis-selling being established in relation to those claims. The final amount required to settle the potential liability is therefore uncertain.

Provision for customer redress and other provisions

A provision for customer redress is held in those instances where the Group has agreed to make payments to customers whether on an ex-gratia or compensatory basis. Provisions can arise as a result of legal or regulatory action and incorporate the costs of skilled persons, and where appropriate other elements of administration.

Other provisions include provisions in respect of legal proceedings and claims arising in the ordinary course of the Group's business. None of these are deemed to be individually material in relation to the Group's operations.

On 29 June 2012, the FSA announced that it had reached agreement with a number of UK banks in relation to a review and redress exercise on certain interest rate hedging products that were offered to small and medium sized entities.

The Group agreed to participate in this exercise as announced by the FSA on 23 July 2012 and has embarked on a structured programme to identify those small and medium sized customers that may have been affected. The exercise voluntarily incorporates certain of the Group's tailored business loan products as well as the stand alone hedging products identified in the FSA's notice.

Notes to the consolidated financial statements (continued)

27. Provisions (continued)

Provision for customer redress and other provisions (continued)

The total cost of this exercise is uncertain and subject to a number of estimates, many of which require agreement with the FSA.

A provision of £48m for customer redress including the interest rate hedging review has been raised and reflects management's best estimate of this and a number of other ongoing matters as at 30 September 2012.

Restructuring provision

Following the UK Banking strategic review announced on 30 April 2012, a further restructuring provision of £139m was raised. The provision covers redundancy payments, lease break fees, surplus space costs and associated enablement costs. The provision is expected to be utilised by September 2015. As part of the restructure the majority of the commercial real estate (CRE) assets of the Group transferred to NAB on 5 October 2012. The transferred portfolio will be placed into run-off and will be managed separately by NAB. The restructure reflects the Group's reduced risk appetite and will improve the return and cost profile of the ongoing business by simplifying the business model to focus on retail operations and SME business lending in Scotland and northern England.

28. Bonds, notes and subordinated debt

	Group		Bank	
	2012 £m	2011 £m	2012 £m	2011 £m
Medium term notes	-	1,898	-	1,898
Subordinated medium term notes	-	200	-	200
Residential mortgage backed securities	2,094	1,439	-	-
Covered bonds	1,096	-	1,096	-
Total bonds, notes and subordinated debt	3,190	3,537	1,096	2,098
Fair value hedge adjustments	(27)	16	(12)	10
	<u>3,163</u>	<u>3,553</u>	<u>1,084</u>	<u>2,108</u>

On 11 November 2011, £500m of medium term notes matured, a further £750m matured on 9 December 2011 and the remaining £648m matured on 30 May 2012. On 30 March 2012, callable subordinated debt of £200m was redeemed.

On 28 February 2012, €615m of residential mortgage backed securities were issued via Lanark 2012-1. On 27 July 2012, \$800m and £525m of residential mortgage backed securities were issued via Lanark 2012-2. On 31 May 2012, £1,100m of covered bonds were issued via the Clydesdale Regulated Covered Bond structure.

Details of the terms and conditions of the notes issued by Clydesdale Bank PLC as at 30 September 2012 were as follows:

Issue date	Currency	Carrying value £m	Coupon rate	Maturity date
<i>Class A residential mortgage backed securities</i>				
6 August 2007	GBP	590	0.85%	22-May-13
28 February 2012	EUR	490	3.35%	22-May-15
27 July 2012	USD	489	2.19%	22-Feb-16
27 July 2012	GBP	525	2.33%	22-Nov-17
		<u>2,094</u>		
<i>Covered bonds</i>				
31 May 2012	GBP	696	4.63%	08-Jun-26
31 May 2012	GBP	400	2.69%	08-Jun-15
		<u>1,096</u>		
		<u>3,190</u>		

Notes to the consolidated financial statements (continued)

29. Retirement benefit obligations

The Group is the sponsoring employer of one funded defined benefit scheme, the Yorkshire and Clydesdale Bank Pension Scheme ("the Scheme"). The Scheme is a fully sectionalised arrangement, put in place in 2009, in which discrete assets and liabilities of the two sections (Clydesdale and Yorkshire) are independently calculated in accordance with the previously existing scheme structures. The assets of the Scheme are held in trustee administered funds.

	2012 £m	2011 £m
Defined benefit scheme assets	2,485	2,076
Defined benefit scheme obligations	<u>(2,786)</u>	<u>(2,256)</u>
Net defined benefit pension scheme obligations	(301)	(180)
Post-retirement medical benefits obligations	<u>(5)</u>	<u>(5)</u>
Net retirement benefits obligation	<u>(306)</u>	<u>(185)</u>

The Group has implemented a number of reforms to the Scheme to control the liability. It closed the Scheme to new members in 2004 and has determined benefits accruing after April 2006 on a career average revalued earnings basis. The principal pension available to new employees since the closure of the Scheme is the defined contribution scheme, ("Total Pension"). The pension charge for the year in relation to Total Pension is shown in note 7.

The Group implemented additional reforms to the Scheme which were effective from April 2012. These included changing the inflation index used to determine benefit increases from the Retail Price Index (RPI) to the Consumer Price Index (CPI) for future accrual and introducing members' contributions into the Scheme, increasing annually over a three year period. As an alternative to contributions, employees have the option of reducing their future annual rate of accrual from 1/60th of salary to 1/80th.

The Group also provides post-retirement health care under a defined benefit scheme for pensioners and their dependent relatives for which provision has been made. This is a closed scheme and the provision will be utilised over the life of the remaining scheme members. A one percentage point change in the assumed rate of increase in healthcare costs would change the defined benefit pension obligation by £0.4m (2011: £0.4m) and would have no material impact upon service costs and interest costs.

Reconciliation of the defined benefit pension scheme assets	2012 £m	2011 £m
Opening fair value of defined benefit pension scheme assets	2,076	2,011
Actual return on scheme assets	248	33
Employer contributions	242	107
Benefits paid	<u>(81)</u>	<u>(75)</u>
Closing fair value of defined benefit pension scheme assets	<u>2,485</u>	<u>2,076</u>

Reconciliation of the defined benefit pension scheme obligations	2012 £m	2011 £m
Opening defined benefit pension scheme obligations	(2,256)	(2,323)
Interest cost	(120)	(117)
Current service cost	(33)	(36)
Benefits paid	81	75
Actuarial loss	(456)	146
Past service cost	<u>(2)</u>	<u>(1)</u>
Closing defined benefit pension scheme obligations	<u>(2,786)</u>	<u>(2,256)</u>

Employer contributions include a contribution of £130m from NAB. This payment was negotiated with the Scheme Trustees and formed part of a series of actions by NAB which resulted in its withdrawal as a participating employer in the Scheme during January 2012. The withdrawal as a participating employer did not materially impact the liabilities as measured under IAS 19, and the contribution therefore improved the overall Scheme funding position. Consequently, the £130m contribution by NAB is recognised within the Group's income statement for the year ended 30 September 2012.

Notes to the consolidated financial statements (continued)

29. Retirement benefit obligations (continued)

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

	2012 £m	2011 £m
Equities	990	1,023
Government bonds	557	480
Global sovereign bonds	105	-
Corporate bonds	709	457
Property	99	102
Cash	25	14
Fair value of defined benefit pension scheme assets	2,485	2,076

The Scheme is not invested in any of the Group's own financial instruments. The Scheme assets include certain property investments leased by the Group. These investments are within the 5% self-investment limit. The fair value of plan assets includes land and buildings occupied by the Group and Bank with a fair value of £25m (2011: £26m).

Amounts recognised in the income statement	2012 £m	2011 £m
Current service cost	33	36
Past service cost	2	1
Interest cost	120	117
Expected return on scheme assets	(136)	(130)
Defined benefit pension expense for the year (note 7)	19	24

Amounts recognised in the statement of comprehensive income	2012 £m	2011 £m
Opening cumulative actuarial losses	(351)	(400)
Experience gains/(losses) on scheme assets	113	(97)
Experience losses on scheme liabilities	(41)	(16)
Changes in actuarial assumptions	(416)	162
Cumulative actuarial losses recognised in the statement of comprehensive income	(695)	(351)

Actuarial assumptions	2012 % p.a.	2011 %p.a.
Inflation	2.50	3.05
Rate of increase for pensions in payment:		
Pre 5 April 1997 benefits (Clydesdale Bank section)	2.25	2.25
Pre 5 April 1997 benefits (Yorkshire Bank section)	2.40	2.95
5 April 1997 to April 2006 benefits (both sections)	2.40	2.95
Post April 2006 benefits (both sections)	2.25	2.25
Rate of increase for pensions in deferment ¹	2.00	2.05
Discount rate	4.30	5.40
Expected rate of return on plan assets		
Equities	7.40	7.90
Government bonds	3.00	3.55
Global sovereign bonds	3.40	-
Corporate bonds	3.95	4.95
Property	6.40	6.85
Cash	3.00	3.55

The expected return on assets assumption has been determined by considering the assets expected to be held over the following year and the expected returns for each asset class.

¹ The assumption for the rate of increase for pensions in deferment has been linked to the Consumer Price Index from 30 September 2010, following a government announcement on 8 July 2010 relating to increases in pensions that are not specifically linked to the Retail Prices Index.

Notes to the consolidated financial statements (continued)

29. Retirement benefit obligations (continued)

Actuarial assumptions (continued)

Post retirement mortality:	2012 years	2011 years
Current pensioners at 60 – male	27.9	26.4
Current pensioners at 60 – female	28.4	28.2
Future pensioners at 60 – male	29.4	28.0
Future pensioners at 60 – female	29.9	29.7

History of experience gains and (losses)	2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
On scheme assets	113	(97)	46	(112)	(319)
On scheme liabilities	(41)	(16)	45	(2)	4
Changes in actuarial assumptions	(416)	162	(158)	(477)	320
	<u>(344)</u>	<u>49</u>	<u>(67)</u>	<u>(591)</u>	<u>5</u>

History of net defined benefit pension scheme obligation	2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
Defined benefit assets	2,485	2,076	2,011	1,828	1,842
Defined benefit obligation	(2,786)	(2,256)	(2,323)	(2,138)	(1,593)
Net (obligation)/asset	<u>(301)</u>	<u>(180)</u>	<u>(312)</u>	<u>(310)</u>	<u>249</u>

30. Other liabilities

	Group		Bank	
	2012 £m	2011 £m	2012 £m	2011 £m
Accruals and deferred income	52	40	51	39
Notes in circulation	1,567	1,335	1,567	1,335
Accrued interest payable	362	450	350	538
Other liabilities	141	142	150	126
	<u>2,122</u>	<u>1,967</u>	<u>2,118</u>	<u>2,038</u>

Notes to the consolidated financial statements (continued)

31. Called up share capital

Group and Bank

Allotted, called up and fully paid	2012 £m	2011 £m
Ordinary shares of £1 each		
Opening ordinary share capital	942	842
Issued during the year	500	100
Closing ordinary share capital	<u>1,442</u>	<u>942</u>
Preference shares of £1 each		
Opening preference share capital	300	100
Issued during the year	-	200
Closing preference share capital	<u>300</u>	<u>300</u>
Closing called up share capital	<u>1,742</u>	<u>1,242</u>

During the year, 500m ordinary shares of £1 each were issued at par, resulting in an increase of £500m of the allotted, called up and fully paid share capital.

The preference shares in issue have all been classified as equity instruments. The preference shares issued on 17 December 2008 entitle the holder to a discretionary fixed non-cumulative dividend of 12% per annum payable every six months on the capital paid up thereon. The preference shares issued on 15 December 2010 entitle the holder to a discretionary non-cumulative dividend of LIBOR plus 779bps every six months on the capital paid up thereon.

The dividends payable on the preference shares are at the Bank's discretion based on a number of factors. The preference shares are redeemable, in whole only, at the option of the Bank on the first business day following the fifth anniversary of the date of issue. No such redemption may be made without the consent of the FSA.

32. Total equity

	Group		Bank	
	2012 £m	2011 £m	2012 £m	2011 £m
Share capital (note 31)	1,742	1,242	1,742	1,242
Share premium account	243	243	243	243
Total share capital and share premium	<u>1,985</u>	<u>1,485</u>	<u>1,985</u>	<u>1,485</u>
Merger reserve	338	338	338	338
Share option reserve	5	14	5	14
Asset revaluation reserve	1	2	1	2
Available for sale investments reserve	12	16	13	15
Cash flow hedge reserve	124	120	124	114
Total other reserves	<u>480</u>	<u>490</u>	<u>481</u>	<u>483</u>
Retained earnings	139	904	24	725
Total equity	<u>2,604</u>	<u>2,879</u>	<u>2,490</u>	<u>2,693</u>

Merger reserve

The merger reserve arose as a result of the transfer of the entire business and undertakings of Yorkshire Bank PLC to Clydesdale Bank PLC on 1 December 2004. As no consideration was paid in relation to the transfer the only impact arising was the crystallisation of the Yorkshire Bank PLC share capital and share premium into a merger reserve in the combined entity.

Notes to the consolidated financial statements (continued)

32. Total equity (continued)

Share option reserve

The Bank's share option reserve represents the outstanding fair value amount in respect of share based payment expense recharged by its ultimate parent that has been charged through the income statement and adjusted for deferred tax.

Asset revaluation reserve

The asset revaluation reserve includes the gross revaluation increments and decrements arising from the revaluation of land and buildings.

Available for sale investments reserve

The available for sale investments reserve records the gains and losses arising from changes in the fair value of available for sale investments.

Cash flow hedge reserve

The cash flow hedge reserve records fair value revaluations of derivatives designated as cash flow hedging instruments to the extent that they are effective.

33. Contingent liabilities and commitments

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

Group and Bank

Contingent liabilities	2012	2011
	£m	£m
Guarantees and assets pledged as collateral security:		
At call	1	-
Due in less than 3 months	57	40
Due between 3 months and 1 year	44	46
Due between 1 year and 3 years	70	65
Due between 3 years and 5 years	4	10
Due after 5 years	102	109
No specified maturity	8	15
	<u>286</u>	<u>285</u>
Other commitments		
Undrawn formal standby facilities, credit lines and other commitments to lend at call	<u>9,290</u>	<u>10,568</u>
Not included in the above:		
Undrawn formal standby facilities, credit lines and other commitments to lend at call in respect of assets held for sale (note 24)	<u>140</u>	<u>-</u>

Capital commitments

The Group and Bank had future capital expenditure which had been contracted for but not provided for in the Financial Statements at 30 September 2012 of £0.6m (2011: £0.2m).

Notes to the consolidated financial statements (continued)

33. Contingent liabilities and commitments (continued)

Operating lease commitments

Group and Bank

	2012 £m	2011 £m
Leases as lessor		
Future minimum lease payments under non-cancellable operating leases are:		
within 1 year	2	3
between 1 year and 5 years	5	9
over 5 years	6	8
	<u>13</u>	<u>20</u>
Leases as lessee		
Future minimum lease payments under non-cancellable operating leases are:		
within 1 year	35	35
between 1 year and 5 years	112	116
over 5 years	224	213
	<u>371</u>	<u>364</u>

Other contingent liabilities

The Group is named in and is defending a number of legal claims arising in the ordinary course of business. The current provision is deemed to be adequate based on the known facts and circumstances of each case.

Financial Services Compensation Scheme

The UK Financial Services Compensation Scheme (FSCS) provides compensation to depositors in the event that a financial institution is unable to repay amounts due. Following the failure of a number of financial institutions, the FSCS has raised borrowings from the UK Government to cover compensation in relation to protected deposits. The principal borrowings are anticipated to be repaid from the realisation of the assets of the institutions. The FSCS has estimated levies due to 31 March 2013 and an accrued expense of £8m (2011: £4m) is presently held for the Group's calculated liability to this date. If the assets of the failed institutions are insufficient to repay the government loan, additional levies will become payable in future periods.

Notes to the consolidated financial statements (continued)

34. Notes to the statements of cash flows

	Group		Bank	
	2012 £m	2011 £m	2012 £m	2011 £m
Adjustments included in the (loss)/profit before tax				
Interest receivable	(1,461)	(1,425)	(1,313)	(1,290)
Interest payable	592	442	605	479
Depreciation (note 7)	19	15	19	15
Profit on sale of tangible fixed assets*	(10)	(2)	(10)	(2)
Loss on revaluation of tangible fixed assets*	10	-	4	-
Transfer from available for sale reserve	(4)	(5)	(2)	(6)
Transfer from cash flow hedge reserve	(1)	4	13	48
Derivative financial instruments fair value movements	(9)	30	(9)	30
Impairment losses on credit exposures (note 16)	737	297	732	286
Dividends received from subsidiaries	-	-	(167)	(137)
Adjustment to carrying value of investments	-	(1)	-	2
Movement in share option reserve	(9)	15	(9)	15
	<u>(136)</u>	<u>(630)</u>	<u>(137)</u>	<u>(560)</u>
Changes in operating assets				
Net decrease /(increase) in:				
Balances with supervisory central banks	(2)	1	(2)	1
Due from other banks	(2)	(1)	(1)	(2)
Derivative financial instruments	429	153	414	31
Financial assets at fair value through profit or loss	2,055	46	2,055	(176)
Loans and advances to customers	3,155	(1,554)	3,149	(1,695)
Due from customers on acceptances	-	1	-	1
Other assets	53	50	19	(364)
Assets held for sale (note 24)	(5,225)	-	(5,225)	-
	<u>463</u>	<u>(1,304)</u>	<u>409</u>	<u>(2,204)</u>
Changes in operating liabilities				
Net (decrease)/increase in:				
Due to other banks	(783)	148	(783)	148
Derivative financial instruments	21	(36)	(293)	(36)
Financial liabilities at fair value through profit or loss	(8)	109	(8)	352
Due to customers	(1,789)	(264)	(1,898)	(155)
Liabilities on acceptances	-	(1)	-	(1)
Provisions (note 27)	184	81	182	81
Defined benefit pension obligations	(223)	(83)	(223)	(83)
Other liabilities	284	78	308	569
Liabilities associated with assets held for sale (note 24)	142	-	142	-
	<u>(2,172)</u>	<u>32</u>	<u>(2,573)</u>	<u>875</u>

For the purposes of the statement of cash flows, cash and cash equivalents comprise the following balances with less than three months maturity from the date of acquisition.

	Group		Bank	
	2012 £m	2011 £m	2012 £m	2011 £m
Cash and balances with central banks (note 10)	7,892	5,993	7,892	5,993
Other assets	153	152	246	142
Due to other banks	(9)	(174)	(9)	(174)
Due to related entities	(13)	(12)	(13)	(12)
Other liabilities	(74)	(115)	(74)	(115)
	<u>7,949</u>	<u>5,844</u>	<u>8,042</u>	<u>5,834</u>

* Tangible fixed assets include property, plant and equipment, investment properties and property inventory.

Notes to the consolidated financial statements (continued)

35. Employees

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

	2012	2011
	Number	Number
Managers	1,698	1,714
Clerical staff	3,672	3,875
	<u>5,370</u>	<u>5,589</u>

All staff are contracted employees of NAGE and its subsidiary undertakings. The numbers above disclose the staff remunerated directly by the Group but exclude employees working within other NAGE subsidiaries who provide support services to the Group. The average number of staff employed in the UK Banking operating division of NAB in the year to 30 September 2012 was 8,105 (2011: 8,587).

36. Equity based compensation

Share incentive plans, share offers, performance options and performance rights in NAB are used to provide short-term and long-term incentives to employees. These incentives are an integral part of the Group's remuneration strategy in rewarding employees' current and future contribution to the Group's performance.

The plans described below involve the provision of shares in NAB to employees and Directors of the Group and performance options and performance rights to senior employees of the Group. The Group reimburses NAB for the cost of these shares and the value of the performance options and performance rights.

Short term incentive (STI)

The STI plan has an element of deferral to provide an appropriate level of reward aligned with sound risk management principles. STI deferral encourages longer-term sustainable decision making and assurance of individual and business performance. Deferral applies to all levels of performance across the organisation. Deferral is in the form of NAB shares, restricted for at least one year. The deferred equity is subject to forfeiture conditions including forfeiture as a result of resignation, termination by NAB or failure to meet Compliance Gateway requirements. A reduction or forfeiture of deferred amounts can also be determined by the Principal Board, at its absolute discretion. Such a determination may be made in relation to the NAB Group, a business unit, executive committee, role or individual.

Recognition shares

These shares enable retention and recognition awards to be provided in the form of shares, rather than in cash. Such awards are made on a very limited basis with NAB Group executive general manager approval, to individuals in significant key roles where retention is critical over a medium-term timeframe (two to three years). Awards under the programme may also be provided to individuals accepting significant project leadership or additional responsibilities for a limited period of time with no related increase in their fixed remuneration. The provision of shares under this plan is desired over the use of cash payments, as it provides a stronger retention and shareholder value link to the reward. The shares are subject to forfeiture conditions including forfeiture as a result of resignation, or retirement or failure to meet Compliance Gateway requirements. The minimum restriction period is until the final key date or milestone has been achieved.

Commencement shares

These shares enable 'buyout' of evidenced equity from previous employment for significant new hires. Shares are provided under this programme or commencement performance options and performance rights if more appropriate. The shares are subject to forfeiture conditions including forfeiture as a result of resignation, termination by NAB or failure to meet Compliance Gateway requirements.

Notes to the consolidated financial statements (continued)

36. Equity based compensation (continued)

UK National Share Incentive Plan

Under the UK National Share Incentive Plan, employees are entitled to purchase up to £1,500 worth of NAB shares each year through the National Partnership Share Plan. Participants contribute each month and the trustee uses the contributions to purchase shares on market which are then held in trust for the participants. Participants are entitled to receive dividends and exercise voting rights in respect of these shares and there is no risk of forfeiture. In addition, up to £3,000 of free shares per employee may be gifted per annum through the plan.

General employee shares

Up to a target value of A\$1,000 of NAB shares are offered to each eligible employee when the NAB Group's performance is on target, measured against a scorecard of objectives for the financial year. These shares are held in trust restricted from dealing for three years and in the UK these shares are forfeited if an employee is summarily dismissed prior to the end of three years.

Long term incentives (LTI)

LTIs help to drive management decisions focused on the long-term prosperity of the NAB Group through the use of challenging performance hurdles. The Executive LTI programme is awarded to senior executives across the NAB Group and is provided wholly as performance rights. A LTI target is set with reference to external and internal relativities for each executive who must also meet minimum performance and compliance thresholds. External and/or internal performance hurdles are measured at the end of a three year restriction period and during the restriction period an executive will forfeit their performance rights for voluntary cessation of employment, if compliance requirements are not met or if performance hurdles are not met.

Performance options and performance rights

These are used to provide long-term incentives in recognition of executive potential and talent in the Group.

A variety of performance measures are used for different grants of long-term incentives (taking the form of shares, performance options, or performance rights) including Total Shareholder Return (TSR) compared against peer companies, and regional or NAB Group ROE and cash earnings. The measures used depend on the level and impact of the participant's role, the business or region in which they work, and the relevant programme. Vesting generally occurs to the extent that the relevant performance hurdle is satisfied (as determined by the NAB Board Remuneration Committee). The performance options and performance rights generally have an expiry date between three and eight years from the effective date if unexercised.

Each performance option or performance right is exchanged for one fully paid ordinary share in NAB upon exercise, subject to standard adjustments for capital actions. The exercise price for performance options is generally the market price for NAB's fully paid ordinary shares as at the date the performance option was granted or such other relevant date determined by the NAB Board Remuneration Committee. No exercise price is payable by the holder on exercise of performance rights.

Notes to the consolidated financial statements (continued)

36. Equity based compensation (continued)

Performance options and performance rights (continued)

Performance options are predominantly offered only to key senior executives of the Group and generally lapse after a specified number of days after cessation of employment as determined by the NAB Board.

The movement in share options and performance rights granted and exercised during the year was as follows:

Share options	2012		2011	
	Number	Weighted average exercise price A\$	Number	Weighted average exercise price A\$
Outstanding at 1 October	3,432,798	36.65	5,135,858	35.41
Forfeited and expired during the year	(3,095,354)	37.92	(1,703,060)	32.89
Exercised during the year	(58,498)	19.89	-	-
Outstanding at 30 September	<u>278,946</u>	<u>26.12</u>	<u>3,432,798</u>	36.65
Exercisable at 30 September	<u>65,343</u>		<u>2,388,925</u>	

For share options outstanding at 30 September 2012, the weighted average remaining contractual life is 1.27 years (2011: 0.87 years). The range of exercise prices for options outstanding at the end of the year was A\$19.89 - A\$31.70 (2011: A\$19.89 - A\$43.43).

Performance rights	2012 Number	2011 Number
Outstanding at 1 October	745,984	1,271,959
Granted during the year	145,729	-
Forfeited and expired during the year	(717,699)	(508,629)
Exercised during the year	(28,285)	(17,346)
Outstanding at 30 September	<u>145,729</u>	<u>745,984</u>
Exercisable at 30 September	<u>-</u>	<u>561,257</u>

For share rights outstanding at 30 September 2012, the weighted average remaining contractual life is 3.21 years (2011: 0.70 years). No exercise price is payable by the holder on exercise of performance rights.

Fair value of share options and performance rights

A fair value of goods or services to the value of £1.4m was measured indirectly by reference to the fair value on the performance rights granted during the year (2011: £Nil).

Notes to the consolidated financial statements (continued)

37. Directors' emoluments

2012 £'000	Performance related pay						Total emoluments
	Salary and fees ⁽¹⁾	Benefits and allowances ⁽³⁾	Short term incentive schemes ⁽⁴⁾			Long term incentive schemes ⁽⁷⁾	
			Annual (cash)	Deferred (shares)	Total short term (PRP)	Shares	
Executive Directors							
Cameron Clyne ^{(5) (6)}	-	-	-	-	-	-	-
John Hooper	703	214	-	-	-	1	918
Mark Joiner ^{(5) (6)}	-	-	-	-	-	-	-
Richard Sawers ^{(5) (6)}	-	-	-	-	-	-	-
David Thorburn	400	109	-	-	-	1	510
Total Executive	1,103	323	-	-	-	2	1,428
Non-executive Directors							
David Allvey ⁽⁵⁾	25	-	-	-	-	-	25
David Browne ⁽⁵⁾	25	-	-	-	-	-	25
Jonathan Dawson ⁽⁵⁾	50	-	-	-	-	-	50
Sir David Fell ⁽⁵⁾	85	-	-	-	-	-	85
Richard Gregory OBE	93	-	-	-	-	-	93
Roy Nicolson ⁽⁵⁾	69	-	-	-	-	-	69
Elizabeth Padmore ⁽⁵⁾	55	-	-	-	-	-	55
James Pettigrew ⁽⁵⁾	-	-	-	-	-	-	-
Barbara Ridpath ⁽⁵⁾	25	-	-	-	-	-	25
Alexander Shapland ⁽⁵⁾	25	-	-	-	-	-	25
Sir Malcolm Williamson ^{(2) (5)}	156	-	-	-	-	-	156
Peter Wood ⁽⁵⁾	4	-	-	-	-	-	4
Total Non-executive	612	-	-	-	-	-	612
Total Directors	1,715	323	-	-	-	2	2,040
2011 £'000	Performance related pay						Total emoluments
	Salary and fees ⁽¹⁾	Benefits and allowances ⁽³⁾	Short term incentive schemes ⁽⁴⁾			Long term incentive schemes ⁽⁷⁾	
			Annual (cash)	Deferred (shares)	Total short term (PRP)	Shares	
Executive Directors							
Cameron Clyne	-	-	-	-	-	-	-
John Hooper	627	144	103	412	515	194	1,480
Lynne Peacock	854	197	459	-	459	-	1,510
David Thorburn	389	113	64	256	320	341	1,163
Total Executive	1,870	454	626	668	1,294	535	4,153
Non-executive Directors							
Jonathan Dawson	75	-	-	-	-	-	75
Sir David Fell	78	-	-	-	-	-	78
Richard Gregory OBE	93	-	-	-	-	-	93
Roy Nicolson	75	-	-	-	-	-	75
Elizabeth Padmore	60	-	-	-	-	-	60
Sir Malcolm Williamson	140	-	-	-	-	-	140
Peter Wood	68	-	-	-	-	-	68
Total Non-executive	589	-	-	-	-	-	589
Total Directors	2,459	454	626	668	1,294	535	4,742

In addition to amounts shown in the above table, social security costs were payable in respect of emoluments for Directors amounting to £430,000 (2011: £777,000) and in respect of emoluments for the highest paid Director of £178,000 (2011: £383,000).

Notes to the consolidated financial statements (continued)

37. Directors' emoluments (continued)

Notes

- (1) Salary costs include salaries paid to Executive Directors and fees paid to Non-executive Directors.
- (2) Sir Malcolm Williamson's Directorship fees exclude NAB Board and Risk Committee fees of A\$171,627 (2011: A\$250,000).
- (3) Benefits and allowances include cash payments in lieu of pension contributions and other taxable allowances and benefits. Retirement benefits accrued to one Director (2011: One) under a defined benefit pension plan. Pension contributions amounting to £18,000 (2011: £38,000) were paid during the year of which contributions for the highest paid Director amounts to £Nil (2011: £Nil).
- (4) Performance related pay relates to the respective financial year. The cash element will be paid in the forthcoming year and the deferred amount represents shares deferred for one and two years. The Remuneration Report disclosed in the NAB Annual Financial Report details the actual remuneration received in the year, for certain of the Directors, including cash paid and the value of equity that vested and lapsed without providing any value. The highest paid Director received 165,132 shares (2011: 127,394) that vested during the year, with a fair value of £960,372 (2011: £1,408,870). Certain historical awards (deferred STI) have been forfeited during the year ended 30 September 2012.
- (5) Mark Joiner and Richard Sawers were appointed as Executive Directors of the Bank on 14 June 2012. Peter Wood, retired as a Non-executive Director of the Bank on 21 October 2011. Elizabeth Padmore, Jonathan Dawson and Roy Nicolson retired as Non-executive Directors of the Bank on 31 May 2012 and Sir David Fell retired on 23 July 2012. David Browne, Barbara Ridpath, David Allvey, Alexander Shapland and James Pettigrew were appointed as Non-executive Directors of the Bank on 2 May 2012, 9 May 2012, 18 May 2012, 23 May 2012 and 25 September 2012 respectively. Sir Malcolm Williamson retired as Chairman and Non-executive Director on 23 July 2012 and Cameron Clyne was appointed as Executive Chairman upon Sir Malcolm Williamson's retirement.
- (6) Cameron Clyne, Mark Joiner and Richard Sawers are remunerated as employees of NAB, and do not receive incremental remuneration in respect of their duties as Directors of the Bank. The Directors believe it would be appropriate to apportion A\$510,000 of their remuneration as being in respect of their duties to the Bank.
- (7) The long term incentive scheme amounts principally represent share options, performance rights and deferred shares for services rendered during the year which require the achievement of performance hurdles and/or milestones before they vest. Typically, the performance period is three years. The value attributed is the fair value of the shares at the date of granting. No Directors (2011: Two) received benefits under an executive long term incentive scheme. One Director exercised share options during the year (2011: Nil). In 2012, the amounts disclosed relate solely to the general employee shares described in note 36.
- (8) The table below shows, for the highest paid Director in the given year, the number of shares in respect of share options, performance rights, short term incentive, long term incentive and other employee share plans (including free shares, commencement shares, recognition shares).

2012 Number	Share options	Share rights	Short term incentive shares	Long term incentive shares	Other employee share plans
Outstanding at 1 October 2011	430,238	28,390	48,091	60,155	26,348
Granted during the year	-	21,146	19,636	-	3,182
Forfeited during the year	-	-	(12,714)	-	-
Exercised during the year	(48,022)	(8,760)	-	-	-
Expired during the year	(136,500)	(19,630)	-	-	-
Restrictions ceased	-	-	(37,211)	(30,365)	(21,311)
Outstanding at 30 September 2012	<u>245,716</u>	<u>21,146</u>	<u>17,802</u>	<u>29,790</u>	<u>8,219</u>
2011 Number	Share options	Share rights	Short term incentive shares	Long term incentive shares	Other employee share plans
Outstanding at 1 October 2010	838,209	119,055	57,451	101,773	125,377
Granted during the year	-	-	12,322	42,177	46
Forfeited during the year	(181,769)	(45,442)	-	(28,705)	-
Exercised during the year	-	(6,982)	(25,000)	-	(25,000)
Expired during the year	(50,000)	(12,500)	-	-	-
Restrictions ceased	-	-	(32,451)	(27,298)	(100,377)
Outstanding at 30 September 2011	<u>606,440</u>	<u>54,131</u>	<u>12,322</u>	<u>87,947</u>	<u>46</u>

Notes to the consolidated financial statements (continued)

38. Fair value of financial instruments

Financial instruments include both financial assets and financial liabilities and also derivatives. Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. For the purposes of this note, carrying value refers to amounts reflected in the Consolidated Balance Sheet.

Group	Footnote	2012		2011	
		Carrying value £m	Fair value £m	Carrying value £m	Fair value £m
Financial assets					
Cash and balances with central banks	(a)	7,923	7,923	6,022	6,022
Due from related entities	(b)	1,256	1,256	4,950	4,951
Due from other banks	(c)	14	14	12	12
Investments – available for sale	(d)	1,039	1,039	1,110	1,110
Other financial assets at fair value	(e)	2,791	2,791	4,846	4,846
Derivative financial assets	(f)	600	600	1,018	1,018
Loans and advances to customers	(g)	24,346	24,420	28,238	28,343
Due from customers on acceptances	(a)	7	7	7	7
Other assets	(h)	232	232	380	380
Assets held for sale	(i)	5,225	5,225	-	-
Financial liabilities					
Due to other banks*	(g)	557	557	1,507	1,514
Other financial liabilities at fair value	(e)	147	147	155	155
Derivative financial liabilities	(f)	952	952	931	931
Due to customers*	(g)	26,381	26,460	28,170	28,200
Liabilities on acceptances	(a)	7	7	7	7
Due to related entities	(b)	7,527	7,527	7,758	7,758
Bonds, notes and subordinated debt*	(g)	3,163	3,164	3,553	3,562
Other liabilities	(j)	1,929	1,929	1,785	1,785
Liabilities associated with assets held for sale	(i)	142	142	-	-

The fair value estimates are based on the following methodologies and assumptions:

- The carrying amounts of these financial assets and financial liabilities approximate fair value.
- The carrying value of amounts due from and due to related entities is considered to approximate fair value. Amounts due from related entities are repayable on demand or within twelve months. Amounts due to related entities are repayable up to five years and over but are materially repriced every 3-6 months relative to market rates. As a result, the carrying value approximates the fair value.
- The carrying value of amounts due from other banks is net of allowances for impairment losses and unearned income. The fair value of amounts due from other banks equates to the carrying value at 30 September 2012.
- The fair values of investments are based on quoted closing market prices. Where investments are unlisted and quoted market prices are not available, the Group obtains fair value by means of other valuation techniques that are commonly used by market participants.
- The fair value of assets and liabilities designated as being carried at fair value through profit or loss are based on quoted market prices and data or valuation techniques based upon observable market data as appropriate to the nature and type of the underlying instrument. Derivatives which did not meet the requirements for hedge accounting and that are related to loans held at fair value through profit or loss are accounted for as derivative financial instruments (note 13).
- The fair value of derivatives, including foreign exchange contracts, interest rate swaps, interest rate and currency option contracts, and currency swaps, are obtained from quoted closing market prices as at the balance sheet date, discounted cash flow models or option pricing models as appropriate.
- The fair value of these financial assets and financial liabilities are obtained from discounted cash flow models.
- Other assets include accrued interest receivable and other short term receivables whose carrying values approximate fair value.

* The prior year comparative figures have been restated to conform to current year presentation.

Notes to the consolidated financial statements (continued)

38. Fair value of financial instruments (continued)

- (i) The fair value of assets held for sale and associated liabilities is estimated in accordance with the methodologies and assumptions applied to the classifications that were applicable for the underlying assets before classification as held for sale. The breakdown of the assets held for sale and associated liabilities is shown in note 24. The assets were transferred on 5 October 2012.
- (j) Other liabilities include accrued interest payable and notes in circulation whose carrying values approximate fair value.

Fair value hierarchy

For financial instruments carried at fair value on the balance sheet the fair value measurement is in accordance with the following hierarchy as defined by IFRS 7:

- Level 1: Financial instruments with quoted prices for identical instruments in active markets;
- Level 2: Financial instruments with quoted prices for similar instruments in active markets and financial instruments valued using models where all significant inputs are observable; and
- Level 3: Financial instruments valued using valuation techniques where one or more significant inputs are unobservable.

The classification of assets and liabilities into the fair value hierarchy is outlined for each class of financial instrument within the relevant notes for those assets and liabilities.

Level 3 movements analysis

	Group			Bank		
	Investments – available for sale £m	Other financial assets at fair value £m	Other financial liabilities at fair value £m	Investments – available for sale £m	Other financial assets at fair value £m	Other financial liabilities at fair value £m
At 1 October 2010	6	-	-	6	-	-
Gains/(losses) recorded in equity	1	-	-	-	-	-
At 30 September 2011	7	-	-	6	-	-
Gains/(losses) recorded in the income statement	1	-	-	1	-	-
Gains/(losses) recorded in equity	(1)	-	-	-	-	-
Purchases	-	-	-	-	-	-
Sales	-	-	-	-	-	-
Settlements	-	-	-	-	-	-
Transfers into level 3 from level 2	-	4,266	147	-	4,266	147
At 30 September 2012	7	4,266	147	7	4,266	147

Other financial assets at fair value incorporates a suite of loan products which were removed from sale with effect from 30 April 2012. Alternative products are now offered for future advances and these are accounted for within Loans and Advances to Customers. The removal from sale added uncertainty to the level of early repayments within the residual portfolio and led to a reduction in the level of observable inputs. This resulted in the loans being reclassified from level 2 to level 3 at 30 September 2012.

A sensitivity analysis of the valuation of the level 3 other financial assets at fair value is included in note 3. Reasonable changes in the assumptions used in valuing the level 3 available for sale investments would not result in material changes in the valuation.

Notes to the consolidated financial statements (continued)

39. Financial risk management

Strategy in using financial instruments

By their nature, the Group's activities are principally related to the use of financial instruments including derivatives. The Group accepts deposits from customers at both fixed and floating rates for various periods, and seeks to earn interest margins by investing these funds in high-quality assets. The Group seeks to improve these margins by consolidating short-term funds and lending for longer periods at higher rates, while maintaining sufficient liquidity to meet all claims that might fall due.

Fair value hedges

The Group hedges part of its existing interest rate and foreign currency risk from any decrease in the fair value of fixed rate assets or increase in fair value of fixed rate liabilities using interest rate and cross currency swaps. The net fair value of these swaps is disclosed in note 14. There were no transactions for which fair value hedge accounting had to be discontinued in the year.

Cash flow hedges

The Group hedges a portion of the variability in future cash flows attributable to interest rate risk arising from variable interest rate assets and liabilities using interest rate swaps, forward rate agreements and futures contracts. There were no transactions for which cash flow hedge accounting had to be discontinued in the year as a result of the highly probable cash flows no longer being expected to occur. The fair value of derivatives entered into is disclosed in note 14.

Credit risk

Credit risk is inherent within any transaction that creates an actual or potential obligation for a borrower to pay the Group. Credit risk is the risk that a borrower will fail to meet its obligations to the Group in accordance with agreed terms.

The Group structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, and to geographical and industry segments. Such risks are monitored on a revolving basis and subject to an annual or more frequent review.

Exposure to credit risk is managed through regular analysis of the ability of borrowers and potential borrowers to meet interest and capital repayment obligations and by changing these lending limits where appropriate. Exposure to credit risk is also managed in part by obtaining collateral and corporate and personal guarantees where appropriate.

Derivatives

The Group maintains control limits on net open derivative positions (i.e. the difference between purchase and sale contracts), by both amount and term. At any one time, the amount subject to credit risk is limited to the current fair value of instruments that are favourable to the Group (i.e. assets where their fair value is positive), which in relation to derivatives is only a small fraction of the contract, or notional values used to express the volume of instruments outstanding. This credit risk exposure is managed as part of the overall lending limits with customers, together with potential exposures from market movements.

Notes to the consolidated financial statements (continued)

39. Financial risk management (continued)

Credit risk (continued)

Credit-related commitments

Credit-related commitments are facilities where the Group is under a legal obligation to extend credit unless some event occurs, which gives the Group the right, in terms of the commitment letter of offer or other documentation, to withdraw or suspend the facilities. The primary purpose of these instruments is to ensure that funds are available to a customer as required. Guarantees and standby letters of credit, which represent irrevocable assurances that the Group will make payments in the event that a customer cannot meet its obligations to third parties, carry similar credit risk to loans.

Commitments to extend credit represent unused portions of authorisations to extend credit in the form of loans, guarantees or letters of credit. With respect to credit risk on commitments to extend credit, the Group is potentially exposed to loss of an amount equal to the total unused commitments. However, the likely amount of loss is less than the total unused commitments, as most commitments to extend credit are contingent upon customers maintaining specific credit standards. The Group monitors the term to maturity of credit commitments because longer-term commitments generally have a greater degree of credit risk than shorter-term commitments.

Forbearance

Forbearance primarily refers to the support options granted by the Group to its retail home loan and commercial customers when they experience financial difficulty or distress. The Group utilises a number of potential impairment indicators ("PII") to try and identify those customers in need of assistance including forbearance at the earliest possible opportunity. These PIIs and the data that underpins them are under continuous development and refinement to ensure they continue to capture and reflect the current customer behaviours and market conditions.

Forbearance is considered to take place where the Group grants a concession to provide a customer with more affordable terms and conditions than those originally contracted for. It is a consequence of concerns about the customer's ability to meet the contracted repayments when due and specifically relates to such instances where the changes to the arrangement have been made on terms that the Group would not ordinarily consider on a commercial basis.

The Group is committed to ensuring that any forbearance strategy implemented is on affordable and sustainable terms to the customer with the ultimate aim of minimising the risk of losses for the Group and its customers.

The Group exercises forbearance in two distinct areas: retail and non-retail.

Retail forbearance

The Group considers providing forbearance to its retail (primarily mortgage) customers when they have been identified as experiencing financial difficulties or distress. The Group makes every effort to follow its principles of treating customers fairly by working with customers in times of distress in order to find a solution that enables the Group to continue its relationship with the customer but with the ultimate aim of minimising the risk of the customer losing their home where this is in the interest of the customer.

Forbearance is exercised on retail customers in a number of different ways and is specific to the individual customer and their circumstances with the primary aim of ensuring that a sustainable solution can be found. These sustainable solutions can take a variety of forms and customers can be subject to more than one forbearance strategy at any one time where this is considered to be the most appropriate course of action.

Notes to the consolidated financial statements (continued)

39. Financial risk management (continued)

Credit risk (continued)

Retail forbearance (continued)

The principal forbearance facilities operated by the Group are:

- **Formal arrangements:** this includes arrangements with the customer to repay any arrears over a shorter period than capitalisation would involve, or may include the capitalisation of arrears, which are added to the remaining capital balance of the loan to be repaid over the remaining term.
- **Short-term or temporary measures:** these allow for a period of relief for customers to facilitate their anticipated return to the previous terms or completion of the sale of the property which would lead to a full recovery by the Group. This will usually take the form of agreeing with the customer to either temporarily suspend or reduce their monthly payments to less than they would have been on a fully commercial basis.
- **Conversion to interest only repayments:** this allows the customer to maintain payments with the intention that the capital balance outstanding would be recovered at the end of the term through the sale of the property or by some other repayment vehicle.
- **Extensions to the loan term:** this allows the customer to make lower repayments whilst still repaying the outstanding balance in full.

At an operational level, forbearance measures that either extend the loan term or relate to a conversion to interest only repayments are undertaken within a dedicated Financial Solutions Unit, which was established in 2009 with the aim of helping our retail customers in financial difficulty to manage their finances more effectively. All other forbearance measures are exercised within Mortgage Collections.

Retail home loans subject to forbearance are of low financial significance in the context of the Group's overall lending operations. The tables below summarise the number of arrangements in place and the loan balances and impairment provisions associated with those arrangements. Where a customer is subject to more than one forbearance measure, they have been categorised into the primary method of forbearance.

2012			% of total portfolio %	Impairment allowance £m	% coverage %
	Number	£m			
Temporary forbearance	210	17	0.11	1	5.88
Interest only conversion	27	2	0.01	-	0.00
Term extension	15	1	0.00	-	0.00
Formal arrangements	673	52	0.34	2	3.85
Other arrangements	9	-	0.00	-	0.00
	934	72	0.46	3	4.17

2011			% of total portfolio %	Impairment allowance £m	% coverage %
	Number	£m			
Temporary forbearance	298	21	0.15	-	0.00
Interest only conversion	60	5	0.04	-	0.00
Term extension	19	1	0.01	-	0.00
Formal arrangements	1,227	94	0.68	3	3.19
Other arrangements	28	1	0.01	-	0.00
	1,632	122	0.89	3	2.46

Notes to the consolidated financial statements (continued)

39. Financial risk management (continued)

Credit risk (continued)

Retail forbearance (continued)

A further forbearance reserve of £4m (2011: £5m) is presently held within the overall collective provision. The effect of this on the above tables would be to increase the impairment provision to £7m (2011: £8m) and to increase overall coverage to 9.72% (2011: 6.56%). The overall reduction in the volume of customers who are subject to forbearance measures as at 30 September 2012 can be attributed to a number of factors including, but not limited to, some customers returning to a stable position following a short period of successful forbearance and other customer circumstances where forbearance is no longer suitable.

Examples of short-term or temporary forbearance measures included in the category “temporary forbearance” above are:

- Arrangement or short term promise to pay.
- Payment of fees/charges on behalf of the customer to protect security of the property.
- Reduced payment concession.
- Temporary transfer to interest only terms.
- Non-contractual payment holidays/redraw of previous overpayments.

The above list of short-term or temporary forbearance solutions is not exhaustive and is applied on a case-by-case basis where appropriate.

When all other avenues of resolution including forbearance have been explored the Group will take steps to repossess and sell underlying collateral. In the year to 30 September 2012 there were 200 repossessions including 50 voluntary (2011: 161 including 55 voluntary).

The Group also currently exercises limited forbearance strategies in relation to unsecured loans and credit cards which mainly consist of term extensions (subject to negotiations with the customer) for the former and reduced payment arrangements for the latter. Forbearance strategies implemented on unsecured loans and credit cards are of low financial significance in the context of the Group’s overall lending operations.

Non-retail forbearance

The Group identifies commercial customers where a forbearance strategy may be appropriate on a case by case basis. Commercial customer relationships are individually managed with lending tailored to the specific requirements of the business.

Commercial customer terms can be renegotiated or modified for a variety of reasons, not all of which will be as a direct result of the introduction of a non-retail forbearance strategy.

Non-retail forbearance is undertaken selectively where the Group has identified that repayment difficulties against the originally approved terms already have, or are very likely to materialise. Where the changes are made on terms that the Group would not ordinarily consider on a commercial basis, such cases are treated as impaired facilities in accordance with the Bank Credit Policy on Restructured Obligations. Terms renegotiated or modified on a commercial basis would not be treated as non-retail forbearance, reflecting the Bank Credit Policy on Re-contracted Obligations.

Where loans have been renegotiated on a non-commercial basis and concessions have been granted, non-retail forbearance would be considered to be in place until such time as there is evidence to show a significant reduction in the risk of non-payment from future cash flows consistent with the Bank Credit Policy on Cured Default. When the terms of the loan have been renegotiated, the loan is no longer considered past due.

Notes to the consolidated financial statements (continued)

39. Financial risk management (continued)

Credit risk (continued)

Non-retail forbearance (continued)

For the purposes of determining whether non-retail forbearance is evident the following types of modification are considered as concessionary:

- extending of facility payment term;
- deferral of contracted capital repayments (i.e. capital repayment holiday or rescheduling);
- reduction in the contracted interest rate, including a reduction in the level of accrued interest, or amendment to the original fee structure;
- debt forgiveness; and
- use of alternative forms of payment, including debt for equity and asset transfer.

Modification of facilities which do not affect payment terms, including restructuring of security arrangements or waiver of rights under documented covenants are not considered as sufficient to indicate non-retail forbearance. In isolation such amendments do not necessarily constitute evidence of financial difficulty.

Covenants are frequently documented to give the Bank rights of repricing or other action at the early stages of credit deterioration where payment capacity is yet to be affected. Where covenant breaches have occurred which could imply financial difficulty normal impaired asset review procedures are followed in line with Bank Credit Policy

If the Group has made a demand for repayment, such facilities are not considered to evidence non-retail forbearance as the facilities are withdrawn and a debt repayment process, through realisation of security or otherwise, is instigated.

The tables below summarise the number of arrangements in place and the loan and impairment allowances associated with those arrangements. Where a customer is subject to more than one forbearance measure, they have been categorised into the primary method of forbearance.

2012	Number	£m	% of total portfolio %	Impairment allowance £m	% coverage %
Term extension	1,059	1,078	6.52	168	15.59
Deferral of contracted capital payments	296	234	1.41	21	8.97
Reduction in contracted interest rate	24	22	0.13	4	18.18
Debt forgiveness	36	53	0.32	11	20.75
Alternative forms of payment	31	86	0.52	4	4.65
	1,446	1,473	8.90	208	14.12

Notes to the consolidated financial statements (continued)

39. Financial risk management (continued)

Credit risk (continued)

Non-retail forbearance (continued)

The tables below summarise the number of arrangements in place and the loan balances and impairment provisions associated with those arrangements for assets that are classified as being held for sale as described in note 24. These amounts are included within the table above summarising the total number of arrangements in place.

2012 – Assets classified as held for sale	Number	£m	% of total of held for sale portfolio %	Impairment allowance £m	% coverage %
Term extension	645	979	17.32	164	16.75
Deferral of contracted capital payments	54	78	1.38	6	7.69
Reduction in contracted interest rate	11	13	0.23	4	30.77
Debt forgiveness	10	15	0.26	1	6.67
Alternative forms of payment	13	34	0.60	2	5.88
	733	1,119	19.79	177	15.82

Maximum exposure to credit risk

The Group's credit exposure has been determined in accordance with capital adequacy guidelines. The Group has comprehensive credit risk management policies that restrict the level of exposure to any one borrower or group of borrowers, industries and countries. Unless otherwise noted, the amount that best represents the maximum credit exposure at reporting date is the carrying value of the financial asset.

The table below shows the maximum exposure to credit risk for the components of the balance sheet, including derivatives. The maximum exposure is shown gross, before the effect of mitigation through use of master netting and collateral agreements. The table also shows the maximum amount of commitments from its banking operations.

Maximum credit risk exposure	Group		Bank	
	2012 £m	2011 £m	2012 £m	2011 £m
Cash and balances with central banks (note 10)	7,923	6,022	7,923	6,022
Due from related entities (note 11)	1,256	4,950	5,782	9,803
Due from other banks	14	12	13	12
Investments – available for sale (note 12)	1,039	1,110	1,039	1,109
Investments – held to maturity (note 12)	-	-	709	701
Other financial assets at fair value (note 13)	2,791	4,846	2,791	4,846
Derivative financial assets (note 14)	600	1,018	600	1,009
Loans and advances to customers (note 15)	24,346	28,238	19,704	23,585
Due from customers on acceptances	7	7	7	7
Assets held for sale (note 24)	5,225	-	5,225	-
	43,201	46,203	43,793	47,094
Contingent liabilities (note 33)	286	285	286	285
Commitments (note 33)	9,290	10,568	9,290	10,568
Commitments relating to assets held for sale (note 33)	140	-	140	-
Maximum credit risk exposure	52,917	57,056	53,509	57,947

The commitments balance includes sale and option to repurchase transactions and other commitments.

Notes to the consolidated financial statements (continued)

39. Financial risk management (continued)

Credit risk (continued)

Credit quality of financial assets

Notes 15 and 24 contain an assessment of the credit quality of loans and advances to customers including assets held for sale. Note 12 contains an assessment of the credit quality of investments.

Collateral held as security and other credit enhancements

The Group evaluates each customer's creditworthiness on a case by case basis. The amount of collateral obtained, if deemed necessary by the Group upon extension of credit, is based on management's credit evaluation of the counterparty. Collateral held varies, but may include:

- specific charges over defined assets of the counterparty;
- a floating charge over all assets and undertakings of an entity, including uncalled capital and called but unpaid capital;
- specific or interlocking guarantees; and
- loan agreements which include affirmative and negative covenants and in some instances guarantees of counterparty obligations.

Generally, the Group does not take possession of collateral it holds as security or call on other credit enhancements that would result in recognition of an asset on its balance sheet.

It is the Group's policy to dispose of repossessed properties in an orderly fashion. The proceeds are used to reduce or repay the outstanding claim. In general, the Group does not occupy repossessed properties for its own business use.

Risk concentration

Concentration of risk is managed by client / counterparty, by product, by geographical region and by industry sector. In addition single name exposure limits exist to limit exposure to a single entity / counterparty.

Eurozone risk

The Group and Bank have no material operations outside the UK and have no direct sovereign exposure to the peripheral Eurozone countries (Greece, Ireland, Italy, Portugal and Spain) (2011: Nil). The Group and Bank had an exposure to the European Investment Bank of £100m at 30 September 2012 (2011: £100m).

Notes to the consolidated financial statements (continued)

39. Financial risk management (continued)

Credit risk (continued)

Industry concentration of credit risk

The following tables show the levels of industry concentration of credit risk as at 30 September:

Loans and advances to customers including loans designated at fair value through profit or loss and assets held for sale	Group		Bank	
	2012 £m	2011 £m	2012 £m	2011 £m
Government and public authorities	39	34	39	34
Agriculture, forestry, fishing and mining	1,913	1,864	1,913	1,864
Financial, investment and insurance	886	1,110	886	1,110
Property – construction	3,722	4,436	3,722	4,436
Manufacturing	922	1,047	922	1,047
Instalment loans to individuals and other personal lending (including credit cards)	2,372	2,553	2,372	2,553
Property – mortgage	15,369	13,981	10,822	9,462
Asset and lease financing	694	901	569	636
Other commercial and industrial	7,303	7,751	7,303	7,838
	<u>33,220</u>	<u>33,677</u>	<u>28,548</u>	<u>28,980</u>

Contingent liabilities and credit related commitments	Group		Bank	
	2012 £m	2011 £m	2012 £m	2011 £m
Agriculture, forestry, fishing and mining	753	745	753	745
Financial, investment and insurance	66	187	66	187
Property – construction	543	827	543	827
Manufacturing	211	242	211	242
Instalment loans to individuals and other personal lending (including credit cards)	3,674	4,022	3,674	4,022
Property – mortgage	1,724	1,581	1,724	1,581
Other commercial and industrial	2,745	3,249	2,745	3,249
	<u>9,716</u>	<u>10,853</u>	<u>9,716</u>	<u>10,853</u>

Available for sale and held to maturity investments	Group		Bank	
	2012 £m	2011 £m	2012 £m	2011 £m
Financial, investment and insurance	<u>1,039</u>	<u>1,110</u>	<u>1,748</u>	<u>1,810</u>

The industry categories used in the above tables include assets that are designated as held for sale at the balance sheet date.

Notes to the consolidated financial statements (continued)

39. Financial risk management (continued)

Market risk

Market risk is the risk that movements in market factors, including foreign exchange rates, interest rates, credit spreads and equity prices, will reduce income or portfolio values.

The focus of the Group's activity is to provide high quality banking services to its customers. These services include provision of foreign exchange and derivative products to enable customers to manage risks within their businesses. As a result of these activities the Group may be exposed to forms of market risk that would arise from movements in price on these products. These risks are managed to a de minimus risk position in accordance with the Bank's Trading Policy Statement.

The Group's participation in wholesale markets, along with its use of financial instruments, is to fund its banking activities and to manage the liquidity and interest rate risks arising from these activities.

Interest rate risk in the banking book (IRRBB)

IRRBB is measured, monitored, and managed from both an internal management and regulatory perspective. The risk management framework incorporates both market valuation and earnings based approaches in accordance with the NAB Group IRRBB policy. Risk measurement techniques include: Value at Risk (VaR), Earnings at Risk (EaR), interest rate risk stress testing, repricing analysis, cash flow analysis, and scenario analysis.

The key features of the internal interest rate risk management model are:

- Historical simulation approach utilising instantaneous interest rate shocks.
- Static balance sheet (i.e. any new business is assumed to be matched, hedged or subject to immediate repricing).
- VaR and EaR are measured on a consistent basis.
- 99% confidence level.
- Three month holding period.
- EaR utilises a twelve month forecast period.
- 8 years of business day historical data.
- Rate changes are proportional rather than absolute.
- Investment term for capital is modelled with an established benchmark term of between 1 and 5 years.
- Investment term for core "non-interest" bearing assets and liabilities is modelled on a behavioural basis with an established benchmark term of between 1 and 5 years.

Model parameters and assumptions are reviewed and updated on at least an annual basis by Non-Traded Market Risk, in consultation with Treasury. Material changes require the approval of the UK ALCO.

Interest rate risk	Value at risk		Earnings at risk	
	2012 £m	2011 £m	2012 £m	2011 £m
As at 30 September	31	41	4	14
Average value during the year	37	31	6	9
Minimum value during the year	31	26	2	2
Maximum value during the year	45	41	13	14

Prepayment risk

Early repayment charges on fixed rate business loans are calculated on an economic cost basis, fully recompensing the Bank for any loss on the unwinding of the underlying hedge. Early repayment charges on fixed rate mortgages are calculated on a sliding scale basis, whereby an agreed percentage of the balance is charged dependent upon the residual time to maturity of the loan.

Notes to the consolidated financial statements (continued)

39. Financial risk management (continued)

Maturity analysis of assets and liabilities

The following tables represent a breakdown of the Group's balance sheet according to the assets and liabilities contractual maturity. Many of the longer-term monetary assets are variable rate products, with actual maturities shorter than the contractual terms. Accordingly, this information is not relied upon by the Group in its management of interest rate risk.

The Group has disclosed certain term facilities with a revolving element at the maturity of the facility as this best reflects their contractual maturity.

Group 2012	Call £m	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	No specified maturity £m	Total £m
Assets							
Cash and balances with central banks	6,800	-	-	-	-	1,123	7,923
Due from related entities	1,223	-	-	-	33	-	1,256
Due from other banks	-	14	-	-	-	-	14
Investments – available for sale	-	-	-	100	932	7	1,039
Other financial assets at fair value	1	45	165	1,006	1,574	-	2,791
Derivative financial assets	-	37	50	314	199	-	600
Loans and advances to customers	4,132	488	796	3,799	14,695	436	24,346
Due from customers on acceptances	-	7	-	-	-	-	7
All other assets	153	340	62	-	-	465	1,020
Assets held for sale	587	135	723	2,462	1,298	20	5,225
Total assets	12,896	1,066	1,796	7,681	18,731	2,051	44,221
Liabilities							
Due to other banks	-	521	36	-	-	-	557
Other financial liabilities at fair value	-	-	5	74	68	-	147
Derivative financial liabilities	7	87	51	236	571	-	952
Due to customers	15,599	3,527	3,453	3,802	-	-	26,381
Liabilities on acceptances	-	7	-	-	-	-	7
Due to related entities	595	26	4,350	1,006	1,550	-	7,527
Bonds, notes and subordinated debt	-	-	590	1,370	1,203	-	3,163
All other liabilities	1,641	436	40	-	-	624	2,741
Liabilities associated with assets held for sale	-	-	6	48	88	-	142
Total liabilities	17,842	4,604	8,531	6,536	3,480	624	41,617

Notes to the consolidated financial statements (continued)

39. Financial risk management (continued)

Maturity analysis of assets and liabilities (continued)

Group 2011 As restated	Call £m	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	No specified maturity £m	Total £m
Assets							
Cash and balances with central banks	5,071	-	-	-	-	951	6,022
Due from related entities	799	2,724	1,427	-	-	-	4,950
Due from other banks	-	12	-	-	-	-	12
Investments – available for sale	-	-	66	100	937	7	1,110
Other financial assets at fair value	-	113	386	1,933	2,414	-	4,846
Derivative financial assets	-	59	444	349	166	-	1,018
Loans and advances to customers	4,979	652	1,143	5,969	15,012	483	28,238
Due from customers on acceptances	-	7	-	-	-	-	7
All other assets	-	639	37	-	-	373	1,049
Assets held for sale	-	-	-	-	-	-	-
Total assets	10,849	4,206	3,503	8,351	18,529	1,814	47,252

Liabilities							
Due to other banks	238	655	614	-	-	-	1,507
Other financial liabilities at fair value	-	-	-	33	122	-	155
Derivative financial liabilities	-	30	75	248	578	-	931
Due to customers	16,672	5,838	4,044	1,616	-	-	28,170
Liabilities on acceptances	-	7	-	-	-	-	7
Due to related entities	34	1,153	2,415	2,151	2,005	-	7,758
Bonds, notes and subordinated debt	-	1,255	1,504	590	204	-	3,553
All other liabilities	1,335	566	38	-	-	353	2,292
Liabilities associated with assets held for sale	-	-	-	-	-	-	-
Total liabilities	18,279	9,504	8,690	4,638	2,909	353	44,373

Bank 2012	Call £m	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	No specified maturity £m	Total £m
Assets							
Cash and balances with central banks	6,800	-	-	-	-	1,123	7,923
Due from related entities	5,749	-	-	-	33	-	5,782
Due from other banks	-	13	-	-	-	-	13
Investments – available for sale	-	-	-	100	932	7	1,039
Investments – held to maturity	-	-	-	709	-	-	709
Other financial assets at fair value	1	45	165	1,006	1,574	-	2,791
Derivative financial assets	-	37	50	314	199	-	600
Loans and advances to customers	4,018	485	779	3,578	10,408	436	19,704
Due from customers on acceptances	-	7	-	-	-	-	7
All other assets	246	325	185	-	-	882	1,638
Assets held for sale	587	135	723	2,462	1,298	20	5,225
Total assets	17,401	1,047	1,902	8,169	14,444	2,468	45,431

Liabilities							
Due to other banks	-	521	36	-	-	-	557
Other financial liabilities at fair value	-	-	5	74	68	-	147
Derivative financial liabilities	7	86	-	217	571	-	881
Due to customers	15,598	3,527	3,454	3,802	-	-	26,381
Liabilities on acceptances	-	7	-	-	-	-	7
Due to related entities	595	646	4,350	3,867	1,550	-	11,008
Bonds, notes and subordinated debt	-	-	-	1,084	-	-	1,084
All other liabilities	1,641	436	40	-	-	617	2,734
Liabilities associated with assets held for sale	-	-	6	48	88	-	142
Total liabilities	17,841	5,223	7,891	9,092	2,277	617	42,941

Notes to the consolidated financial statements (continued)

39. Financial risk management (continued)

Maturity analysis of assets and liabilities (continued)

Bank 2011 As restated	Call £m	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	No specified maturity £m	Total £m
Assets							
Cash and balances with central banks	5,071	-	-	-	-	951	6,022
Due from related entities	5,429	2,947	1,427	-	-	-	9,803
Due from other banks	-	12	-	-	-	-	12
Investments – available for sale	-	-	66	100	937	6	1,109
Investments – held to maturity	-	-	-	701	-	-	701
Other financial assets at fair value	-	113	386	1,933	2,414	-	4,846
Derivative financial assets	-	59	444	340	166	-	1,009
Loans and advances to customers	5,120	650	2,308	4,662	10,362	483	23,585
Due from customers on acceptances	-	7	-	-	-	-	7
All other assets	-	639	37	-	-	993	1,669
Assets held for sale	-	-	-	-	-	-	-
Total assets	15,620	4,427	4,668	7,736	13,879	2,433	48,763
Liabilities							
Due to other banks	238	655	614	-	-	-	1,507
Other financial liabilities at fair value	-	-	-	33	122	-	155
Derivative financial liabilities	-	30	318	248	578	-	1,174
Due to customers	16,781	5,838	4,044	1,616	-	-	28,279
Liabilities on acceptances	-	7	-	-	-	-	7
Due to related entities	34	1,959	2,415	4,067	2,005	-	10,480
Bonds, notes and subordinated debt	-	1,255	59	590	204	-	2,108
All other liabilities	1,335	566	38	-	-	421	2,360
Liabilities associated with assets held for sale	-	-	-	-	-	-	-
Total liabilities	18,388	10,310	7,488	6,554	2,909	421	46,070

Comparative disclosures have been restated to conform with current year presentation. The reclassification of derivative balances from other financial assets and liabilities at fair value to derivative financial assets and liabilities is referred to in note 13. The maturity profile of all other assets and all other liabilities has been adjusted in line with the presentation in the NAB Annual Financial Report.

Liquidity risk

Liquidity risk is the risk that the Group will encounter difficulty in meeting obligations associated with financial liabilities when they fall due. The Group manages liquidity and funding risk through a combination of positive cash flow management, the maintenance of portfolios containing high quality liquid assets, maintenance of a prudent funding strategy and diversification of its funding base. The Group undertakes a conservative approach by imposing internal limits, including stress and scenario testing that are in addition to regulatory requirements.

Notes to the consolidated financial statements (continued)

39. Financial risk management (continued)

Liquidity risk (continued)

Cash flows payable under financial liabilities by contractual maturities

Group 2012	Call £m	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	No specified maturity £m	Total £m
Due to other banks	-	522	36	-	-	-	558
Other financial liabilities at fair value	-	2	9	103	81	-	195
Derivative financial liabilities	-	2	4	-	-	-	6
Due to customers	15,599	3,549	3,492	3,873	-	-	26,513
Liabilities on acceptances	-	7	-	-	-	-	7
Bonds, notes and subordinated debt	-	20	647	1,598	1,313	-	3,578
All other liabilities	1,567	-	-	-	-	-	1,567
<i>Risk management derivatives</i>							
Contractual amounts payable	-	2	1	-	-	-	3
Contractual amounts receivable	-	-	(4)	-	-	-	(4)
	17,166	4,104	4,185	5,574	1,394	-	32,423
Group 2011	Call £m	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	No specified maturity £m	Total £m
Due to other banks	238	662	617	-	-	-	1,517
Other financial liabilities at fair value	-	2	5	59	130	-	196
Derivative financial liabilities	-	-	-	-	-	44	44
Due to customers	16,688	5,862	4,069	1,667	-	-	28,286
Liabilities on acceptances	-	7	-	-	-	-	7
Bonds, notes and subordinated debt	-	1,270	1,526	640	210	-	3,646
All other liabilities	1,335	-	-	-	-	-	1,335
<i>Risk management derivatives</i>							
Contractual amounts payable	-	11	18	1	-	-	30
Contractual amounts receivable	-	(2)	(4)	-	-	-	(6)
	18,261	7,812	6,231	2,367	340	44	35,055
Bank 2012	Call £m	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	No specified maturity £m	Total £m
Due to other banks	-	522	36	-	-	-	558
Other financial liabilities at fair value	-	2	9	103	81	-	195
Derivative financial liabilities	-	2	4	-	-	-	6
Due to customers	15,599	3,549	3,492	3,873	-	-	26,513
Liabilities on acceptances	-	7	-	-	-	-	7
Bonds, notes and subordinated debt	-	11	32	548	808	-	1,399
All other liabilities	1,567	-	-	-	-	-	1,567
<i>Risk management derivatives</i>							
Contractual amounts payable	-	2	1	-	-	-	3
Contractual amounts receivable	-	-	(4)	-	-	-	(4)
	17,166	4,095	3,570	4,524	889	-	30,244

Notes to the consolidated financial statements (continued)

39. Financial risk management (continued)

Liquidity risk (continued)

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

Bank 2011	Call £m	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	No specified maturity £m	Total £m
Due to other banks	238	662	617	-	-	-	1,517
Other financial liabilities at fair value	-	2	5	59	130	-	196
Derivative financial liabilities	-	-	-	-	-	44	44
Due to customers	16,688	5,862	4,069	1,667	-	-	28,286
Liabilities on acceptances	-	7	-	-	-	-	7
Bonds, notes and subordinated debt	-	1,269	660	46	210	-	2,185
All other liabilities	1,335	-	-	-	-	-	1,335
<i>Risk management derivatives</i>							
Contractual amounts payable	-	11	18	1	-	-	30
Contractual amounts receivable	-	(2)	(4)	-	-	-	(6)
	<u>18,261</u>	<u>7,811</u>	<u>5,365</u>	<u>1,773</u>	<u>340</u>	<u>44</u>	<u>33,594</u>

The balances in the cash flow tables above will not agree directly to the balances in the consolidated balance sheet as the table incorporates all cash flows, on an undiscounted basis, related to both principal as well as those associated with all future coupon payments. The balances for other financial liabilities at fair value and derivative financial liabilities are less than shown on the consolidated balance sheet as they exclude cash flows on related party balances.

The Group and Bank all other liabilities balance for 2011 has been reclassified from no specified maturity to call to align with the presentation in the NAB Annual Financial Report.

40. Management of risk

Effective management of risk is a key capability for a successful financial services provider and is fundamental to the Group's strategy, as well as that of its parent entity NAB Group. A key component of the Group's risk management strategy is the establishment by the Board of a formal 'Risk Appetite Statement'.

This places an overall limit on the total amount of risk that the Group is prepared to take. This is set with respect to the returns that the Group is seeking to provide to its shareholder, the credit rating that the Bank is seeking to maintain and the Group's capital position and desired capital ratios.

This informs the Group's risk, capital and business limits and policies. It is regularly reviewed by the Board as a part of the strategic planning process, or as the commercial circumstances of the Group change.

The Group's approach to risk management is based on an overriding principle that risk management capability must be embedded within the businesses' front-line teams to be effective. This overriding principle embodies the following concepts:

- all business decisions proactively consider risk and the impact on the Group's customers;
- business managers use the Risk Management Framework which assists in the appropriate balancing of both the risk and reward components;
- all employees are responsible for risk management in their day-to-day activities; and
- risk management is a core competency for all employees.

Notes to the consolidated financial statements (continued)

40. Management of risk (continued)

Within this context, the Group manages risk within a three lines of defence framework. Control is exercised through clearly defined delegation of authority, with clear and rapid communication and escalation channels throughout the organisation. The first line of defence comprises the business units managing the risks associated with their activities. The second line encompasses dedicated risk functions who are accountable for establishing risk policy, standards and the oversight of risk management effectiveness within the business. The third line of defence is Internal Audit who are responsible for independently reviewing, monitoring, and testing business unit compliance and regularly assessing the overall effectiveness of the Risk Management Framework.

The NAB Group Risk and Reward Management Committee, chaired by the Group Chief Executive Officer, serves as the principal risk strategy and policy decision making body within the NAB Group, and provides the Principal Board with assurance on the performance of the overall Risk Management Framework. This Committee is supported by three sub-committees - the NAB Group Credit Risk Committee, the NAB Group Asset and Liability Committee (NAB Group ALCO), and the NAB Group Capital Committee - each with a specialised focus.

Within the UK, Board oversight of risk management is facilitated through the European Boards' Risk Committee, which enables Board members to challenge Executives on the profile and management of risk. This is supplemented by the annual ICAAP Board submission, which is completed alongside the Capital Plan, Strategic Plan, the Internal Liquidity Adequacy Assessment (ILAA), Recovery and Resolution Plan and the Risk Appetite Statement. There is also a UK Risk Committee, chaired by the Chief Executive Officer UK, and comprised of senior Bank executives, which serves to provide leadership focus on key risk issues from a Group perspective. The Committee is supported by the following UK Governance Committees: UK Asset & Liability Committee (UK ALCO), Pension Management Committee and Model Oversight Committee. First line responsibility for risk management resides with the Management Assurance Committees in each of the Bank's principal operating divisions: Retail, Business & Private Bank and Operations & Information Technology. Each of the Management Assurance Committees provide reports to the UK Risk Committee and European Board Risk Committee.

The UK Risk Management team independently monitors and systematically assesses the risk profile within the Group against established risk appetite parameters. They also assist the front line business units in the design and implementation of appropriate risk management policies / strategies and work with the business units to promote awareness of the need to manage risk.

Credit risk

Credit risk is the potential that a borrower or a counterparty will fail to meet its obligations in accordance with agreed terms. The Group's credit risk management infrastructure is framed to provide sound management principles and practices for the maintenance of appropriate asset quality.

The management of credit risk within the Group is achieved through both approval and monitoring of individual transactions and asset quality, analysis of the performance of the various credit risk portfolios and the independent oversight of credit portfolios across the Group. Portfolio monitoring techniques cover such areas as industry or geographic concentrations and delinquency trends. Roles and responsibilities within the Group are clearly defined.

Significant credit risk strategies and policies are approved, and reviewed annually, by the NAB Board, and the NAB Group Credit Risk Committee. Through such policies the NAB Board establishes the NAB Group's tolerance for risk. For complex credit products and services, the Group Chief Credit Officer (and associated teams) provides a policy framework that identifies and quantifies risks and establishes the means of mitigating such risks. These policies and frameworks are delegated to, and disseminated under the guidance and control of, executive management within the UK, with appropriate oversight through the UK executive management governance committees.

The Group's credit policies and procedures, which are subject to ongoing review, are documented and disseminated in a form that supports the credit operations of the Group.

Single large exposure policies are in place within the Group. Overall composition and quality of credit portfolio exposures are monitored and periodically reported to the Board, and, where required, to the relevant supervisory authorities.

Notes to the consolidated financial statements (continued)

40. Management of risk (continued)

Operational risk

Operational risk is the risk of loss resulting from inadequate or failed processes, people or systems or from external events. This includes legal risks as well as operational risk components associated with other risks categories (e.g. credit, traded market, non-traded market).

To assist with the management of operational risk, risk categories aligned to Basel II are used to categorise and facilitate the consistent identification, assessment, mitigation, monitoring and reporting of risks and events.

These risk categories are defined as follows:

- Customer, Products and Sales Practices – the treatment of customers and the management of customers impacts on all the Group's core activities. This is a principal focus of the Board, Senior Management and the regulators and the Group seeks to ensure customers are treated fairly, products are designed and sold to meet their needs, that customer expectations are met and complaints are dealt with effectively. Consideration of customer outcomes is embedded within the Group's operating processes and metrics are regularly monitored to ensure outcomes are appropriate.
- Regulatory Environment and Market Practices – the Group is required to comply with a large volume of laws and regulations and the regulatory environment has also been subject to substantial change in recent years. This is likely to continue and represents an on-going focus of the Group's management in ensuring the Group continues to operate within prudential parameters and that the conduct of the Group's activities meets the expectations of the Group's customers, shareholders and regulators. The Group operates a zero tolerance for regulatory breaches and organises its activities to ensure controls over regulatory risk are maintained in addition to maintaining a strong, open and trusted relationship with its regulators.
- Monitoring, Reporting and Oversight – effective controls over business operations are essential for the protection of the Group's customers and shareholders and is a key responsibility of all employees and managers. The Group continues to reinforce frameworks, standards and oversight arrangements to enhance the quality of risk management in the organisation. Each business unit maintains a risk profile with embedded controls and actions to manage inherent risks.
- Payments and Process Management – the Group processes a large volume of transactions for customers every day and manages the risks in this and other operations to ensure these activities are conducted safely and efficiently. However, in all operational activity there is a potential risk of established procedures not being followed, a failure to detect errors or that inadequate controls are in place.
- External Fraud and Criminal Activities – the Group takes seriously its responsibilities to protect customers against financial crime. This includes preventing fraud activities in all channels through which customers transact; the prevention of money laundering; and compliance with legal sanctions requirements. Fraud management is an ongoing challenge for the financial services industry and presents a constant risk to the Group as criminal activities evolve on a national and global basis. The Group takes steps to ensure its systems and controls remain appropriate to mitigate against the risks faced.
- Internal Fraud and Criminal Activities – The Group recognises the risk of internal fraud associated with internal acts intended to defraud, misappropriate funds, information and physical assets, and circumvent policy. The Group has no tolerance for internal fraud and has a strong control framework in place to mitigate this risk.
- Workplace Practices and Environment – providing a safe environment for customers and colleagues is important for the success of the business and the Group seeks to ensure adequate safeguards are in place and are operating effectively.
- Systems and Infrastructure – There is a risk of service interruption due to failure of the Group's systems leading to a period of service disruption. The Group has a strong framework of controls over the continuity of service provision for all critical processes including recovery procedures in the event of unplanned service interruption.
- Third Party Providers - Failure to manage third party providers effectively may also impact on the level of service available to customers. The Group's controls to mitigate this risk include regular oversight of third party processes and assurance testing of the effectiveness of relationship management.

Notes to the consolidated financial statements (continued)

40. Management of risk (continued)

Operational Risk (continued)

Responsibility for the management of operational risk rests with the business managers with oversight from the Risk Management function and independent assurance activities undertaken by Internal Audit. The Group has an established Operational Risk Framework which operates across the Group. This is based on a set of core principles and defines the Group's standards for Operational Risk Management and compliance. Its design recognises the importance of embedding the management of operational risk into business activities. It has particular focus on defining and implementing the right behaviour and incorporating risk considerations into the Group's systems and processes.

The Operational Risk Framework is an essential element of the business strategy which underpins all operational risk management activities that could impact the achievement of business objectives or impact core business processes. It includes:

- an established governance structure that is used to ensure consistent application, control and reporting of the Operational Risk Management process. This element also includes the establishment and communication of the Group's operational risk appetite; and
- a structured process to facilitate the identification, quantification and management of risks underpinned by clear policies and guidelines. Material risks are reported monthly to the Management Assurance Committees and the UK Risk Committee, and to each European Boards' Risk Committee to provide visibility and understanding of the Group's overall risk profile.

Non-traded market risk

Non-traded market risks include liquidity and funding risk, structural interest rate risk, foreign exchange risk and risks associated with the Group's defined benefit pension scheme. The primary objective for the management and oversight of non-traded market risks is to maintain the risk profile within approved risk appetite and limits, while implementing strategies that protect current and future earnings from the impact of market volatility.

Policies relating to non-traded market risks are approved by the Board of the NAB Group. The consistent application of NAB Group policies across the Group is the responsibility of the Bank's Board with the support of executive management governance committees. In relation to non-traded market risks, the primary management committee is the UK ALCO.

Risk appetite and limits are approved for non-traded market risk by the Bank's Board, with authority delegated to the UK ALCO for their subsequent implementation and monitoring.

UK ALCO oversees the management of non-traded market risks. UK ALCO meets monthly and reports to the UK Risk Committee. The Group's Treasury division is responsible for the development and execution of strategy subject to oversight from the Non-Traded Market Risk team.

Liquidity and funding risk

Liquidity risk is the risk that the Group is unable to meet its current and future financial obligations as they fall due at acceptable cost. These obligations include the repayment of deposits on-demand or at their contractual maturity dates, the repayment of borrowings and loan capital as they mature, the payment of operating expenses and tax, the payment of dividends and the ability to fund new and existing loan commitments.

Liquidity within the Group is managed in accordance with the Bank's Individual Liquidity Adequacy Assessment (ILAA) that is approved by the Board. The ILAA includes the manner in which the Bank meets all regulatory requirements of the FSA and includes the Group's policy for the management of liquidity risk. Oversight of liquidity risk is undertaken by the UK ALCO. In recognition of the global nature of liquidity risk the liquidity position of entities across the NAB Group, including the Bank, is monitored by the NAB Group ALCO in accordance with the NAB Group Non-Traded Market Risk Policy. To meet the requirements of local regulatory authorities the liquidity of the Bank is managed on a daily basis as a stand-alone undertaking. UK ALCO delegates daily management responsibilities to the Group's Treasury division.

Notes to the consolidated financial statements (continued)

40. Management of risk (continued)

Non-traded market risk (continued)

Liquidity and funding risk (continued)

The ILAA encompasses the requirements of local regulatory authorities and those of the NAB Group. This results in liquidity being managed through a combination of positive cash flow management, including under a series of assumptions to simulate stressed market conditions, the maintenance of portfolios of high quality liquid assets and diversification of the funding base.

A contingency plan has also been established for management of an escalated liquidity requirement where the Bank or the NAB Group experiences either restricted access to wholesale funding, or a large increase in the withdrawal of funds. The plan identifies triggers for escalation, details the action required, allocates the key tasks to individuals, provides a timeframe and defines a management committee to manage the action plan.

Structural interest rate risk

Structural interest rate risk comprises the sensitivity of the Group's current and future net interest income to movements in market interest rates.

There are three major contributors to interest rate risk:

- the investment of non-interest bearing deposits and equity into interest-bearing assets;
- the mismatch between repricing dates of interest-bearing assets and liabilities; and
- the inability of the pricing 'basis' for customer asset and liability products to be replicated in the financial markets i.e. basis risk.

Within the objective to secure stable and optimal net interest income over both a 12-month period and over the long term, mismatch risk can be minimised with the investment of equity and non-interest-bearing deposits targeting the stability of net interest income.

Interest rate risk is principally managed through the use of interest rate swaps. All products are used within approved mandates, with strategies subject to monthly reporting to UK ALCO and NAB Group ALCO.

Interest rate risk management across the Group is directed by UK ALCO with delegation for day-to-day management to the Group's Treasury division. The UK Risk Committee, through UK ALCO oversight, monitors risk to ensure it remains within approved policy and Board approved risk appetite.

Basis risk is managed through a combination of wholesale market basis risk products, pricing strategies and product innovation.

A key feature of the risk management and oversight framework is the use of Value at Risk (VaR) as a measure of interest rate risk, along with Earnings at Risk (EaR) to measure the impact on future net interest income. Limits for VaR and EaR are complemented by sensitivity and scenario analysis.

Oversight of interest rate risk is conducted by the Group's Risk Management team that is independent of the Treasury division.

Notes to the consolidated financial statements (continued)

40. Management of risk (continued)

Non-traded market risk (continued)

Foreign exchange risk

Exposures arise if future cash flows can only be converted to Sterling at less favourable rates than at the time of the original transaction. The Group's policy is to fully hedge these exposures at the time of commitment for all exposures that are considered to be of a marketable size.

The transactional currency exposures principally arise from dealings with customers and the Group maintains a matched position through transactions with a range of counterparties including the NAB Group in order to comply with the Group's Trading Policy Statement.

Pension risk

Pension risk is the risk that, at any point in time, the available assets to meet pension liabilities are at a value below current and future scheme obligations. The operation of a pension scheme gives rise to a number of risks, e.g. movements in equity valuations, changes in bond yields and life expectancy of scheme members. The Scheme is managed by independent Trustees however the impact of the Scheme on the Group is subject to management by the Group and corresponding risk oversight. The Group's Pension Management Committee reports to the UK Risk Committee on pension risks.

41. Capital management overview

The Group is governed by NAB Group's Capital Management Policy. The objectives of the NAB Group's Capital Management Policy are to efficiently manage the capital base to optimise shareholder returns whilst maintaining robust capital adequacy, meeting Regulators requirements and managing the ratings agencies assessment of the Group.

The Group implemented Basel II requirements from 1 January 2008 in measuring operational and credit risks under the standardised approach. Under Pillar I of Basel II, the Group calculates its minimum capital requirements based on 8% of RWAs. The FSA then adjusts this requirement to cover risks under Pillar II of Basel II and generate an Individual Capital Guidance (ICG) and a Capital Planning Buffer (CPB). The CPB is designed to be available to absorb losses and / or to cover increased capital requirements in adverse circumstances that are outside the Group's normal and direct control.

The ultimate responsibility for capital adequacy rests with the Board of Directors. The UK ALCO, which consists of the Chief Executive Officer, Executive Director, the Chief Financial Officer and other senior executives, is responsible for the management of the capital process including approving policy, overseeing internal controls and setting internal limits over capital ratios.

The Group actively manages its capital position and reports this on a regular basis to senior management via UK ALCO and other governance committees. Capital requirements are included within an annual capital management plan presented to and approved by the Board of Directors.

Notes to the consolidated financial statements (continued)

42. Basel II Capital Requirements Directive Pillar 3 disclosure

The FSA has granted the Bank a waiver direction under BIPRU 11.2.5: (Waiver: Comparable disclosures provided on a consolidated basis by a parent undertaking established in a non EEA state).

The waiver direction can be found on the FSA website: <http://www.fsa.gov.uk/register/pdf/A1375943P.pdf>

In line with the FSA waiver direction, the Group will rely on the following references to comparable National Australia Bank Limited consolidated disclosure to satisfy its Pillar 3 disclosure obligations plus an additional capital resources disclosure made on pages 12 and 13 of these Financial Statements.

National Australia Bank Limited 2012 Full Year Risk and Capital Report: <http://www.nabgroup.com/0,,32863,00.html>

National Australia Bank Limited 2012 Full Year Financial Results, Section 6 (Supplementary Information): <http://www.nab.com.au/vgnmedia/download/asx-2012-supplementary-information.pdf>

National Australia Bank Limited 2012 Annual Financial Report: <http://www.nabgroup.com/0,,32863,00.html>

The first published disclosure was based on the financial position of the Group and NAB as at 30 September 2008. After due consideration by the Group Directors, subsequent Pillar 3 disclosures will be made annually by way of the National Australia Bank Limited Risk and Capital Report. These disclosures will be in line with the FSA Waiver direction as outlined above.

The information contained in these qualitative disclosures has not been audited by the Group's external auditors except to the extent that they are equivalent to those made under accounting requirements and is limited to those required by BIPRU 11.

43. FSA Remuneration Pillar 3 disclosure

In December 2010, the FSA issued Policy Statement 10/21 'Implementing CRD3 requirements on the disclosure of remuneration'. The Pillar 3 disclosures required are specified within BIPRU 11.5.18R to BIPRU 11.5.21G. The Group will rely on the following references to comparable National Australia Bank Limited consolidated disclosures plus additional aggregate disclosures for UK Code Staff to satisfy the Pillar 3 disclosure obligations.

National Australia Bank Limited 2012 Annual Financial Report: <http://www.nabgroup.com/0,,32863,00.html>

The remuneration report is held within the Report of the Directors on pages 15 - 40 of the National Australia Bank Limited 2012 Annual Financial Report.

44. Events after the balance sheet date

On 5 October 2012, the Group successfully completed the transfer of the majority of its commercial real estate lending portfolio and associated assets and liabilities to NAB at their carrying value. The results of this element of the Group's business are accordingly excluded from the future financial performance of Clydesdale Bank PLC from 6 October 2012.

The balance transferred reflected those amounts disclosed in note 24 adjusted for transactions between 30 September 2012 and the date of transfer.

Glossary

Term	Description
APRA	Australian Prudential Regulatory Authority.
Arrears	A customer is in arrears when they fail to adhere to their contractual payment obligations resulting in an outstanding loan that is unpaid or overdue.
ATM	Automated teller machine.
Average assets	Represents the average of assets over the year adjusted for any disposed operations.
Bank	Clydesdale Bank PLC.
Basel II	The capital adequacy framework issued by the Basel Committee on Banking Supervision in June 2006 in the form of the “International Convergence of Capital Measurement and Capital Standards”.
Basel III	In December 2010, the Basel Committee issued final rules “Basel III: A global regulatory framework for more resilient banks and banking systems” and “Basel III: International framework for liquidity risk measurement, standards and monitoring”. Together these documents present the Basel Committee’s reforms to strengthen global capital and liquidity rules with the goal of promoting a more resilient banking sector. The new requirements will be phased in starting 1 January 2013 with full implementation by 1 January 2019.
Cash earnings	<p>A non Generally Accepted Accounting Principles (GAAP) key performance measure that excludes certain items within the calculation of net profit attributable to owners of the Group. It is also a key performance measure used by the Australian peers of the ultimate parent with a similar business portfolio. These specified items are excluded in order to better reflect what is considered to be the underlying performance of the Group.</p> <p>Net profit attributable to owners of the Group Adjusted for:</p> <ul style="list-style-type: none"> Distributions Treasury shares Fair value and hedge ineffectiveness Payment Protection Insurance provision charge Efficiency, quality and service initiatives (“EQS”) Restructure costs Litigation expense Property revaluation Goodwill impairment Software impairment
CFI	Customer funding index.
Collective impairment provision	Impairment assessment on a collective basis for homogeneous groups of loans that are not considered individually significant and to cover losses which have been incurred but have not yet been identified on loans subject to individual assessment.
Contractual maturities	The date on which the final payment (principal or interest) of any financial instrument is due to be paid, at which point all the remaining outstanding principal and interest have been repaid.

Glossary (continued)

Core Tier 1 capital	The highest quality form of regulatory capital that comprises total shareholders' equity (excluding preference shares issued) and related non-controlling interests, less goodwill and intangible assets and certain other regulatory adjustments.
CRE	Commercial real estate.
Credit enhancements	Facilities used to enhance the creditworthiness of financial obligations and cover losses due to asset default.
Credit risk	Risk of financial loss if a customer or counterparty fails to meet a payment obligation under a contract. It arises mainly from direct lending, trade finance and leasing business, but also from products such as guarantees, derivatives and debt securities.
Credit risk adjustment	An adjustment to the valuation of over the counter (OTC) derivative contracts to reflect the creditworthiness of OTC derivative counterparties. Can also be known as a credit value adjustment (CVA).
Customer deposits	Money deposited by account holders. Such funds are recorded as liabilities.
Debt restructuring	A restructuring by which the terms and provisions of outstanding debt agreements are changed. This is often done in order to improve cash flow and the ability of the borrower to repay the debt. It can involve altering the repayment schedule as well as debt or interest charge reduction.
Delinquency	See "Arrears".
Derivative	A derivative financial instrument is a contract or agreement whose value is related to the value of an underlying instrument, reference rate or index.
EaR	Earnings at risk. A measure of the quantity by which net interest income might change in the event of an adverse change in interest rates.
Efficiency, quality and service initiatives	Represent those costs that the Group accelerated in response to the economic downturn to bring forward efficiency gains that would otherwise have been realised in subsequent years.
Exposure	A claim, contingent claim or position which carries a risk of financial loss.
Fair value	Fair value is defined as the amount for which an asset could be exchanged, or a liability settled, between willing parties in an arm's length transaction.
Fair value adjustment	An adjustment to the fair value of a financial instrument which is determined using a valuation technique (level 2 and level 3) to include additional factors that would be considered by a market participant that are not incorporated within the valuation model.
Fair value and hedge ineffectiveness	Represents volatility attributable to the Group's application of the fair value option, ineffectiveness from designated accounting and economic hedge relationships and economic hedges of significant approved funding activities where hedge accounting has not been applied.
Forbearance	The term generally applied to the facilities provided to assist borrowers, both retail and non-retail, who are experiencing a period of financial stress and can take a variety of forms such as negotiating an arrangement or short term promise to pay, transfer to interest only terms, or term extensions.

Glossary (continued)

FSA	Financial Services Authority.
FSCS	Financial Services Compensation Scheme.
Funding risk	A form of liquidity risk arising when the liquidity needed to fund illiquid asset positions cannot be obtained at the expected terms and when required.
Group	Clydesdale Bank PLC and its controlled entities.
IFRS	International Financial Reporting Standards.
Impaired loans	Retail mortgages with security insufficient to cover principal and arrears of interest revenue; business lending where there is sufficient doubt about the ultimate collectability of principal and interest; and off-balance sheet credit exposures where current circumstances indicate that losses may be incurred.
Impaired losses	Where an asset's recoverable amount is less than its carrying value and the difference recognised in the income statement with the carrying value of the asset reduced by creating an impairment allowance. This may be assessed at either the individual level or collectively.
Impairment allowances	A provision held on the balance sheet to recognise that a loan is impaired. This can be at either the individual or collective level.
Indexed LTV	Outstanding balance divided by indexed property valuation.
Indexed property valuation	Based upon the movement in the seasonally adjusted Halifax House Price Index between the latest valuation date of the property and the current date, which is then applied to the latest property valuation.
Internal Capital Adequacy Assessment Process ("ICAAP")	The Group's own assessment of the levels of capital that it needs to hold through an examination of its risk profile from regulatory and economic capital viewpoints.
Internal ratings-based approach ("IRB")	A method of calculating credit risk capital requirements using internal, rather than supervisory, estimates of risk parameters.
Investments - AFS	Investments - available for sale.
Investments - HTM	Investments - held to maturity.
IRB advanced approach	A method of calculating credit risk capital requirements using internal PD (probability of default), LGD (loss given default) and EAD (exposure at default) models.
IRB foundation approach	A method of calculating credit risk capital requirements using internal PD models but with supervisory estimates of LGD and conversion factors for the calculation of EAD.
IRRBB	Interest rate risk in the banking book.
Key management personnel	Directors of the Group, members of the UK Executive Committee and FSA approved persons with a controlled function 1 – 29 (as defined in the FSA handbook available at www.fsahandbook.info/FSA/html/handbook/).
Level 1	Financial instruments with quoted prices for identical instruments in active markets.

Glossary (continued)

Level 2	Financial instruments with quoted prices for similar instruments in active and financial instruments valued using models where all significant inputs are observable.
Level 3	Financial instruments valued using valuation techniques where one or more significant inputs are unobservable.
LIBOR	London Interbank Offered Rate.
Liquidity risk	The risk that the Group does not have sufficient financial resources to meet its obligations as they fall due, or will have to do so at an excessive cost. This risk arises from mismatches in the timing of cash flows.
LTV	Loan to value. A mathematical calculation that expresses the amount of the loan as a percentage of the value of security. A high LTV indicates that there is less cushion to protect the lender against asset price falls or increases in the loan if repayments are not made and interest is added to the outstanding loan balance.
Market risk	The risk that movements in market risk factors, including foreign exchange rates and commodity prices, interest rates, credit spreads and equity prices, will reduce income or portfolio values.
Medium term notes (“MTNs”)	Notes issued by corporates including financial institutions across a range of maturities. MTNs are frequently issued by corporates under MTN Programmes whereby notes are offered on a regular and continuous basis to investors.
NAB	National Australia Bank Limited. A company incorporated in the State of Victoria, Australia. The ultimate parent of Clydesdale Bank PLC.
NAGE	National Australia Group Europe Limited. A company incorporated in the UK and registered in England. The immediate parent of Clydesdale Bank PLC.
Net interest income	The amount of interest received or receivable on assets net of interest paid or payable on liabilities.
Net interest margin	Net interest income as a percentage of average interest earning assets.
Net profit attributable to owners of the Group	Represents the Group's statutory profit after tax and reflects the amount of net profit that is attributable to owners.
Non-impaired assets 90+ days past due	Non-impaired assets 90+ days past due consist of well-secured assets that are more than 90 days past due and portfolio-managed facilities that are not well secured and between 90 and 180 days past due.
Non-retail deposits and other borrowings	Comprises other wholesale deposits, certificates of deposits, securities sold under agreements to repurchase and borrowings.
Operational risk	The risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, including legal risk.
Past due loans and advances	Loans and advances on which repayments are overdue.
PPI	Payment Protection Insurance.
Probability of default (“PD”)	The probability that an obligor will default within a one-year time horizon.

Glossary (continued)

Property revaluation	Represents revaluation increments and decrements of land and buildings based on Directors' valuations to reflect fair value.
Regulatory capital	The capital which the Group holds, determined in accordance with rules established by APRA for the consolidated NAB Group and by local regulators (in the UK the FSA) for individual Group companies.
Residential mortgage-backed securities ("RMBSs")	Securities that represent interests in groups of mortgages. Investors in these securities have the right to cash received from future mortgage payments (interest and/or principal).
Restructured loans	<p>A restructured loan is where the terms and conditions of a loan contract have been varied that may involve one or both of the following:</p> <ul style="list-style-type: none">- the original scheduled repayment contract has been re-written by changing the frequency and pattern of repayments with a lengthening of the final repayment/maturity profile on a non-commercial basis (e.g. non market extension of principal repayment period);- the Group has previously made a specific provision for the customer/obligor and written off the debt in part or converted the debt to a changed obligation in exchange for realisable assets not previously held or a debt for equity swap. <p>See also forbearance.</p>
Retail loans	Money lent to individuals rather than institutions. This includes both secured and unsecured loans such as residential mortgages, overdrafts and credit card balances.
Risk appetite	An assessment of the types and quantum of risks to which the Group wishes to be exposed.
Risk weighted assets ("RWAs")	On and off balance sheet assets of the Group are allocated a risk weighting based on the amount of capital required to support the asset.
Sale and repurchase agreement ("repo")	A repo is a short-term funding agreement that allows a borrower to create a collateralised loan by selling a financial asset to a lender. As part of the agreement the borrower commits to repurchase the security at a date in the future repaying the proceeds of the loan. For the party on the other end of the transaction (buying the security and agreeing to sell in the future) it is a reverse repurchase agreement or a reverse repo.
Securitisation	Structured finance transaction which involves pooling and packaging cash flow converting financial assets into securities that can be sold to investors. It provides a mechanism that assists the Group in reducing funding costs by providing the investor with access to security / collateral.
Scheme	The Yorkshire and Clydesdale Bank Pension Scheme.
SFI	Stable funding index.
SME	Small and medium enterprises.
Sovereign exposures	Exposures to governments, ministries, departments of governments, embassies, consulates and exposures on account of cash balances and deposits with central banks.

Glossary (continued)

Special Purpose Entity (“SPE”)	An entity created to accomplish a narrow well-defined objective (e.g. securitisation of financial assets). An SPE may take the form of a corporation, trust, partnership or unincorporated entity. SPEs are often created with legal arrangements that impose strict limits on the activities of the SPE. These can also be known as Special Purpose Vehicles (“SPVs”).
Specific impairment provision	A specific provision relates to a specific loan, and represents the estimated shortfall between the carrying value of the asset and the estimated future cash flows, including the estimated realisable value of securities after meeting securities realisation costs.
Standardised approach	In relation to credit risk, a method for calculating credit risk capital requirements using External Credit Assessment Institutions (“ECAI”) ratings and supervisory risk weights. In relation to operational risk, a method of calculating the operational capital requirement by the application of a supervisory defined percentage charge to the gross income of eight specified business lines.
Strategic Review	Review of the business model and operations as a result of prevailing and expected economic and market conditions.
Subordinated liabilities	Liabilities which rank after the claims of other creditors of the issuer in the event of insolvency or liquidation.
Tier 1 capital	A component of regulatory capital, comprising core Tier 1 and other Tier 1 capital. Other Tier 1 capital includes qualifying capital instruments such as non-cumulative perpetual preference shares and hybrid capital securities.
Tier 2 capital	A component of regulatory capital, comprising qualifying subordinated loan capital, related non-controlling interests, allowable collective impairment allowances and unrealised gains arising on the fair valuation of equity instruments held as available-for-sale. Tier 2 capital also includes reserves arising from the revaluation of properties.
Tier 1 ratio	Tier 1 capital, as defined by the FSA, divided by risk weighted assets.
Tier 2 ratio	Tier 2 capital, as defined by the FSA, divided by risk weighted assets.
UK	United Kingdom of Great Britain and Northern Ireland.
UK ALCO	UK Asset and Liability Committee.
VaR	Value at risk. A measure of the loss that could occur on risk positions as a result of adverse movements in market risk factors (e.g. rates, prices, volatilities) over a specified time horizon and to a given level of confidence.
Write-down	Reduction in the carrying value of an asset due to impairment or fair value movements.

