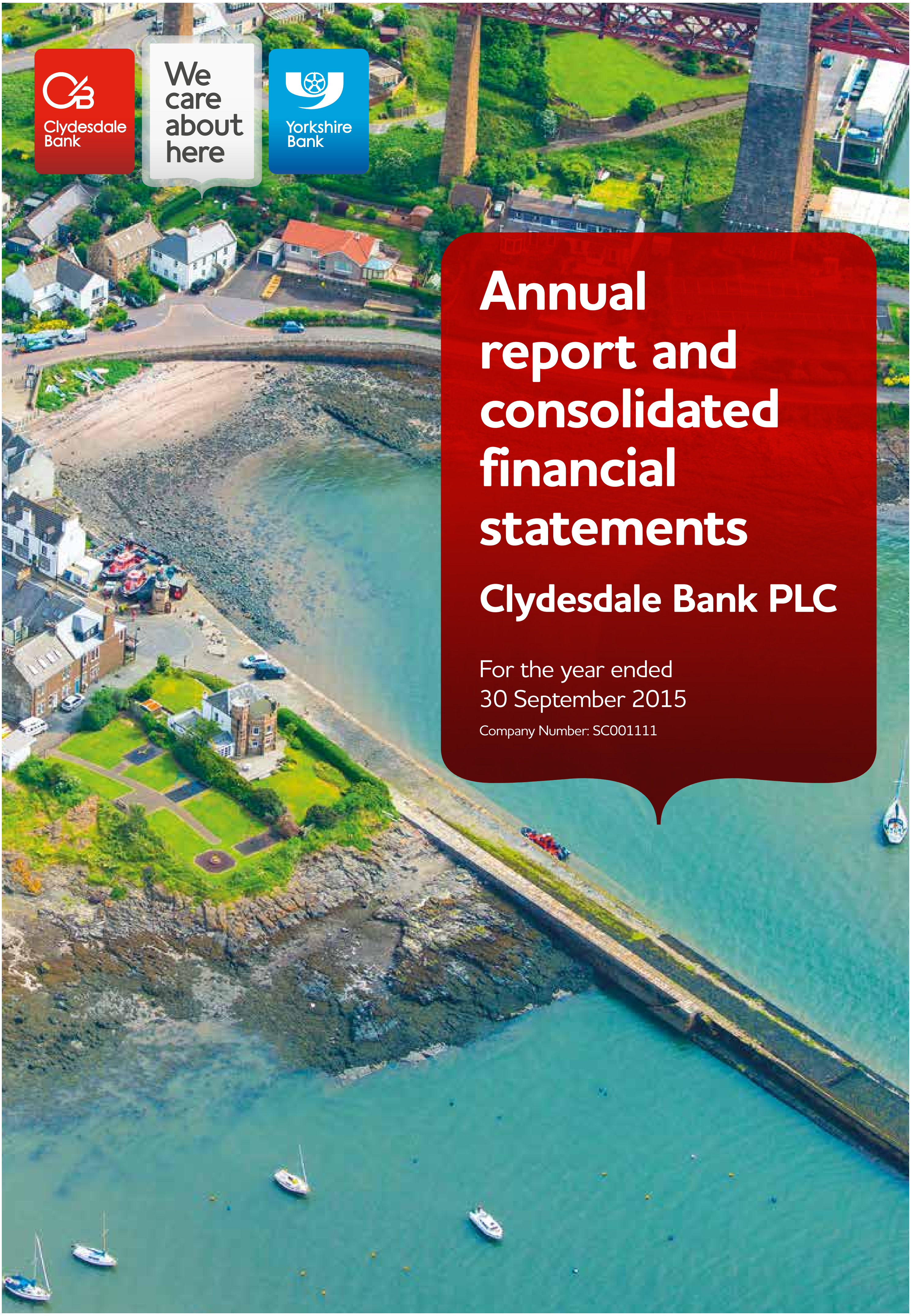


Clydesdale Bank

We care about here

Yorkshire Bank

Annual report and consolidated financial statements

Clydesdale Bank PLC

For the year ended 30 September 2015

Company Number: SC001111

Clydesdale Bank PLC

Annual report and consolidated financial statements

For the year ended 30 September 2015

Contents

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 ("NAB"). Its immediate parent is CYB Investments Limited. 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 & Private Banking centres, direct and online banking and brokers.

All percentage movements noted in the document are calculated based on unrounded figures and may therefore not be able to be recalculated from the figures provided on the face of the document.

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 to be 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, business and political 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.

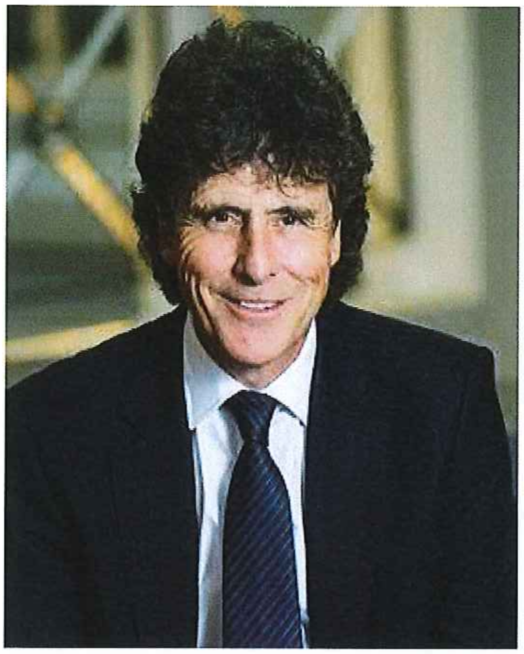
Officers and professional advisers

Directors	Chairman	Jim Pettigrew ^
	Non-executive	David Allvey * # David Bennett, Deputy Chairman (appointed 22 October 2015) David Browne * # ^ Adrian Grace (appointed 23 December 2014) ^ Richard Gregory OBE, Senior Independent Director * # ~ Barbara Ridpath # ~ Dr Teresa Robson-Capps (appointed 8 October 2014)* Alexander Shapland # ~
	Executive	David Duffy, Chief Executive Officer (appointed 5 June 2015) Debbie Crosbie, Chief Operating Officer Richard Sawers (National Australia Bank) Ian Smith, Chief Financial Officer (appointed 11 March 2015)
Clydesdale and Yorkshire Bank Leadership Team		David Duffy, Chief Executive Officer (appointed 5 June 2015) Debbie Crosbie, Chief Operating Officer Ian Smith, Chief Financial Officer (appointed 1 November 2014) David Gillespie, Customer Banking Director (appointed 18 February 2015) Derek Treanor, Acting Chief Risk Officer (appointed 1 July 2015) James Peirson, General Counsel (appointed 27 November 2014) Lynn McManus, People & Communications Director Helen Page, Customer Proposition Director
Company Secretary		Lorna McMillan James Peirson (appointed 16 February 2015)
Registered Office		30 St Vincent Place Glasgow, G1 2HL
Auditor		Ernst & Young LLP 25 Churchill Place London, E14 5RE

^ Member of the Boards' Remuneration Committee
* Member of the Boards' Audit Committee
# Member of the Boards' Risk Committee
~ Member of the Boards' Governance and Nomination Committee

Chairman's statement

Jim Pettigrew



It's been a year of significant change for the business as we prepare to stand alone as an independent bank and to create a genuine alternative in the UK banking market.

We delivered a solid financial performance in 2015 despite the uncertainties in the broader economic environment. Our capital, liquidity and funding ratios are all robust and strengthening. We saw good momentum in the mortgage market and in current accounts and further asset quality improvements. While the underlying performance of the business remains positive, our reported profit was impacted by additional provisions to cover the cost of past conduct related issues.

During the year, we made several significant changes to further strengthen our capabilities, governance, culture, and leadership team as we progress towards our objective of being a truly customer focused bank.

David Duffy joined as CEO from Allied Irish Banks, p.l.c. in June and we are already benefiting from his focus on improving customer experience and empowering our people to play their part in creating a commercially driven, customer-centric business.

The Executive Leadership Team was also strengthened by the appointment of Ian Smith as Chief Financial Officer from Deloitte. Debbie Crosbie was also appointed Chief Operating Officer during the year having held a number of senior roles in the Bank over 18 years.

The new Leadership Team's emphasis is firmly focused on delivering our customer centric strategy.

In anticipation of becoming an independent bank, a number of non-executive appointments were made that enhanced the capacity, skills and expertise of the Board. Adrian Grace, CEO of Aegon UK, joined the Board as a Non-Executive Director and brings extensive financial services and banking experience. Dr Teresa Robson-Capps also joined as Non-Executive Director, and brings a wealth of digital and direct banking expertise. I also recently announced the appointment of David Bennett as Deputy Chairman. David has over 30 years' experience in banking, having held a range of executive and senior positions in retail banking including Chief Executive and Finance Director roles at Alliance & Leicester. David will bring extensive plc and additional retail banking experience to the Board.

The Board also reviewed and, where appropriate, strengthened its governance arrangements to ensure that they will meet plc standards, including establishing a Remuneration Committee.

David Thorburn and John Hooper stood down from the Board this year and I would like to place on record the Board's appreciation for their very substantial contribution over many years.

Through this transitional period for the Bank, employees have continued to show great dedication and enthusiasm. They have also maintained their commitment to the communities we serve and our corporate responsibility initiatives. This year saw the largest employee fundraising event to date for our charity partner, Hospices UK, and the proportion of our people who contribute to charitable causes through payroll giving remains one of the highest of any financial services employer in the UK.

This has been a challenging year and as we prepare for a new independent future everyone at the Bank is determined, through a relentless focus on customer experience, to deliver an alternative to the status quo in UK banking.

While there is still more to do to realise the full potential of the Bank, I believe that we are well placed to realise the opportunities that lie ahead.

Jim Pettigrew
Chairman

Chief Executive Officer's statement

David Duffy

Delivering Our Strategic Objectives

The 2015 results are a positive reflection of the work we are doing to build a better bank for customers and to position ourselves for an independent and sustainable future. Continued investment in the appropriate products, channels and services for our customers is having an encouraging impact, helping us to grow our deposit base in a balanced manner while simultaneously delivering our strategic priority of increasing lending volumes. Going forward, we will continue to invest in our digital, direct and branch channels to offer customers greater convenience, choice and an improved overall experience.

We have a clear strategy in place for our Retail and SME franchises and 2015 saw the Bank successfully deliver a number of strategic initiatives as we become fit for purpose in the future. The environment in our key target markets remains highly competitive and our customer focused and digitally enabled strategy will be an important element of remaining relevant to our customers as we move into the future. Economic conditions remain supportive of our overall growth agenda albeit with continued uncertainty over the timing and scale of any future interest rate rises.

The overall regulatory environment is demanding and is a constant reminder to the Bank of the need to ensure that the lessons learned from the most recent financial downturn are central to our forward agenda and planning. This includes maintaining appropriate risk appetite for lending, a prudent approach to funding and margin dynamics, a strongly capitalised balance sheet and an overarching requirement to treat all of our customers fairly. The Bank will continue to integrate emerging regulatory themes and requirements into its forward strategy in the context of cost control, competitive dynamics, capital allocation and our overall approach to customer fairness.

I joined the business in June of this year and was immediately impressed by the commitment and loyalty to our brands that our customers, employees and key stakeholders share, and also the determination of the Board and Leadership Team to build a better bank for the communities we serve. I have spent a considerable amount of time meeting staff, customers and other key stakeholders during the last few months and it is clear to me that we play a critical role in supporting the communities in which we operate.

The Bank has the fundamentals in place to help support our customers, deliver our strategic ambitions and a strong and successful independent business in the future. In addition to the underlying business performance, the organisation is concentrating more than ever before on improving customer experience, raising our brand profile, delivering greater product innovation, and in creating the commercially driven culture we will need in order to thrive as an independent franchise.

Cultural Transformation

The ability of the Bank to execute its strategic plan is predicated on ensuring that the appropriate talent, capabilities and experience are in place throughout the organisation. This starts with the Board and the Executive Leadership Team and requires the Bank to have the appropriate accountability, organisational structure, governance, capacity and capability in place to deliver that plan.

The appointments of Ian Smith (Chief Financial Officer) and James Peirson (General Counsel) during the year have helped to significantly bolster the strength of the Leadership Team and additionally we have made a number of appointments at senior levels across the organisation as we seek to deepen the talent and capabilities in the Bank. This process will continue ahead of a return to independent ownership.

Cultural Transformation (continued)

I have reorganised and reduced the size of the Bank's Leadership Team to provide better individual and collective accountability, and create the right mix of experience that we need to meet forthcoming challenges. In addition to the commercial agenda, it is imperative that the Bank maintains a key focus on ensuring that the internal governance model is appropriate for a bank of our size and is supported by best in class risk, audit, legal and compliance functions as part of a robust and effective three lines of defence governance model.

I am heartened that the organisation has accepted that being an independent business demands a relentless focus on customers, precise accountability, focused leadership and a much more productive and commercially-driven outlook. This will require a further cultural transformation over time and a critical component of this is being clear on the Bank's key priorities and ensuring open communication throughout the firm – a process which is already well under way.

Customer Focus

Our customers remain the central component of our strategy and that is why we have been laying the foundations for consistently reliable and accessible services for customers across branch, online, mobile and direct channels, simplifying how we do things and focusing our efforts on what matters most to them.

Reflective of the improvements we have made during the course of 2015, the Bank's Net Promoter Score metrics with customers improved and the Bank also received a number of service awards including being named "Best Provider for Branch Customer Service" and rated as having the best "Switching Service and Mobile Banking App" by uSwitch.

We have continued to focus on supporting existing customers while increasingly seeking to attract new customers in both our core geographic areas and also new target regions throughout the UK. Our Retail strategy has delivered encouraging growth in both mortgage and deposit balances as we expand our offerings to customers through online, direct and in-branch and also continue successful partnerships with an invitation only panel of mortgage brokers. From a Retail perspective, the Bank is also focused on reinvigorated personal loan and credit card offerings as part of a holistic approach to balance sheet growth into the future. Our SME franchise has been successfully restructured and is now repositioned to focus on growth in our target segments including the use of sector and product specialist and a relationship management approach for our larger customers.

Overall, we will continue to implement our strategy to focus on delivering an appropriate return on capital while remaining competitive and relevant for our customers.

Digital Enablement

At the heart of delivering convenient services for customers is our focus on our digitally enabled omni-channel strategy. Increasingly, this is enabling customers to interact with the Bank at times and in locations that suit their preferences and it has empowered employees to respond to customer needs more quickly and simply.

We have invested significantly in an exciting and differentiated digital approach to our mobile and tablet based platform that has been designed from the bottom up by more than 10,000 customers and is ready for launch early in 2016. A key component of this platform will be its ability to offer updated content to customers as functionality on the platform increases over time.

We are also successfully continuing to invest in the digitisation of our operating model to improve process efficiency, employee productivity levels, decision timelines and cost dynamics.

We have much more to do to create a truly integrated, consistent and connected offering for our customers and staff as part of the omni-channel strategy and are continuing to align our investment and approach to emerging customer needs and commercial requirements and imperatives based on data analytics and customer economics.

As part of this approach, we intend to deliver the optimal service model for our customers identifying the appropriate size and structure of our network as part of an omni-channel strategy. We are also continuing to invest in the broader network to ensure that our in-branch offerings are competitive and that our customers have access to the latest technology offerings and services.

Operating Performance

Our results underline that the core financial metrics in the Bank are solid and moving in a positive direction. Aligned to our strategic priorities and focus, deposit volumes grew as the Bank's funding and liquidity position strengthened and overall customer lending volumes increased during the year, particularly in our key target segment of mortgages.

Chief Executive Officer's statement (continued)

Operating Performance (continued)

The Bank's capital ratios are robust in a fully loaded Basel III context and are now at our stated target levels. Asset quality continues to improve against the backdrop of a benign economic environment while also reflecting the Bank's prudent risk appetite for new business and volume growth.

Excluding provisions related to legacy conduct issues, the business is profitable and generating capital which is supportive of our longer term strategy to increase lending volumes in new and existing geographies. We raised further provisions for dealing with historical PPI complaint handling and other conduct issues during the year, as we continue to effectively and transparently deal with legacy conduct issues.

While demonstrating the progress that the business has made, these results also illustrate the areas where we still have much more work to do. Operating expenses remain elevated in part due to essential restructuring and pre-separation costs, and the increased marketing and investments that we are making now to grow the business in the future and deliver our longer term strategic goals.

The Bank's overall cost-to-income ratio remains too high, I am very focused on implementing a much more efficient and rigorous approach to cost management in future. This approach is fully aligned to our strategy of investing in our growth ambitions and digitally enabled omni-channel model while also ensuring that our core operating models and systems remain resilient and robust in the modern market environment.

Colleagues

I am heartened by the diligence, professionalism and customer approach I have witnessed in my new colleagues and their support and determination will be crucial enablers in the delivery of our strategic objectives over the coming period.

I would like to thank the management and Board of National Australia Bank for their constructive approach and support since I joined the Bank and look forward to continuing this engagement into the future.

Finally, I am very grateful to the Chairman and the rest of the Board for their backing and insight as we embark on the journey ahead and navigate the current challenges that the Bank faces into the future.

Outlook

Within the annual report and consolidated financial statements, we set out in much greater detail our financial performance for the year, strategic priorities, current and emerging risks and some of the indicators that our future performance will be judged on. I hope that it also conveys the passion and enthusiasm that the organisation has for the opportunity ahead of us as well as our determination to appropriately, fairly and swiftly deal with legacy issues including conduct.

We will be outlining our plans for the future in greater detail as part of the formal process of returning the Bank to public markets, currently expected to conclude in early February 2016.

A relentless focus on our customers and being a more commercial, efficient, digitally enabled and individually accountable organisation are the critical components of creating a better bank for our customers and delivering our strategic ambitions.

I am determined to build on the progress that we have made this year so that we can realise all of the opportunities that a standalone future offers. The organisational changes needed to deliver the strategic plan and effectively deal with the challenges that lie ahead will take time to implement but are eminently achievable.

I believe the core fundamentals are in place for the Bank to position itself as a differentiated alternative to the other full service banks in the UK banking market and I am excited about the journey ahead as we continuously strive to improve our offering to customers, our operating metrics and ultimately deliver improved shareholder returns.

David Duffy
Chief Executive Officer
13 November 2015

Strategic Report

The Directors of the Bank with its subsidiary undertakings (which together comprise "the Group") present their Strategic Report for the year ended 30 September 2015.

Highlights

- The Group's ultimate parent company, NAB, announced its intention to pursue a demerger of approximately 75% of its shares to NAB shareholders and a sale of the balance by way of an initial public offering ("IPO") to institutional investors. A detailed timetable was announced on 28 October 2015. In preparation for the transaction, the Group's immediate parent changed its name from National Australia Group Europe Limited to CYB Investments Limited on 29 October 2015.

- In order to prepare for the demerger and IPO, the Group has made changes to senior management, most notably the appointments of David Duffy as Chief Executive Officer and Ian Smith as Chief Financial Officer. It has also incurred costs relating to separation, invested in the customer franchise and run off low yielding non-core business lending assets.

- On 7 May 2015, NAB publicly announced it intended to provide a Conduct Mitigation Package in respect of legacy conduct issues of £1.7bn (including the Group's risk share of £120m). The Conduct Mitigation Package will, from the point of separation, provide the Group with a capped indemnity in respect of certain historic conduct related liabilities including Payment Protection Insurance ("PPI") and Interest Rate Hedging Products ("IRHP") [(1)].

- On 30 September 2015, the Group acquired CYB Intermediaries Holdings Limited. CYB Intermediaries Holdings Limited operates through its subsidiary CYB Intermediaries Limited and acts as an intermediary for third party providers of insurance and investment products (note 21). The Group distributes these products through its retail mortgage and retail banking advisors. The Group also acquired CYB Services Limited from its immediate parent. CYB Services Limited provides a range of information technology services to the Group. As at 30 September 2015, CYB Services Limited had total assets of £422m and total liabilities of £418m (note 21).

- In order to use capital more efficiently and improve returns on risk-weighted assets, the Group has grown its mortgage book by 11.2% from £18,444m as at 30 September 2014 to £20,504m as at 30 September 2015. The principal source of gross new mortgage lending has been intermediary mortgage lending (74% of gross new lending). The use of the intermediary channel enables the Group to compete effectively and efficiently outside of its core regions, and facilitates diversification across the mortgage book.

- On a management basis, the profit before tax was 33% lower at £146m driven by an increase in investment in the business with expenditure focusing on revenue generation, regulatory and compliance activities. On a statutory basis, the loss on ordinary activities before tax increased to £308m for the year ended 30 September 2015, as a result of the aforementioned investment as well as an increase in PPI and IRHP redress expenses.

- In line with its stated strategy, the Group's business lending portfolio reduced by 11.4% to £7,061m in the year to 30 September 2015. This has been driven by the managed run-off of lower yielding assets to improve overall returns, the subdued demand for business credit and competitive pressures. The Group continues to reshape its business lending portfolio, focusing principally on small and medium sized businesses ("SME") in its core regional markets.

- The Group continues to diversify and improve its funding with 10% growth in customer deposits, from £23,989m to £26,349m, and issuance of external term funding. £709m was raised in December 2014 and a further £498m in August 2015 through the Lanark residential mortgage backed securities programme. As a result, the Group's loan to deposit ratio improved to 109% and funding from NAB reduced by £1,473m.

- The impact of dealing with legacy conduct related issues continues to have an impact on the Group's results. The Group incurred a Financial Conduct Authority ("FCA") fine of £21m in the year in relation to its historic PPI complaint handling following an FCA review and enforcement action. Further provisions for PPI of £390m and IRHP of £75m were also raised in the year. As the result of these and other factors, the Group's loss after tax increased to £249m (2014: £178m).

(1) References to "IRHP" incorporate: (i) standalone hedging products identified in the Financial Services Authority ("FSA") 2012 notice; (ii) the voluntary inclusion of certain of the Group's more complex tailored business loan ("TBL") products; and (iii) the Group's secondary review of all fixed-rate tailored business loans ("FRTBLs") complaints which were not in scope for the FSA notice.

Highlights (continued)

- The Group has continued to reshape and strengthen its balance sheet. Asset quality has improved, and the bad and doubtful debt charge to average customer loans ratio was 0.21% as at 30 September 2015, a 9bp year-on-year improvement. Capital has been strengthened. The Common Equity Tier 1 ("CET1") Ratio was 13.3% as at 30 September 2015 (up from 12.1% as at 30 September 2014) and the leverage ratio of 7.2% as at 30 September 2015 (up from 5.7% as at 30 September 2014). The Group's balance sheet is resilient and strongly capitalised which, together with the capital protection expected to be provided by the Conduct Mitigation Package from the point of separation, provides a strong foundation to support the Group's future growth.

Key performance indicators

12 months to:	30 Sep 2015	30 Sep 2014	2015 v 2014
Profitability:			
Net interest margin [(1)]	2.21%	2.30%	(9)bp
Return on tangible equity ("ROTE") [(2)]	(9.7)%	(7.1)%	(260)bp
Management basis ROTE [(3)] [(4)]	5.0%	6.3%	(130)bp
Cost-to-income ratio [(5)]	123%	115%	(800)bp
Management basis cost-to-income ratio [(6)]	77%	70%	(700)bp
Return on assets [(7)]	(0.64)%	(0.49)%	(15)bp
Management basis return on assets [(8)]	0.33%	0.44%	(11)bp

As at:	30 Sep 2015	30 Sep 2014	2015 v 2014
Asset Quality:			
Bad and doubtful debt charge to average customer loans [(9)]	0.21%	0.30%	9bp
90+ days past due ("DPD") to customer loans [(10)]	0.50%	0.66%	16bp
Gross impaired assets to customer loans [(11)]	0.91%	1.35%	44bp
Specific provision to gross impaired assets [(12)]	39.2%	37.3%	190bp
Total provision to customer loans [(13)]	0.93%	1.15%	22bp
Indexed loan-to-value ("LTV") of mortgage portfolio [(14)]	55.3%	58.8%	350bp
Regulatory Capital:			
Common Equity Tier 1 ratio [(15)]	13.3%	12.1%	120bp
Tier 1 ratio [(16)]	15.8%	12.1%	370bp
Total capital ratio [(17)]	19.1%	18.6%	50bp
Leverage ratio [(18)] [(22)]	7.2%	5.7%	150bp
Funding and Liquidity:			
Loan to deposit ratio [(19)]	109%	115%	600bp
Liquidity coverage ratio ("LCR") [(20)] [(22)]	136%	110%	2,600bp
Net stable funding ratio ("NSFR") [(21)] [(22)]	120%	108%	1,200bp

Key performance indicators (continued)

(1) Net interest margin is defined as net interest income divided by average interest earning assets for a given period.
(2) ROTE is defined as profit/(loss) after tax less preference share and non-controlling interest distributions as a percentage of average tangible equity (total equity less intangible assets excluding minorities, Additional Tier 1 and preference shares) for a given period. Average tangible equity has been calculated using tangible equity spot balances at each of the month ends of the applicable period.
(3) Management basis ROTE is defined as underlying profit after tax (as defined in footnote 4) less preference share and other distributions as a percentage of average tangible equity (total equity less intangible assets excluding minorities, Additional Tier 1 and preference shares) for a given period.
(4) Underlying profit after tax is defined as underlying profit before tax less tax charge (or plus tax credit, as the case may be), less dividends and was equal to £125m (2014: £159m). The management basis tax credit/(charge) is calculated by applying the statutory tax rate for the relevant period (30 September 2015: 20.5%; 30 September 2014: 22.0%) to the taxable items adjusted on the management basis. The taxable items are calculated with reference to the underlying profit before tax (including items such as PPI redress expense and IRHP redress expense), adjusted for items such as the non-taxable pension increase exchange gain, net gain on capital and debt restructuring and non-deductible separation costs and restructuring expenses. The Group had an unrecognised deferred tax asset of £16m (representing trading losses with a gross value of £80m) at the balance sheet date, reflecting the uncertainty of projections towards the end of the period over which such differences might be expected to reverse. Average tangible equity has been calculated using the tangible equity spot balances at each of the month ends of the applicable period.
(5) Cost-to-income ratio is defined as total operating expenses as a percentage of total operating income for a given period.
(6) Management basis cost-to-income ratio is defined as management basis total operating expenses as a percentage of management basis total operating income for a given period.
(7) Return on assets is defined as profit/(loss) after tax as a percentage of average assets for a given period.
(8) Management basis return on assets is defined as underlying profit after tax (as defined in footnote 4) as a percentage of average assets for a given period. Average assets have been calculated using the asset spot balances at each of the month ends in the applicable period.
(9) Bad and doubtful debt charge to average customer loans (defined as loans and advances to customers, other financial assets at fair value and due from customers on acceptances) is defined as impairment losses on credit exposures plus credit risk adjustment on fair value loans to average customer loans.
(10) 90+ DPD to customer loans is defined as customer loans that are more than 90 days overdue as a percentage of total customer loans.
(11) Gross impaired assets to customer loans is defined as gross impaired assets as a percentage of total customer loans at a given date.
(12) Specific provision to gross impaired assets is defined as the specific impairment provision on credit exposures as a percentage of gross impaired assets at a given date.
(13) Total provision to customer loans is defined as total impairment provision on credit exposures as a percentage of total customer loans at a given date.
(14) Indexed LTV of the mortgage portfolio is defined as mortgage portfolio weighted by balance and indexed using the Halifax house price index at a given date.
(15) Common Equity Tier 1 ratio is defined as Common Equity Tier 1 capital divided by risk-weighted assets at a given date.
(16) Tier 1 ratio is defined as Tier 1 capital resources divided by risk-weighted assets at a given date.
(17) Total capital ratio is defined as total capital resources divided by risk-weighted assets at a given date.
(18) Leverage ratio is defined as Tier 1 capital divided by the total on and off balance sheet exposures expressed as a percentage. The Basel Committee proposed to test a minimum requirement of 3% for the leverage ratio during a parallel run period from 1 January 2013 to 1 January 2017, with a view to migrating to a Pillar 1 treatment on 1 January 2018 based on appropriate review and calibration.
(19) Loan to deposit ratio is defined as customer loans as a percentage of customer deposits at a given date.
(20) The Group monitors the LCR based on its own interpretations of current guidance available for CRD IV LCR reporting. Therefore, the reported LCR may change over time with regulatory developments. Due to possible differences in interpretation of the rules, the Group's ratio may not be directly comparable with those of other financial institutions.
(21) The Group monitors the NSFR based on its own interpretations of current guidance available for CRD IV NSFR reporting. Therefore, the reported NSFR may change over time with regulatory developments. Due to possible differences in interpretation of the rules, the Group's ratio may not be directly comparable with those of other financial institutions.
(22) New regulatory standard ratio proposed by the Basel III reforms.

Our business model

The Group has over 175 years of history and operates a full service UK-focused retail and commercial banking business under the brand names “Clydesdale Bank” and “Yorkshire Bank” across its core regional markets (Scotland, North East England, North West England, Yorkshire and the Humber) and selected national markets. The Group delivers these services through a network of 275 retail branches, 40 Business & Private Banking centres (including 28 sites co-located with retail branches), strong and well-established relationships with leading third-party mortgage intermediaries, a rapidly evolving digital platform (including proprietary website and mobile offerings as well as participation in third-party aggregator sites), access to certain banking services through over 11,800 Post Office branches, telephony and voice services, and an ATM network. The Group's distribution platform continues to develop to allow customers to complete their Retail and SME banking needs seamlessly across multiple distribution channels with an emphasis on digital and non-branch channel usage, reflecting changing customer behaviour and preferences to interact in an omni-channel way. The Group employs 7,244 staff as at 30 September 2015, including employees of entities acquired during the year. The Group is an "authorised person" under the Financial Services and Markets Act 2000 and is regulated by the Prudential Regulation Authority (“PRA”) and FCA.

Through both the Clydesdale Bank and Yorkshire Bank, the Group offers strong local community brands which provide a full range of banking products and services, including mortgages, current accounts, deposits, term lending, personal loans, working capital solutions, overdrafts, credit cards and payment and transaction services. The Group is also one of only a small number of banks in the world that issues banknotes.

The Group's long established Retail and SME franchises have significant scale and strong market shares in personal current accounts (“PCA”), business current accounts (“BCA”), SME business lending and mortgages in its core regions. As at 30 September 2015, the Group had 2.8 million retail and business customers, with £26,349m of customer deposits and a £28,783m customer loan portfolio, of which £20,504m was mortgage loans, £7,061m was business lending and the remainder was unsecured personal lending (including credit cards and overdrafts).

The principal strengths of the Group's business model are built around a number of key components;

- a long established franchise in core regional and selected national markets;
- strong local community brands;
- standalone, scalable and full service operating platform;
- resilient and strongly capitalised balance sheet;
- clear strategy to drive growth and returns; and
- an experienced leadership team.

Our strategic priorities

As announced on 7 May 2015, NAB intends to pursue a demerger and IPO of the Group’s immediate parent and its subsidiaries. Target date for completion of the transaction is early in February 2016. The Group’s business model and strategic direction will not be impacted by the separation from NAB, with the Group committed to delivering a strong, customer-centric banking proposition in the UK.

Following separation from NAB the Group, will have more freedom to pursue the following strategic aims:

- leverage its capabilities in existing core regional markets;
- continue its successful national growth strategy focusing on selected products and sectors where it has strong history and established capabilities;
- deliver a consistently superior experience to its customers underpinned by local community brands and a customer driven omni-channel strategy; and
- deliver enhanced shareholder returns.

The Group’s goal is to be a strong, customer-centric bank that proactively responds to changes in its customers' needs and builds long-standing customer relationships. The Group plans to build on its existing strengths to continue the delivery of customer-driven product and service propositions across both Retail and SME banking in addition to leveraging its position as a strong regional bank with established Retail and SME franchises. The Group plans to continue to take advantage of national opportunities by focusing on growth in selected products and sectors.

Strategic Report (continued)

Our strategic priorities (continued)

In order to support the development of sustainable, multi-product customer relationships, the Group aims to deliver a customer experience that makes it the first choice for a customer to operate their main bank account. Due to the nature of the PCA product and the relationship developed with customers, the Group believes that growth in this area will provide valuable opportunities to meet customers' needs for other banking products with a particular focus on unsecured lending and savings and mortgage products.

The Group has introduced product offerings targeted at increasing the number of PCA customers outside of its core regions, including the Group's £150 current account switching bonus which resulted in 25,000 switches in 2015. The Group also intends to increase the retail customer base nationally through continued development of its digital distribution capability. Digital distribution will be supported by access to telephony channels providing personal interaction as required by customers seeking support for advice or service requirements.

The Group has grown its mortgage book during the year and will continue to do so, increasing market share while maintaining its prudent risk appetite. The Group originates mortgages through both the proprietary channels in its core regions and via third party broker channels, primarily in the South East of England. During the year, the majority of mortgages originated were through the broker channel. The Group offers both owner occupied loans and buy to let mortgages. During the year, the Group also continued to see a modest run off within the mortgage tracker portfolio.

The Group aims to deepen its relationships with existing SME customers, grow its BCA customer base, and develop its business lending in selected products and sectors. The Group targets the acquisition of new micro customers, Business Direct customers and small business customers principally through digital and direct channels, including marketing campaigns specifically aimed at these customer segments, such as the BCA free day-to-day banking offer. The Group aims to further develop small business relationships and believes this presents an opportunity to leverage its existing relationships and product offerings to capitalise on growth opportunities within the small business segment. Through the provision of a full suite of banking products, the Group seeks to meet the working capital and longer-term funding requirements of all business customers, as well as their cash management and payment services needs. The Group is also in the process of running-off its low yielding non-core portfolio which is releasing capital to be redeployed into higher yielding activities.

In October 2014, the Group embarked on a programme to further digitise the customer experience for retail and SME banking and to provide improved solutions for customers to manage their finances. The Group intends for the digital proposition to be an important part of its growth agenda and to drive efficiency, process simplification and customer acquisitions. The digital proposition is expected to appeal to a more affluent demographic that may have little or no association with the Group's brands, as well as our current customer base.

The Group commenced a programme in 2015 to reshape and optimise its physical network. As part of the programme, the Group closed 24 branches and in addition to this spent £10m on various improvements to the network including the relocation of 4 branches, the extensive refurbishment of 15 branches as well as minor improvements to a number of other branches during the year.

The Group also aims to deliver a consistently superior experience to customers underpinned by its local community brands and a customer driven omni-channel strategy. Progress is monitored through a number of metrics including staff surveys, customer surveys, the level of and satisfaction with the resolution of complaints and net promoter scores ("NPS"). The principal metrics used by the Group are NPS which it monitors for both the Clydesdale and Yorkshire Bank brands.

Our strategic priorities (continued)

The Board identified four overarching goals against which to regularly monitor progress during the year through the use of management information supported by key performance indicators ("KPI").

The Customer | *Risk & Control* | *Sustainable Returns* | *People*

The Customer – The primary metric used to monitor the Bank's progress in meeting customer expectations is NPS. NPS is monitored separately for the Clydesdale and Yorkshire Bank brands. It showed an overall change of +12 in new to bank customers over 2015. Secondary metrics include the level of customer complaints, which (excluding PPI) fell year on year, and industry awards. Clydesdale Bank was crowned best provider for branch customer service and rated as having the best switching service and mobile banking app by uSwitch. For the second year running, Clydesdale Bank also won the 'Best First Time Buyer Mortgage Provider' accolade at the 2015 Moneyfacts Awards.

Risk & Control – The Group has a formal risk appetite approved by the Board. Each risk appetite statement is monitored by reference to management and Board (breach) thresholds. Risk appetite is formally monitored by management monthly and all amber metrics and any red breaches are reported to the Board as part of monthly reporting. The Group's overall risk profile remained within the Board's risk capacity limits at all points in 2015.

Sustainable Returns – The Group uses a series of KPIs to support its analysis of returns. The key performance measures used are disclosed on page 7 In order to ensure that returns are sustainable the Group also monitors capital, liquidity and funding further detail on these are included on pages 21 to 27.

People – A motivated and engaged workforce is a prerequisite for a customer focused, well controlled and sustainable business. The Group uses a range of measures in addition to a formal people management and leadership framework to support its employees and understand their engagement with the Group. The primary tool is SUSU – Speak Up Step Up, the Group's engagement survey. There was an increase in employee engagement in the 2015 survey, both compared to the previous year and to the global average benchmark. Clydesdale Bank won the Best Employer Award at the S1 Jobs Recruitment Awards which provides external corroboration of the results of SUSU.

Business model challenges and top and emerging risks

The principal areas of risk to the Group's business model are outlined below. Tolerances for appropriate levels of risk for each category, as well as the other risks to which the Group is exposed, are set regularly through the Group's risk appetite statement ("RAS") process. The RAS places an overall limit on the total amounts and types of risk that the Group is prepared to take within its capacity to achieve its strategic objectives and business plan. The position against the various RAS settings is monitored and reported to the Group's various management and Board Governance Committees as set out in note 40 to the financial statements.

- *Credit risk*: is the potential that a customer or counterparty will fail to meet its obligations to the Group in accordance with agreed terms and arises from both the Group's lending activities and markets and trading activities. Further detail on the Group's approach to the management of credit risk is included in note 39 to the financial statements.
- *Conduct risk*: is the risk that the Group's operating model, culture or actions result in unfair outcomes to customers. The treatment of customers and the management of customers impacts on all core activities. This is a principal focus of the Board, senior management and regulators, and the Group seeks to ensure customers are treated fairly, products are designed and sold to meet their needs, customer expectations are met and complaints are dealt with effectively and fairly. Consideration of customer outcomes is embedded within the Group's operating processes, and metrics are regularly monitored to help ensure outcomes are appropriate. Further detail on the Group's approach and exposures to conduct risk related matters can be found in notes 3, 27, 33, 40 and 43 to the financial statements.

Business model challenges and top and emerging risks (continued)

- *Operational risk (excluding conduct risk):* is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events and arises from the day to day operational activities of the Group, which may result in direct or indirect losses and could adversely impact the Group's financial performance and position. These losses may result from both internal and external events, and risks, including, but not limited to, process error or failure, inadequate process design, poor product development and maintenance, poor change management, ageing infrastructure and systems, system failure, security and physical protection, fraud, deficiencies in employees' skills and performance or human error, operational failures by third party providers (including offshored and outsourced providers), natural disasters, extreme weather events, political, security and social events and failings in the financial services industry or other idiosyncratic components of operational risk that are related to the Group's particular size, nature and complexity.
- *Regulatory risk:* this represents regulatory strategy and change risk and regulatory relationship risk. Regulatory strategy and change risk is the risk of failing to identify and monitor changes in the regulatory environment and of failing to take opportunities to help shape the development of emerging legislative frameworks and/or to effectively implement the required changes. Regulatory relationship risk is the risk of damaging the Group's relationship with regulators through non-compliance with regulatory requirements, failing to inform regulators of relevant issues impacting (or which may potentially impact) the Group, and not meeting the information requests and review findings of regulators, by providing incorrect or inadequate information, not meeting regulatory deadlines or obstructing the regulator from fulfilling its role.
- *Compliance risk*: is the risk of failing to understand and comply with relevant laws, regulations, licence conditions, supervisory requirements, self-regulatory industry codes of conduct and voluntary initiatives, as well as internal policies, standard procedures and frameworks. Compliance risk incorporates financial crime risk, which includes risks relating to money laundering, terrorism financing, bribery and corruption and sanctions and embargoes.
- *Balance sheet and 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:
  - *Market risk:* is the risk associated with adverse changes in the fair value of positions held by the Group as a result of movement in market factors such as interest rates and foreign exchange rates, volatility and credit spreads;
  - *Structural interest rate risk:* is the risk which comprises the sensitivity of the Group's current and future net interest income to movements in market interest rates;
  - *Foreign exchange risk:* is the risk arising as a result of future cashflows being converted to pounds sterling ("GBP") at a rate different to that prevailing at the time of the original transaction.
- *Defined benefit 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. Further detail on the Group's pension scheme (including the actuarial assumptions) is included in note 29 to the financial statements.
- *Strategic risk*: is the risk of significant loss or damage arising from business decisions that impact the long-term interests of the Group's stakeholders or from an inability to adapt to external developments.

Further detail on the risks the Group faces and how these are managed is included in note 40 to the financial statements.

The Group monitors the environment in which it operates to identify those emerging risks that can have an impact on how it operates from a strategic, operational and financial perspective.

Business model challenges and top and emerging risks (continued)

As part of its separation from NAB, the Group has developed and restructured its own functions and processes in a range of areas, including making its risk systems independent from NAB's, enhancing or streamlining certain of its back office processes, separating knowledge and education management systems, separating human resource processes as well as introducing shareholder services and investor relations platforms. Some of these functions and processes will in some respects continue to be supported by various services under a transitional services agreement ("TSA") and others have been developed as standalone functions. In addition to the TSA, the Group's ongoing contractual relationship with NAB will include NAB acting as the Group's sole clearing provider for central clearing of derivative transactions and the Group providing certain operational support services to NAB's London branch. There is a possibility that these functions and processes may not operate as intended or the execution of the separation process and the creation of new processes may not have been properly completed. Consequently, there is a risk that the Group could suffer operational difficulties which, either directly or as a result of the need for further financial investment or through the depletion of management resources in developing, monitoring and/or rectifying these new services and functions, could have an adverse effect on the Group's business, financial condition, results of operations and prospects.

In addition to the potential separation risks referred to above, the Group currently considers its top emerging risks to be:

- Risks relating to the macro-economic environment in which the Group operates: These include risks arising from macro-economic conditions in the UK, risks related to volatility in UK house prices and to the supply and affordability of property in the UK, risks associated with interest rate levels and volatility, risks relating to higher levels of unemployment, principally in the UK, risks from the macro-economic conditions in the Eurozone and globally and risks relating to a proposed referendum on the UK's continued membership of the European Union ("EU").

  Key mitigating actions

  The Group has comprehensive credit risk management policies. 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. The Group has no material operations outside the UK and has no direct sovereign exposure to any Eurozone countries.

- Risks relating to the operation of the Group businesses: These include risks associated with compliance with a wide range of laws and regulations, risks associated with the implementation of its strategy, the risk that the reputation of the Group and its brands may be damaged by the actions, behaviour or performance of the Group, its employees, affiliates, suppliers, counterparties, regulators or customers or the financial services industry generally, risks relating to the cost and availability of liquidity and funding, the amount and quality of the Group's capital and risks associated with complaints and redress issues from historic sales of financial products, risks from the highly competitive market in which the Group operates, its relationships with mortgage intermediaries and with customer and counterparty non-performance, dependence on third party service providers for certain functions, cyber-crime and fraud, the Group's hedging and treasury operations including potential negative fair value adjustments, actual or perceived deterioration in the soundness of other financial institutions and counterparties, a significant reduction or withdrawal of the Funding for Lending Scheme or other funding schemes increasing competition for other sources of funding, and risks related to inadequate or failed internal processes, people and systems.

  Key mitigating actions

  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. The Group has an established Operational Risk Framework which operates across the Group. It 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.

Business model challenges and top and emerging risks (continued)

- Risks relating to pension schemes: Clydesdale Bank PLC is the sponsoring employer of the Yorkshire and Clydesdale Bank Pension Scheme, a defined benefit scheme. Risk arises as from time to time there may be insufficient assets to cover the defined benefit liabilities of the scheme and Clydesdale Bank PLC and any other employers from time to time in the Group are obliged by legislation and the governing documents of the scheme to fund the liabilities.

  Key mitigating actions

  The Group has implemented a number of reforms to the scheme to manage the liability. A recovery plan was agreed on 7 May 2014 to eliminate the deficit. The Pension Risk Management Committee has been established under the authority of the Chief Executive Officer UK.

- Regulatory risks: The Group is subject to substantial and changing prudential regulation, conduct regulations, the potential impacts of UK and European banking financial services reform initiatives and to the substantial and increasing industry-wide regulatory and governmental oversight.

  Key mitigating actions

  The Group's risk governance structure strengthens risk evaluation and management, while also positioning the Group to manage the changing regulatory environment in an efficient and effective manner.

The risks and challenges identified in the Strategic Report do not represent an exhaustive list of the risks and issues associated with the Group. Other risks and issues not specifically referenced may adversely impact the future financial position and performance of the Group. Accordingly, no assurances or guarantees of future performance, profitability or returns on capital are given by the Group.

Operating environment

UK economic environment

Overall UK banking performance is correlated with the health of the UK economy. UK GDP growth, which has been increasing ahead of European peers, grew by 2.8% in 2014, and real GDP is forecast to grow 2.6% in 2015 (Source: Office for National Statistics).

Other key UK macro-economic indicators are also strong. In the quarter to August 2015 the unemployment rate fell to a seven year low of 5.4% and the employment rate rose to 73.6% which is the highest rate since records began in 1971. Also, in the quarter to August 2015 workers' total earnings were up 3% from a year earlier. Inflation, as measured by the Consumer Prices Index fell to (0.1)% in September 2015. Core inflation, which strips out volatile elements like food and energy, remained weak at 1.0%. The British Chambers of Commerce expect inflation to remain at or below 0% for the remainder of the year and remain below the Monetary Policy Committee target of 2% until well into 2017.

The Bank of England bank rate has remained at 0.5% since March 2009, and the spread between bank rate and 3 month London Interbank Offered Rate ("LIBOR") has remained relatively narrow throughout the year.

Regulatory and political environment

The regulatory and political environment in which the Group operates continues to evolve. Key changes, all of which the Group is responding to, include:

- Under the Capital Requirements Directive ("CRD IV"), Financial Reporting ("FinRep") was mandated by the European Banking Authority ("EBA") as a standardised financial reporting framework on 1 July 2014. The intention of FinRep is to harmonise financial reporting, and significantly increases the level of reporting of financial information to the EBA. The Group currently complies with the inforce measures, with the first quarterly reporting (as at September 2014) submitted to the Regulator in November 2014.

Regulatory and political environment (continued)

- The PRA, published Policy Statement 11/15 on "CRD IV: Liquidity" on 8 June 2015. In this, the PRA confirmed that the Liquidity Coverage Ratio ("LCR") would be phased in from 1 October 2015 at a level of 80% until the end of 2016. The PRA also clarified that firms with a balance sheet total above £5bn should be able to produce the Common Reporting ("CoRep") LCR return on a daily basis. The Group is currently compliant with an LCR in excess of 100% (30 September 2015: 136%). As a subsidiary of NAB, under Australian Prudential Regulatory Authority ("APRA") rules, the Group was required to meet a 100% LCR from 1 January 2015.

- On 22 December 2014, the Basel Committee on Banking Supervision ("BCBS") published proposals to revise the standardised approach to credit risk. They form part of the BCBS' broader work on reducing variability in risk-weighted assets, increasing risk sensitivity, reducing national discretions and enhancing comparability of capital requirements across banks. If the proposals were to be implemented, prior to mitigation, there would be a significant increase in the Group's capital requirements.

- In June 2014, the recast Deposit Guarantee Schemes Directive was finalised and published in the Official Journal. It introduced harmonised funding requirements, protection for certain types of temporary high balances, a reduction in pay-out deadlines, harmonisation of eligibility categories and new disclosure requirements. The PRA set out its near final rules on 1 April 2015 to implement the Directive by the implementation date of 3 July 2015. However, on the implementation date, the PRA also announced that the depositor protection limit was being reduced from £85,000 to £75,000 from 1 January 2016, reflecting the increased value of the pound against the euro. The Group has already implemented a number of the changes but as a result of this announcement, a number of new disclosure requirements originally scheduled for implementation on 3 July have been revised and implementation is now postponed until 1 January 2016.

- The PRA published its near final rules on the implementation of ring-fencing in Policy Statement 10/15 on 27 May 2015. It published Consultation Paper ("CP") 33/15 on 18 September 2015 and CP 37/15 on 15 October 2015 on additional aspects of the ring-fencing regime and the Group is monitoring developments closely. The Government has stated that its intention is for ring-fencing to be implemented from 1 January 2019. On 19 June 2015 the Council of the EU issued a press release stating that it has agreed its negotiation stance on structural measures to improve the resilience of the EU credit institutions. The Presidency will start negotiations with the European Parliament as soon as it has adopted its position.

- The Mortgage Credit Directive ("the Directive") was published in the Official Journal on 28 February 2014. The FCA issued policy statements in March 2015 (2nd charge mortgages) and June 2015 (buy-to-let mortgages). These policy statements outlined the key changes that will be required to be made regarding the mortgage sales process, documentation, and regulatory reporting. The UK is required to implement these rules by March 2016, and the Group has mobilised a project to assess their impact.

- The EBA has developed liquidity metrics in addition to those used to report liquidity coverage and stable funding requirements, with a view to providing supervisors with an adequate toolkit to assess liquidity risk, and to facilitate their work in performing their reviews of Internal Liquidity Adequacy. The Group has a project in place to deliver Additional Monitoring Metrics ("AMM") reporting from 1 January 2016.

- On 6 November 2014, the Competition and Markets Authority ("CMA") announced that it would carry out an in-depth investigation into the supply of personal current accounts and banking services to small and medium-sized enterprises. The Group has been an active participant by providing data and written submissions and attending a panel hearing. In late October 2015, the CMA issued its provisional findings and a notice of possible remedies which the Group is currently considering. The CMA has stated that it will reach a preliminary decision on remedies in February 2016 and issue their final report by May 2016.

- On 2 October 2015, the FCA announced its intention to issue a consultation, before the end of the calendar year, in relation to the introduction of a deadline by which consumers would need to make their PPI complaints and also on how firms should handle PPI complaints in light of a recent Supreme Court decision ("Plevin"). The Group will consider the implications of the FCA's consultation once it has been published. Further detail is included in note 33.

Strategic Report (continued)

Financial analysis

Management basis

The consolidated income statement is presented on a management basis which includes adjustments to present items that the Group believes are non-recurring, or not otherwise indicative of the underlying performance of the business.

Consolidated income statement – management basis	2015 £m	2014 £m	2015 vs 2014 %
Net interest income	789	784	0.6%
Non-interest income	172	192	(10.5%)
Total operating income	961	976	(1.6%)
Total operating and administrative expenses	(737)	(685)	(7.6%)
Operating profit before impairment losses	224	291	23.0%
Impairment losses on credit exposures [(1)]	(78)	(74)	(5.2%)
Underlying profit on ordinary activities before tax	146	217	32.6%
PPI redress expense	(390)	(420)	
PPI complaint handling fine	(21)	-	
IRHP redress expense	(75)	-	
Other conduct expenses	-	(13)	
Restructuring expense	(17)	-	
Separation costs	(10)	-	
Net gain on capital and debt restructuring [(2)]	41	-	
Pension increase exchange gain	18	-	
Statutory loss on ordinary activities before tax	(308)	(216)	
Tax credit	59	38	
Statutory loss attributable to equity holders	(249)	(178)	

(1) Impairment losses on credit exposures relate solely to loans and advances to customers (refer to 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 other assets and liabilities at fair value within non-interest income (refer to notes 6 and 13 to the financial statements).

(2) Includes gains of £41m, and a loss of £2m, in relation to capital restructuring and a further £2m gain on debt restructuring (refer to notes 6, 7 and 11 to the financial statements).

The Group made a statutory loss after tax of £249m in the current year compared to a statutory loss after tax of £178m for the year to September 2014. This was primarily due to increased conduct provisions, restructuring expenses, costs associated with separation activities, investment costs to support growth of the franchise, and lower fees and commissions. These impacts were partially offset by a one off gain arising from a capital restructure in December 2014 and a one off pension scheme gain. In the year ended 30 September 2015, the conduct redress expense of £465m was offset by a capital contribution by NAB which forms part of the Conduct Mitigation Package.

In the year ended 30 September 2015, underlying profit on ordinary activities before tax decreased to £146m from £217m in the year ended 30 September 2014. This was primarily due to a decrease in non-interest income, reflecting the Group's strategy to reduce fees on customer accounts, and an increase in marketing to support balance sheet growth and franchise investment.

Net interest income remained relatively flat in 2015 compared to 2014, primarily due to the reduction in interest rates on lending and deposits which largely offset each other.

Strategic Report (continued)

Income statement analysis – management basis

Net interest income – management basis

	2015 £m	2014 £m	*2015 vs 2014* *%*
Gross interest income and similar income	1,110	1,135	(2.2%)
Gross interest expense and similar charges	321	351	8.5%
Total net interest income	789	784	0.6%

Net interest income increased by £5m (0.6%). The key drivers in this increase were higher mortgage lending income and lower funding costs driven by an improved customer deposit mix. This was partially offset by lower business lending income driven by a reduction in business lending balances due to the managed run-off of lower yielding assets and subdued demand for business credit There was also lower income from the structural hedging of non-interest bearing deposits and capital as a result of the on-going low interest rate environment.

The net interest margin reduced by 9bps to 2.21% (2014: 2.30%). Lower lending margins due to competitive pressures and lower deferred fee income due to a reduction in business lending balances were largely offset by lower funding costs. There was also lower income from hedging derviatives.

Non-interest income – management basis

	2015 £m	2014 £m	*2015 vs 2014* *%*
Gains less losses on financial instruments at fair value	2	(8)	large
Fees and commission	144	164	(12.1%)
Gain on disposal of tangible fixed assets	-	7	large
Other income	26	29	(10.3%)
Total non-interest income	172	192	(10.5%)

Non-interest income reduced by £20m (10.5%). The key drivers in the reduction were lower fees and commissions as a result of our decision to reduce current account fees to improve the customer proposition. This was partially offset by a reduction in the credit risk adjustment on loans accounted for at fair value as asset quality improved.

Operating and administrative expenses – management basis

	2015 £m	2014 £m	2015 vs 2014 %
Personnel expenses	214	216	0.7%
Depreciation expense	20	19	(3.2%)
Other operating and administrative expenses:	503	450	(11.8%)
of which operating lease rentals	32	31	(2.1%)
of which other occupancy charges	38	39	3.2%
of which related entity charges	298	262	(13.8%)
of which other operating and administrative expenses	135	118	(14.8%)
Total operating and administrative expenses	737	685	(7.6%)

Operating and administrative expenses increased by £52m (7.6%) primarily due to an increase in marketing and investment costs to support growth of the franchise. These increases were partially offset by lower personnel expenses primarily due to a reduction in performance related remuneration and restructuring benefits.

Balance sheet

	2015 £bn	2014 £bn	*2015 vs 2014 %*
Customer loans [1] [2]	28.2	26.9	4.8%
Interest earning assets [1]	35.8	34.1	4.9%
Total assets [1]	38.7	36.5	6.1%
Customer deposits [1] [3]	25.1	23.4	7.3%

[1] Average volume.

[2] Customer loans include gross loans and advances to customers, loans designated at fair value through profit or loss and amounts due from customers on acceptances.

[3] Customer deposits include both interest and non-interest bearing accounts and deposits.

Balance sheet analysis

	2015			2014		
	Average balance £m	Interest income/ expense £m	Average yield/ rate %	Average balance £m	Interest income/ expense £m	Average yield/ rate %
Interest earning assets:						
Mortgages	19,576	647	3.31%	17,155	584	3.40%
Business lending	7,339	278	3.79%	8,337	324	3.89%
Unsecured personal lending	1,274	138	10.83%	1,295	155	11.99%
Liquid assets	6,781	36	0.53%	6,180	33	0.54%
Due from related entities	810	3	0.37%	1,102	4	0.33%
Swap income	-	8	n/a	-	35	n/a
Total average interest-earning assets	35,780	1,110	3.10%	34,069	1,135	3.33%
Interest bearing liabilities:						
Current accounts	10,416	12	0.12%	9,741	12	0.12%
Savings accounts	7,171	54	0.75%	5,911	35	0.59%
Term deposits	5,500	129	2.35%	5,975	165	2.77%
Other wholesale deposits	96	1	1.04%	171	1	0.69%
Bonds and notes	3,868	82	2.12%	3,280	81	2.47%
Due to related entities	2,090	38	1.82%	2,736	51	1.86%
Liquid liabilities	978	5	0.51%	808	6	0.72%
Total average interest-bearing liabilities	30,119	321	1.07%	28,622	351	1.23%
Total average equity attributable to equity holders of the parent	2,875			2,579		
Net interest margin	2.21%			2.30%		

Balance sheet analysis (continued)

Customer loans [(1)]

	2015 £m	2014 £m
Mortgages	20,504	18,444
Business lending	7,061	7,970
Unsecured personal lending	1,218	1,282
Total customer loans	28,783	27,696
Loans and advances to customers	27,687	26,121
Other financial assets at fair value	1,092	1,570
Due from customers on acceptances	4	5
Total customer loans	28,783	27,696

(1) Spot balances excluding accrued interest receivable.

Customer loans increased by £1,087m (3.9%) from £27,696m at 30 September 2014 to £28,783m at 30 September 2015, with growth in mortgages partially offset by a reduction in business lending.

Mortgages

Mortgages comprise the Group's largest asset portfolio and have a significant impact on its overall financial performance. The mortgage portfolio increased by 11.2% from £18,444m at 30 September 2014 to £20,504m at 30 September 2015. While the Group is focused on growing its mortgage portfolio through all distribution channels, this increase was primarily driven by an increase in mortgage lending via intermediaries. The balance of mortgage lending through the intermediary channel increased by £2,142m to £10,910m at 30 September 2015, enabling the Group to access customers across the UK including regions where the Group does not have a large branch network.

Additionally, the growth in the year reflects an increase in the level of fixed rate mortgages of £3,256m (34.4%) to £12,710m driven by a customer preference for securing fixed rates in a macroeconomic environment where base rates are expected to increase. This was offset in part by a reduction in the base rate tracker book, which was withdrawn from sale to the general public in 2008, and a decrease in the variable rate mortgage portfolio.

Business lending

Business lending comprises term business loans, overdrafts and other lending - predominantly asset and invoice finance. The business lending portfolio reduced by 11.4%, from £7,970m at 30 September 2014 to £7,061m at 30 September 2015. This was primarily due to the managed run-off of lower yielding assets, coupled with the impacts of subdued business credit demand. The core business lending portfolio is now showing signs of stabilising.

Unsecured personal lending

The Group's unsecured personal lending portfolio comprises credit cards, personal loans and overdrafts originated through branches or by way of digital or other direct channels. Unsecured personal lending balances decreased by 5.0% from £1,282m at 30 September 2014 to £1,218m at 30 September 2015. This was primarily due to a managed reduction in personal loan volumes via the web-based digital platform, after competitive pressures reduced margins to unattractive levels. This impact offset an increase in origination via the branch network and direct (telephone) channel in the year.

Balance sheet analysis (continued)

Customer deposits [1]	2015 £m	2014 £m
Current accounts	12,982	12,031
Variable rate savings accounts	7,790	6,165
Fixed rate term deposits	5,483	5,674
Other wholesale deposits	94	119
Total customer deposits	26,349	23,989
Due to customers	26,282	23,901
Other financial liabilities at fair value	67	88
Total customer deposits	26,349	23,989

(1) Spot balances excluding accrued interest payable.

Customer deposits increased by £2,360m (9.8%), from £23,989m at 30 September 2014 to £26,349m at 30 September 2015, primarily due to an increase in current accounts and variable rate savings accounts.

Current accounts

Funding provided by current accounts increased by £951m (7.9%) from £12,031m at September 2014 to £12,982m at September 2015, with growth in customer numbers and customers retaining higher instant access balances in response to falling market rates of interest on savings products.

Savings accounts

Variable rate savings account balances increased by £1,625m (26.4%) from £6,165m at 30 September 2014 to £7,790m at 30 September 2015 primarily driven by a substantial increase in ISAs due to attractive pricing.

Fixed rate term deposits

Fixed rate term deposits decreased by £191m (3.4%) from £5,674m at 30 September 2014 to £5,483m at 30 September 2015 in line with the Group's ongoing strategy to proactively run-off the higher rate part of the book originated in 2012. This was driven by a decline in business term deposits partially offset by growth in the retail term deposit book.

Bonds and notes	2015 £m	2014 £m
Retail mortgage backed securities ("RMBS")	3,031	2,370
Covered bonds	721	1,063
Ultimate parent	382	410
Total bonds and notes	4,134	3,843
Bonds and notes	3,752	3,433
Related party transactions	382	410
Total bonds and notes	4,134	3,843

Bonds and notes increased by £291m (7.6%) from £3,843m at 30 September 2014 to £4,134m at 30 September 2015, primarily due to the issuance of residential mortgage backed securities of €550m and £275m through Lanark 2014-2 in December 2014, a further issuance of £300m and €280m through Lanark 2015-1 in August 2015 and offset by the redemptions of Lanark 2012-1 of €615m and £400m covered bond 2012-1.

Strategic Report (continued)

Capital position

The Group's CET1 ratio increased from 12.1% in September 2014 to 13.3% in September 2015. In December 2014, a capital restructure was completed to strengthen the Bank's capital base and ensure that the PRA's prudential capital requirements continue to be met. As part of this restructure, the Group repaid £601m of Tier 2 capital in the form of subordinated loan debt and issued £350m of CRD IV compliant Additional Tier 1 ("AT1") Perpetual Capital Notes to the Group's immediate parent. A further £100m of AT1 Perpetual Capital Notes were issued to the Group's immediate parent in September 2015. Between June and September 2015, ordinary shares of £770m were issued as part of the preparation for the demerger and IPO. These actions led to a strengthening of the CET1 ratio. Further capital benefits from balance sheet optimisation resulted in a reduction in credit risk-weighted assets. These actions were partially offset by the impact of conduct charges incurred in the year.

The Group's capital position at 30 September 2015 is summarised below. This table shows the capital position on a CRD IV "transitional" basis and includes grandfathered legacy Tier 2 instruments under the transitional rules implemented by the PRA.

Regulatory capital

	CRD IV 2015 £m	CRD IV 2014 £m
CET1 capital		
Capital instruments	2,812	2,042
Share premium account	-	243
Retained earnings and other reserves [1]	193	210
Structured entities reserves [1]	-	(4)
Prudent valuation adjustment [2]	(5)	(2)
Intangible assets [3]	(265)	-
Deferred tax asset ("DTA") relying on future profitability [4]	(273)	(223)
Defined benefit pension fund assets (net of deferred tax liabilities)	(42)	(39)
	2,420	2,227
Tier 1 capital		
Additional Tier 1 capital instruments	450	-
	450	-
Total Tier 1 capital	2,870	2,227
Tier 2 capital		
Subordinated loans [5]	475	1,076
Credit risk adjustments [6]	138	135
	613	1,211
Total capital	3,483	3,438

(1) Under Capital Requirements Regulation ("CRR") the cash flow hedge, available for sale and asset revaluation reserves now form part of regulatory capital resources. The inclusion of the available for sale asset reserve became a requirement under CRR with effect from 1 January 2015. Structured entities reserves are also excluded for regulatory capital purposes.

(2) A prudent valuation adjustment is applied in respect of fair valued instruments as required under regulatory capital rules.

(3) Intangible assets do not qualify as capital for regulatory purposes.

(4) Under CRD IV, deferred tax assets that rely on future profitability are deducted from CET1 capital.

(5) Subordinated loans reflect the principal outstanding and do not include accrued interest.

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

Capital position (continued)

Risk-weighted assets [1]	2015 £m	2014 £m
Retail mortgages	7,526	6,917
Business lending	7,061	7,984
Other retail lending	951	1,030
Other lending	763	674
Credit risk	16,301	16,605
Credit valuation adjustment	206	137
Operational risk	1,562	1,549
Counterparty risk	138	181
	18,207	18,472

Capital ratios		
CET1 ratio [2]	13.3%	12.1%
Tier 1 ratio	15.8%	12.1%
Total capital ratio	19.1%	18.6%

(1) Risk-weighted assets ("RWAs") are calculated under the standardised approach.

(2) CET1 capital is comprised of shares issued and related share premium, retained earnings and other reserves less specified regulatory adjustments.

Regulatory capital to statutory total equity reconciliation	2015 £m	2014 £m
Regulatory Tier 1 capital	2,870	2,227
Reverse pension regulatory adjustments	42	39
Reverse deductions from capital	270	2
Share option reserve	3	2
Available for sale reserve	-	8
DTA relying on future profitability	273	223
Structured entities reserves	-	4
Statutory total equity	3,458	2,505

Minimum Pillar 1 capital requirements	2015 £m	2014 £m
Credit risk	1,304	1,328
Operational risk	125	124
Counterparty risk	11	14
Credit valuation adjustment	16	11
Tier 1 regulatory capital requirements	1,456	1,477

Capital position (continued)

Regulatory capital flow of funds	CRD IV 2015 £m	CRD IV 2014 £m
CET1 capital		
CET1 capital at 1 October	2,227	2,077
Share capital: ordinary share new issuance	770	600
Share premium	(243)	-
Retained earnings and other reserves (including structured entities)	(13)	(187)
Prudent valuation adjustment	(3)	1
Intangible assets [1]	(265)	-
DTA relying on future profitability	(50)	(223)
Defined benefit pension fund assets	(3)	(39)
Pension fund deficit adjustment	-	(2)
	2,420	2,227
Tier 1 capital		
Tier 1 capital at 1 October	-	300
Share capital repurchased: perpetual non-cumulative preference shares	-	(300)
Capital instruments issued: Additional Tier 1 Perpetual Capital Notes	450	-
	450	-
Total Tier 1 capital	2,870	2,227
Tier 2 capital		
Tier 2 capital at 1 October	1,211	1,230
Credit risk adjustments	3	(20)
Subordinated debt redemption	(601)	-
Asset revaluation reserve	-	(2)
Qualifying and material holding Tier 2 deductions	-	3
	613	1,211
Total capital	3,483	3,438

Risk-weighted assets flow statement	2015 £m	2014 £m
Risk-weighted assets at 1 October	18,472	19,727
Book size	50	(364)
Book quality	(180)	(399)
Methodology and policy	(130)	(492)
Other	(5)	-
Risk-weighted assets at 30 September	18,207	18,472

[1] As a result of the acquisition of CYB Services Limited from its immediate parent, the Bank acquired £265m of intangible assets (note 21).

Capital position (continued)

Capital requirements for calculating RWAs	At 30 September 2015 Capital required £m	RWA £m	Exposure £m	At 30 September 2014 Capital required £m	RWA £m	Exposure £m
Central Governments or Central Banks	-	-	6,477	-	-	5,105
Regional Governments or Local Authorities	2	22	108	2	22	112
Public Sector Entities	-	3	3	-	3	3
Multilateral development banks	-	-	100	-	-	50
Financial Institutions	17	215	837	18	224	1,006
Corporates						
Term lending - Business	151	1,890	1,926	134	1,676	1,715
Other lending	62	772	840	110	1,381	1,426
Overdrafts	23	287	335	27	334	381
Lease	27	333	364	26	328	355
	263	3,282	3,465	297	3,719	3,877
Retail						
Term lending - Retail	43	539	718	46	577	769
Credit cards	21	263	350	21	263	355
Other unsecured including overdrafts	10	128	172	12	154	213
	74	930	1,240	79	994	1,337
Secured by mortgages on residential property						
Mortgages	590	7,371	20,921	541	6,761	18,872
Term lending - Business	50	626	1,081	64	795	1,345
	640	7,997	22,002	605	7,556	20,217
Secured by mortgages on commercial real estate						
Term lending - Business	178	2,230	2,468	189	2,356	2,585
Overdrafts	51	635	727	51	640	723
	229	2,865	3,195	240	2,996	3,308
Exposures in default	34	427	356	49	611	493
Claims in the form of CIU	-	-	-	-	3	3
Collective investments undertakings	-	3	3	-	-	-
Equity exposures	1	16	10	1	12	8
Other items	44	541	1,901	37	465	1,902
	1,304	16,301	39,697	1,328	16,605	37,421
Operational risk	125	1,562		124	1,549	
Counterparty risk	11	138		14	181	
Credit valuation adjustment	16	206		11	137	
	1,456	18,207		1,477	18,472	

The 'Exposure' amounts disclosed above are post Credit Risk Mitigation and Credit Conversion Factors having been applied where applicable. The tables above reflect the Group's interpretation of the revised capital calculation required by CRD IV.

Funding and liquidity

The Group strengthened its funding and liquidity position in the year. The mix of funding was improved by increasing customer deposits and secured funding whilst further reducing parental funding. The loan to deposit ratio reduced from 115% to 109% with growth in the customer deposit portfolio exceeding growth in customer loans. This was primarily due to growth in lower cost current accounts and in cash ISAs. In addition to this, there were two issuances of RMBS in the year of €550m and £275m through Lanark 2014-2 in December 2014, and £300m and €280m through Lanark 2015-1 in August 2015. The Group repaid subordinated debt from its parent as part of the capital restructure and reduced deposits from its parent.

The Group's liquid asset portfolio is managed by diversifying the mix to reduce basis risk and optimise the yield on liquid assets whilst remaining at a prudent level above PRA liquidity requirements. Core liquidity is held predominantly in deposits with central banks. Total unencumbered liquid assets increased by £1,414m from £4,128m to £5,542m. This is primarily due to a higher balance with the Bank of England which is a result of the funding actions described above and a lower level of repurchase agreements at 30 September 2015.

In May 2015, in response to NAB's announcement that it was evaluating a demerger and IPO, Standard & Poor's placed the Clydesdale Bank PLC Group's counterparty credit rating and all ratings on the Group's debt on CreditWatch with negative implications, whilst affirming the BBB+/A-2 credit ratings. Also in May 2015, Fitch ratings placed the Group's Long-term issuer default rating of "A", Short-term IDR of "F1", and Support Rating of "1" on Rating Watch Negative. In June 2015, Moody's announced an updated rating methodology for UK Banks and as a consequence, the Group's long term deposits rating was upgraded to "Baa1" from "Baa2". The short term rating was affirmed at "P-2" with a stable outlook.

Clydesdale Bank PLC's long-term credit ratings are summarised below:

	Outlook as at 13 November 2015 (1)	2015	2014
Fitch	Rating Watch Negative	A	A
Moody's	Stable	Baa1 (2)	Baa2
Standard & Poor's	Credit Watch Negative	BBB+	BBB+

Liquid asset reserve	2015 £m	2014 £m
Cash and balances with central banks	6,431	5,971
Encumbered cash balances	(2,301)	(2,133)
	4,130	3,838
Financial assets available for sale	1,462	1,168
Encumbered available for sale securities	(50)	(878)
	1,412	290
Total unencumbered liquid assets	5,542	4,128

In addition to the above, as at 30 September 2015, the Bank has £3.9bn (2014: £3.6bn) of gross eligible collateral pre-positioned with the Bank of England for potential use in its liquidity facilities.

(1) For detailed background on the latest credit opinions, including commentary on the impact of the demerger and IPO, by Moodys, S&P and Fitch, please refer to the respective rating agency websites.
(2) Long term bank deposit rating.

Funding and liquidity (continued)

	At 30 September 2015		
	Encumbered £m	Unencumbered £m	Total £m
Encumbered asset summary			
Cash and balances with central banks	2,301	4,130	6,431
Due from related entities	624	162	786
Due from other banks	3	125	128
Financial assets available for sale	50	1,412	1,462
Loans and advances to customers	7,398	20,084	27,482
	10,376	25,913	36,289

Encumbered cash and balances with central banks	
Note cover	2,033
Cash ratio deposit	44
EU payment system pre-funding	5
UK payment system collateral	219
	2,301
Encumbered balances due from related entities	
Structured funding - GIC account balances	380
Cash collateral supporting derivatives transactions	244
	624
Encumbered balances due from other banks	
Cash collateral supporting derivative transactions	1
Cash margin supporting repurchase (“repo”) transactions	2
	3
Encumbered investments – financial assets available for sale	
Payment system collateral [1]	50
Repo transaction collateral [1]	-
	50
Encumbered loans and advances to customers	
Structured Programme collateral – Lanark Master Trust	4,275
Structured Programme collateral – Regulated Covered Bond	1,475
Structured Programme collateral – Lannraig Master Trust	1,648
	7,398

(1) Market value of securities posted as collateral.

Funding and liquidity (continued)

	At 30 September 2014		
	Encumbered £m	Unencumbered £m	Total £m
Encumbered asset summary			
Cash and balances with central banks	2,133	3,838	5,971
Due from related entities	1,073	422	1,495
Due from other banks	6	7	13
Financial assets available for sale	878	290	1,168
Loans and advances to customers	6,770	19,131	25,901
	10,860	23,688	34,548

Encumbered cash and balances with central banks	
Note cover	2,088
Cash ratio deposit	42
EU payment system pre-funding	3
UK payment system collateral	-
	2,133
Encumbered balances due from related entities	
Structured funding - GIC account balances	757
Cash collateral supporting derivatives transactions	316
	1,073
Encumbered balances due from other banks	
Cash collateral supporting derivative transactions	-
Cash margin supporting repurchase (“repo”) transactions	6
	6
Encumbered investments - financial assets available for sale	
Payment system collateral (1)	232
Repo transaction collateral (1)	646
	878
Encumbered loans and advances to customers	
Structured Programme collateral – Lanark Master Trust	3,211
Structured Programme collateral – Regulated Covered Bond	2,007
Structured Programme collateral – Lannraig Master Trust	1,552
	6,770

(2) Market value of securities posted as collateral.

Liquid assets	2015 £bn	2014 £bn
UK Government Treasury Bills and Gilts	1.3	1.1
Interbank lending	0.1	0.1
Cash and cash at central bank	4.4	3.9
Note cover (1)	2.0	2.0
	7.8	7.1

(1) Note cover is excluded from PRA regulatory liquidity.

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

Asset Quality

Provisions on credit exposures (£m)	2015	2014
Specific provision for doubtful debts	92	110
Collective provision for doubtful debts	138	135

Credit risk adjustments on loans at fair value (£m)	2015	2014
Individually assessed credit risk adjustments on loans at fair value	11	30
Collectively assessed credit risk adjustments on loans at fair value	27	44

Past due and impaired assets (£m)	2015	2014
90+ Days Past Due ("DPD") assets	143	182
Gross impaired assets (1)	263	375

Asset Quality measures (%)	2015	2014
90+ DPD plus gross impaired assets to gross loans and acceptances (1)	1.41%	2.01%
Specific provision to gross impaired assets (1)	39.2%	37.3%
Net write-offs to gross loans and acceptances	0.35%	0.43%
Total provision as a percentage of net write-offs (2)	268%	279%
Total provision to gross loans and acceptances (2)	0.93%	1.15%
Impairment losses on credit exposures to credit risk-weighted assets (3)	0.47%	0.45%

Impairment provisions on credit exposures (£m)	2015	2014
Business lending (including lease finance)	168	187
Retail lending	62	58
	230	245

Impairment losses on credit exposures (£m)	2015	2014
Business lending (including lease finance)	45	46
Retail lending	33	28
	78	74
Of which:		
Specific	73	95
Collective	5	(21)
	78	74

(1) Gross impaired assets for September 2015 and September 2014 include £25m and £56m gross impaired fair value assets respectively.

(2) Total provision to gross loans and acceptances/net write-offs includes the credit risk adjustments on loans at fair value through profit or loss.

(3) Impairment losses on credit exposures to credit risk-weighted assets excludes credit risk adjustments on loans at fair value.

A number of key Asset Quality measures improved in the period as the impacts of management actions in prior years and improvement in the UK economy took effect. Retail asset quality remains strong and lower default rates continue to be observed. Housing lending impaired loan levels have remained subdued against a growing portfolio supported by the prolonged period of low interest rates and recovery in residential property prices. The 90+ DPD levels for both housing lending and the unsecured portfolios show a steady reduction through the 12 months to 30 September 2015.

While the non-retail portfolio remains sensitive to economic conditions, the recent improvement in the environment, combined with management actions, has had a positive impact on asset quality metrics. The overall collective provision for doubtful debts, including credit risk adjustments on loans at fair value, continues to decrease, reflecting the reduction in the business lending portfolio and stabilisation in non-retail asset quality. The personal lending collective provision also continues to reduce, driven by the improved delinquency profile of these portfolios.

Asset Quality (continued)

The ratio of total provisions to gross loans and acceptances decreased by 22 basis points to 0.93% at 30 September 2015. The movement in the ratio reflects the reduction in the level of specific provisions recognised in the period, resulting from the improvement in economic conditions and improving asset quality trends, combined with the lower risk profile of the book, with a reduced business lending portfolio and growth in the mortgage portfolio which has a lower provisioning requirement.

Investment spend

The Group has increased its investment in the business with expenditure focused on regulatory and compliance, revenue generation activities and refreshing the infrastructure landscape in preparation for being a standalone entity.

Significant progress has been made during the year including the development of our new digital offering to further enhance our customer proposition. The Group has also delivered mandatory reporting capabilities for our Automated Anti Money Laundering Transaction Screening and Mortgage Product Sales Data requirements.

The second half of the year saw the implementation of our new mortgage processing platform and a refresh of the call centre infrastructure as part of the Unified Telephony Programme. This year also saw the launch of the People Programme, investing in the cross enterprise employee proposition.

Community

The Group continues to support the communities it serves.

The Yorkshire and Clydesdale Bank Foundation provides financial support to a large number of charities. In the last 12 months the Foundation has distributed over £864,000 to 350 worthy causes. The third year of the annual Spirit in the Community Awards saw £150,000 being donated to 24 charities in June 2015. The charity relationship with Help the Hospices is now in its eighth year and over £4.5m has been raised in this time, including matching and donations from the Group. In addition, 19% 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 received the HM Government Payroll Giving Platinum Award for the third consecutive year.

Employee engagement

We can only deliver our strategy if our people are motivated and equipped to do their best. Key to this is determining and understanding what they think about the Group as an employer and as a place to work. To do this, we undertake an annual "Speak Up Step Up" ("SUSU") survey, that asks a range of questions to gauge how engaged our employees are with the business and what the Group can do to enable our people going forward.

The recent SUSU results were positive and we have seen an increase in our employee engagement index compared to last year and to the global average benchmark. 84% of employees responded to the voluntary survey. Employee advocacy, pride and commitment to making the Bank successful continue to improve year on year. Furthermore, our employees responded favourably to understanding how they can contribute to meeting the needs of our customers, something which has been a key focus for the Bank. The results indicate a strong customer focus, a risk and compliance culture that aligns with our strategy and brand and also provide a good indicator of where improvements can be made to strengthen our employee proposition. We will continue to work proactively on the insights that are derived from SUSU to ensure we understand and act on areas where improvements can be made.

The Strategic Report was approved by the Board of Directors on 13 November 2015 and was signed on its behalf by:

David Duffy

Chief Executive Officer

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 2015.

Profits and appropriations

The Group loss before tax for the year ended 30 September 2015 was £308m (2014: loss of £216m). The loss attributable to the shareholders for the year ended 30 September 2015 amounted to £249m (2014: loss of £178m). As the preference shares were repurchased in December 2013, no preference share dividends were paid in the year (2014: £14m). The Directors do not recommend the payment of a dividend on the ordinary shares in respect of this financial year (2014: £Nil).

The Group's strategic highlights and business developments are set out in the Strategic Report on pages 6 to 29.

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.

Directors' interests

No Director had any interest in the shares of the Bank or its subsidiaries at any time during the year. As the Group is a wholly owned subsidiary of NAB, 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.

Appointments

Dr Teresa Robson-Capps was appointed as a Non-executive Director of the Bank on 8 October 2014.
Adrian Grace was appointed as a Non-executive Director of the Bank on 23 December 2014.
Ian Smith was appointed as a Director of the Bank on 11 March 2015.
David Duffy was appointed as a Director of the Bank on 5 June 2015.
David Bennett was appointed as a Non-executive Director of the Bank on 22 October 2015.

Resignations

John Hooper resigned as a Director of the Bank on 31 October 2014.
David Thorburn resigned as a Director of the Bank on 28 February 2015.

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 regularly communicates with staff to keep them informed of business objectives and results using methods including the intranet site and all employee telephone calls with the Clydesdale and Yorkshire Bank Leadership Team ("CYB Leadership Team").

Under the UK National Share Incentive Plan, employees are entitled to purchase up to £1,800 worth of NAB shares each year. Participants contribute each month and the trustee uses the contributions to purchase shares on the open market or issue shares 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.

An offer of NAB shares is not being made for the 2015 financial year due to the planned demerger and IPO. In respect of the 2014 financial year, NAB gifted ordinary shares of A$1,000 in total to each eligible employee based on Group performance under the UK National Share Incentive Plan.

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

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.

Political donations

No political donations were made during the year (2014: £Nil).

Corporate governance

The Group confirms that it complies with the PRA's General Organisational Requirements 5.8 and the FCA's Senior Management Arrangements, Systems and Controls sourcebook ("SYSC") 4.3A.11R. These rules require a firm that maintains a website to explain on the website how it complies with certain of the General Organisational Requirements and SYSC rules relating to governance. Statements of compliance are included in the Corporate Governance section of the Group's websites at www.cbonline.co.uk/corporategovernance and www.ybonline.co.uk/corporategovernance.

To demonstrate compliance with certain of the General Organisational Requirements and SYSC rules, the Group has published a Corporate Governance Statement. 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 full 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 and the UK. Whilst the Group remains part of the NAB Group 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 Boards' Risk Committee for the consideration of risks. The membership is shown on the list of Directors on page 1 and the Committee meets at quarterly intervals.

Additional risk and capital related disclosures for the Group can be found in the CYB Investments Pillar 3 Report, https://secure.cbonline.co.uk/debtinvestors/clydesdale-bank-update/, and also within the Strategic Report on pages 21 to 24. Further information on the Group's risk management structure is included in note 40.

The Group also continues to report on the Enhanced Disclosure Task Force ("EDTF") recommendations taking a measured and proportionate approach to the disclosures provided. Further information on the EDTF disclosures can be found on page 154.

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.

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 of the Group's consolidated financial statements.

Events after the balance sheet date

On 28 October 2015 NAB confirmed its intention to divest the Group's immediate parent, CYB Investments Limited, to CYBG PLC ("CYBG") through a demerger and subsequently list CYBG by IPO in February 2016. CYBG will be the newly created holding company for the Group. The proposed demerger is subject to a range of matters including various court and regulatory approvals and NAB shareholder approval.

In order to achieve the proposed CYBG demerger and IPO the PRA requires capital support for CYBG of £1.7bn in relation to potential future legacy conduct costs. The provisions of £465m recognised in the year ended 30 September 2015 will form part of the £1.7bn support package.

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.

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
Company Secretary
13 November 2015

Statement of Directors' responsibilities

The Directors are responsible for preparing the Strategic Report, 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 year. 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
Company Secretary
13 November 2015

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 2015 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 Flows and the related notes 1 to 43. 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 and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

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 33 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 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 and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

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 2015 and of the Group's loss for the year then ended;
- the Group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- the Bank's financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Strategic Report and the Report of the Directors for the financial year for which the financial statements are prepared is consistent with the financial statements.

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

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

Ernst & Young LLP

Andrew Gilder (Senior Statutory Auditor)
For and on behalf of Ernst & Young LLP
Statutory Auditor, London
13 November 2015

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

Contents

Consolidated income statement
for the year ended 30 September 2015

	Note	2015 £m	2014 £m
Interest income and similar income		1,110	1,135
Interest expense and similar charges		(321)	(351)
Net interest income	5	789	784
Gains less losses on financial instruments at fair value		2	(8)
Other operating income		213	200
Non-interest income	6	215	192
Total operating income		1,004	976
Personnel expenses		(198)	(216)
Restructuring expenses		(17)	-
Depreciation expense		(20)	(19)
Other operating and administrative expenses		(999)	(883)
Total operating and administrative expenses before impairment losses	7	(1,234)	(1,118)
Operating loss before impairment losses		(230)	(142)
Impairment losses on credit exposures	16	(78)	(74)
Loss on ordinary activities before tax		(308)	(216)
Analysed as:			
Profit before tax, PPI, IRHP redress expense, other conduct expenses, restructuring expense, separation costs, net gain on capital and debt restructure and pension increase exchange gain		146	217
PPI redress expense	7, 27	(390)	(420)
PPI complaint handling fine	7	(21)	-
IRHP redress expense	7, 27	(75)	-
Other conduct expenses	7	-	(13)
Restructuring expenses	7, 27	(17)	-
Separation costs	7	(10)	-
Net gain on capital and debt restructure	6, 11	41	-
Pension increase exchange gain	29	18	-
Loss on ordinary activities before tax		(308)	(216)
Tax credit	8	59	38
Loss for the year attributable to the equity holders of the parent		(249)	(178)

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

The notes on pages 43 to 153 form an integral part of these financial statements.

Statements of comprehensive income
for the year ended 30 September 2015

	Note	Group 2015 £m	Group 2014 £m	Bank 2015 £m	Bank 2014 £m
Loss for the year		(249)	(178)	(240)	(183)
Items that may be reclassified to the income statement					
Change in cash flow hedge reserve					
Gains during the year		21	1	18	1
Transfers to the income statement		(18)	(50)	(18)	(50)
Taxation thereon		-	10	-	10
		3	(39)	-	(39)
Change in available for sale reserve					
Gains during the year		5	4	5	4
Taxation thereon		(1)	(1)	(1)	(1)
		4	3	4	3
Total items that may be reclassified to the income statement		7	(36)	4	(36)
Items that will not be reclassified to the income statement					
Change in asset revaluation reserve					
Taxation thereon		-	1	-	1
		-	1	-	1
Remeasurement of defined benefit pension plans	29	(36)	24	(36)	24
Taxation thereon		7	(2)	7	(2)
		(29)	22	(29)	22
Total items that will not be reclassified to the income statement		(29)	23	(29)	23
Other comprehensive losses net of taxation		(22)	(13)	(25)	(13)
Total comprehensive losses for the year		(271)	(191)	(265)	(196)
Attributable to equity holders of the parent		(271)	(191)	(265)	(196)

The notes on pages 43 to 153 form an integral part of these financial statements.

Balance sheets
as at 30 September 2015

		Group		Bank	
		2015	2014	2015	2014
	Note	£m	£m	£m	£m
Assets					
Cash and balances with central banks	10	6,431	5,971	6,431	5,971
Due from related entities	11	786	1,495	3,013	3,010
Due from other banks		128	13	36	13
Financial assets available for sale	12	1,462	1,168	1,455	1,168
Financial assets held to maturity	12	-	-	1,440	1,483
Other financial assets at fair value	13	1,097	1,583	1,097	1,583
Derivative financial instruments	14	285	220	228	220
Loans and advances to customers	15	27,482	25,901	26,208	24,450
Due from customers on acceptances		4	5	4	5
Current tax assets		-	-	23	-
Property, plant and equipment	18	109	106	96	106
Investment properties	19	32	44	32	44
Property inventory	20	-	2	-	2
Investments in controlled entities and associates	21	2	2	16	12
Intangible assets	22	265	-	-	-
Deferred tax assets	23	389	287	308	281
Defined benefit pension assets	29	52	49	52	49
Other assets	24	177	237	152	204
Total assets		38,701	37,083	40,591	38,601
Liabilities					
Due to other banks	25	393	914	393	914
Other financial liabilities at fair value	13	67	91	67	91
Derivative financial instruments	14	534	548	466	451
Due to customers	26	26,407	24,073	26,407	24,073
Liabilities on acceptances		4	5	4	5
Current taxes		-	19	-	36
Provisions	27	1,006	952	1,006	952
Due to related entities	11	979	2,452	6,087	6,465
Bonds and notes	28	3,766	3,453	707	1,108
Retirement benefit obligations	29	4	4	4	4
Deferred tax liabilities	23	10	10	10	10
Other liabilities	30	2,073	2,057	2,010	2,017
Total liabilities		35,243	34,578	37,161	36,126
Equity (parent entity interest)					
Share capital	31	2,812	2,042	2,812	2,042
Other equity instruments	32	450	-	450	-
Share premium	32	-	243	-	243
Other reserves	32	4	334	1	334
Retained earnings	32	192	(114)	167	(144)
Total equity		3,458	2,505	3,430	2,475
Total liabilities and equity		38,701	37,083	40,591	38,601

The notes on pages 43 to 153 form an integral part of these financial statements.
These financial statements were approved by the Board of Directors on 13 November 2015 and were signed on its behalf by:

David Duffy
Chief Executive Officer

Ian Smith
Chief Financial Officer

Company name: Clydesdale Bank PLC

Company number: SC001111

Statements of changes in equity
for the year ended 30 September 2015

Group	Notes	Share capital £m	Other equity instruments £m	Share premium account £m	Merger reserve £m	Share option reserve £m	Asset revaluation reserve £m	Available for sale reserve £m	Cash flow hedge reserve £m	Retained earnings £m	Total equity £m
As at 1 October 2013		1,742	-	243	338	2	2	5	23	55	2,410
Loss for the year		-	-	-	-	-	-	-	-	(178)	(178)
Other comprehensive income/(losses)		-	-	-	-	-	-	3	(39)	23	(13)
Total comprehensive income/(losses) for the year		-	-	-	-	-	-	3	(39)	(155)	(191)
Dividends paid – preference shares	9	-	-	-	-	-	-	-	-	(14)	(14)
Shares issued – ordinary shares		600	-	-	-	-	-	-	-	-	600
Share redemption – preference shares		(300)	-	-	-	-	-	-	-	-	(300)
Share options expensed		-	-	-	-	6	-	-	-	-	6
Share options settled		-	-	-	-	(6)	-	-	-	-	(6)
As at 30 September 2014	31, 32	2,042	-	243	338	2	2	8	(16)	(114)	2,505
Loss for the year		-	-	-	-	-	-	-	-	(249)	(249)
Other comprehensive income/(losses)		-	-	-	-	-	-	4	3	(29)	(22)
Total comprehensive income/(losses) for the year		-	-	-	-	-	-	4	3	(278)	(271)
Shares issued – ordinary shares		770	-	-	-	-	-	-	-	-	770
Shares issued - ordinary B shares		338	-	-	-	-	-	-	-	-	338
Cancellation of B ordinary shares		(338)	-	-	-	-	-	-	-	338	-
Capitalisation of merger reserve		-	-	-	(338)	-	-	-	-	-	(338)
Capital contribution	21	-	-	-	-	-	-	-	-	4	4
Other equity instruments issued		-	450	-	-	-	-	-	-	-	450
Transfer of share premium		-	-	(243)	-	-	-	-	-	243	-
Transfer to share option reserve		-	-	-	-	1	-	-	-	(1)	-
Share options expensed		-	-	-	-	7	-	-	-	-	7
Share options settled		-	-	-	-	(7)	-	-	-	-	(7)
As at 30 September 2015	31, 32	2,812	450	-	-	3	2	12	(13)	192	3,458

The notes on pages 43 to 153 form an integral part of these financial statements

Statements of changes in equity (continued)
for the year ended 30 September 2015

Bank	Notes	Share capital £m	Other equity instruments £m	Share premium account £m	Merger reserve £m	Share option reserve £m	Asset revaluation reserve £m	Available for sale reserve £m	Cash flow hedge reserve £m	Retained earnings £m	Total equity £m
As at 1 October 2013		1,742	-	243	338	2	2	5	23	30	2,385
Profit for the year		-	-	-	-	-	-	-	-	(183)	(183)
Other comprehensive income/ (losses)		-	-	-	-	-	-	3	(39)	23	(13)
Total comprehensive income/ (losses) for the year		-	-	-	-	-	-	3	(39)	(160)	(196)
Dividends paid – preference shares	9	-	-	-	-	-	-	-	-	(14)	(14)
Shares issued – ordinary shares		600	-	-	-	-	-	-	-	-	600
Share redemption – preference shares		(300)	-	-	-	-	-	-	-	-	(300)
Share options expensed		-	-	-	-	6	-	-	-	-	6
Share options settled		-	-	-	-	(6)	-	-	-	-	(6)
As at 30 September 2014	31, 32	2,042	-	243	338	2	2	8	(16)	(144)	2,475
Loss for the year		-	-	-	-	-	-	-	-	(240)	(240)
Other comprehensive income/ (losses)		-	-	-	-	-	-	4	-	(29)	(25)
Total comprehensive income/ (losses) for the year		-	-	-	-	-	-	4	-	(269)	(265)
Shares issued – ordinary shares		770	-	-	-	-	-	-	-	-	770
Shares issued - ordinary B shares		338	-	-	-	-	-	-	-	-	338
Cancellation of B ordinary shares		(338)	-	-	-	-	-	-	-	338	-
Capitalisation of merger reserve		-	-	-	(338)	-	-	-	-	-	(338)
Other equity instruments issued		-	450	-	-	-	-	-	-	-	450
Transfer of share premium		-	-	(243)	-	-	-	-	-	243	-
Transfer to share option reserve		-	-	-	-	1	-	-	-	(1)	-
Share options expensed		-	-	-	-	7	-	-	-	-	7
Share options settled		-	-	-	-	(7)	-	-	-	-	(7)
As at 30 September 2015	31, 32	2,812	450	-	-	3	2	12	(16)	167	3,430

The notes on pages 43 to 153 form an integral part of these financial statements

Statements of cash flows
for the year ended 30 September 2015

	Note	Group 2015 £m	Group 2014 £m	Bank 2015 £m	Bank 2014 £m
Operating activities					
Loss on ordinary activities before tax		(308)	(216)	(305)	(230)
Adjustments for:					
Non-cash or non-operating items included in loss before tax	34	(721)	(696)	(717)	(622)
Changes in operating assets	34	(1,837)	(1,191)	(1,522)	(4,259)
Changes in operating liabilities	34	2,021	563	2,033	528
Interest received		1,257	1,134	1,196	1,085
Interest paid		(432)	(257)	(385)	(278)
Tax repayment received		5	-	5	-
Tax (paid)/received - group relief		(9)	34	(20)	55
Net cash provided by/(used in) operating activities		(24)	(629)	285	(3,721)
Cash flows used in investing activities					
Dividends received		-	-	32	26
Interest received		8	8	8	8
Proceeds from sale or maturity of investments		-	50	526	59
Proceeds from sale of tangible fixed assets [(1)]		17	41	17	41
Purchase of tangible fixed assets [(1)]		(15)	(16)	(15)	(16)
Purchase of financial assets available for sale		(269)	(251)	(269)	(251)
Purchase of financial assets held to maturity		-	-	(481)	(76)
Investment in controlled entities		-	-	(4)	-
Net cash used in investing activities		(259)	(168)	(186)	(209)
Cash flows from financing activities					
Interest received		3	4	40	58
Interest paid		(120)	(132)	(189)	(213)
Proceeds from ordinary shares issued	31	770	600	770	600
Proceeds from other equity instruments issued	32	450	-	450	-
Redemption of preference shares	31	-	(300)	-	(300)
Redemption of medium term notes	11	(427)	-	(427)	-
Redemption of subordinated debt	11	(562)	-	(562)	-
Redemption, principal repayment and other movements on residential mortgage backed securities and covered bonds	17	(921)	(216)	(400)	-
Issuance of residential mortgage backed securities and covered bonds	17	1,207	601	-	-
Net (increase)/decrease in amounts due from related entities		694	(73)	(26)	2,960
Net (decrease)/increase in amounts due to related entities		(354)	(338)	702	174
Dividends paid	9	-	(14)	-	(14)
Net cash provided by financing activities		740	132	358	3,265
Net increase/(decrease) in cash and cash equivalents		457	(665)	457	(665)
Cash and cash equivalents at the beginning of the year		5,880	6,545	5,880	6,545
Cash and cash equivalents at the end of the year	34	6,337	5,880	6,337	5,880

[(1)] Tangible fixed assets include property, plant and equipment, investment properties and property inventory.

The notes on pages 43 to 153 form an integral part of these financial statements.

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 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, CYB Investments Limited, 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 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 2015 were authorised for issue by the Board of Directors on 13 November 2015.

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, financial assets available-for-sale 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 Strategic Report. 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.

In assessing the Group's going concern position as at 30 September 2015, the Directors have considered a number of factors including the Group's capital structure, its funding and liquidity position and its future financial performance. This assessment also took into consideration the impact of the intention to pursue a demerger and IPO as a result of the separation from NAB as announced on 7 May 2015 and confirmed on 28 October 2015. The assessment concluded that, for the foreseeable future, the Group has sufficient capital to support its operations; has a funding and liquidity base which is strong, robust and well managed with future capacity; and has expectations that performance will improve as the economy continues to recover.

As a result of the assessment, the Directors have a reasonable expectation that the Company 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 in line with its business model and stated strategic aims. Accordingly, they continue to adopt the going concern basis in preparing the consolidated financial statements.

2. Accounting policies

Basis of consolidation

Controlled entities are all entities (including structured entities) to which the Bank is exposed, or has rights, to variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. An assessment of control is performed on an ongoing basis. For details of controlled entities refer to note 21.

Controlled entities are consolidated from the date on which control is established by the Group until the date that control ceases. The acquisition method of accounting is used to account for business combination other than those under common control. 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.

New accounting standards and interpretations adopted during the year

The Group has adopted the following IASB pronouncements in the current financial year. Except where otherwise stated, these amendments to standards and interpretations did not have a material impact on the Group's consolidated financial statements:

- *IAS 39 'Novation of Derivatives and Continuation of Hedge Accounting – Narrow Scope Amendment',* issued June 2013 and effective for financial years beginning on or after 1 January 2014. This amends IAS 39 to permit the continuation of hedge accounting in specified circumstances where a derivative, which has been designated as a hedging instrument, is novated from one counterparty to a central counterparty as a consequence of laws or regulations.
- *Amendments to IAS 32 'Financial Instruments – Presentation',* issued December 2011 and effective for financial years beginning on or after 1 January 2014. This amendment adds application guidance to IAS 32 to address inconsistencies identified in applying some of the offsetting criteria of IAS 32, including clarifying the meaning of 'currently has a legally enforceable right of set—off' and that some gross settlement systems may be considered equivalent to net settlement.
- *Amendments to IAS 36 'Recoverable Amount Disclosures for Non-Financial Assets'* issued May 2013 and effective for financial years beginning on or after 1 January 2014. This amends the disclosure requirements of IAS 36 to include additional information about the fair value measurement where the recoverable amount of the impaired asset is based on fair value less costs of disposal.

The Group has elected to early adopt the following IASB pronouncements in the current year. Except where otherwise stated, these amendments to standards and interpretations did not have a material impact on the Group's consolidated financial statements:

- *'Annual Improvements to IFRS 2010-2012 cycle',* issued December 2013 and effective for financial years beginning on or after 1 July 2014 (with the mandatory application date for EU entities being financial years beginning on or after 1 February 2015). The IASB have made amendments to the following standards that are relevant to the Group: IFRS 2 'Share Based Payments', IFRS 3 'Business Combinations', IFRS 8 'Operating Segments', IFRS 13 'Fair Value Measurement', IAS 16 'Property, Plant and Equipment', IAS 24 'Related Party Disclosures' and IAS 38 'Intangible Assets'.
- *'Annual Improvements to IFRS 2011-2013 cycle',* issued December 2013 and effective for financial years beginning on or after 1 July 2014 (with the mandatory application date for EU entities being financial years beginning on or after 1 January 2015). The IASB have made amendments to the following standards that are relevant to the Group: IFRS 3 'Business Combinations', IFRS 13 'Fair value measurement' and IAS 40 'Investment Property'.
- *'Defined Benefit Plans: Employee Contributions (Amendments to IAS 19)',* issued November 2013 and effective for financial years beginning on or after 1 July 2014 (with the mandatory application date for EU entities being financial years beginning on or after 1 February 2015). This amendment to IAS 19 permits certain contributions from employees or third parties (only those contributions that are independent of the number of years of service) to be recognised as a reduction in the service cost in the period in which the employee's services are rendered, rather than being attributed to periods of service as a 'negative benefit'.

There were no other standards or interpretations relevant to the Group's operations which were adopted during the year.

2. Accounting policies (continued)

New accounting standards and interpretations not yet adopted

The following IASB pronouncements are relevant to the Group but were not available for adoption in the EU and have not been applied by the Group in the 30 September 2015 reporting year. The impact of these pronouncements is still being assessed by the Group. Except where otherwise stated, the Group does not expect that the adoption of the following standards, amendments to standards and interpretations will have a material impact on the financial statements:

- IFRS 15 'Revenue from Contracts with Customers', issued May 2014 and effective for financial years beginning on or after 1 January 2018. This standard establishes principles for reporting information about the nature, timing, and uncertainty of revenue and cash flows arising from an entity's contracts with customers. The standard provides a single, principles based five step model to be applied to all contracts with customers. The expected impact on the Group is being evaluated.
- Amendments to IAS 16 and IAS 38: 'Clarification of Acceptable Methods of Depreciation and Amortisation', issued May 2014 and effective for financial years beginning on or after 1 January 2016. IAS 16 and IAS 38 both establish the principle for the basis of depreciation and amortisation being the expected pattern of consumption of the future economic benefits of an asset. This amendment provides clarification that the use of certain revenue based methods to calculate depreciation are not appropriate.
- Amendments to IAS 27: 'Equity Method in Separate Financial Statements', issued August 2014 and effective for financial years beginning on or after 1 January 2016. The amendments to IAS 27 will allow entities to use the equity method to account for investments in subsidiaries, joint ventures and associates in their separate financial statements.
- 'Annual Improvements to IFRS 2012-2014 Cycle', issued September 2014 and effective for financial years beginning on or after 1 January 2016. The IASB have made amendments to the following standards that are relevant to the Group and Bank: IFRS 5 'Non-current Assets Held for Sale and Discontinued Operations', IFRS 7 'Financial Instruments: Disclosures', IAS 19 'Employee Benefits' and IAS 34 'Interim Financial Reporting'.
- Amendments to IAS 1: 'Disclosure Initiative', issued December 2014 and effective for financial years beginning on or after 1 January 2016. Narrow scope amendments providing clarification to existing IAS 1 'Presentation of Financial Statements' requirements.
- Amendments to IFRS 11: 'Accounting for Acquisitions of Joint Ventures and Associates', issued May 2014 and effective for financial years beginning on or after 1 January 2016. The amendments address how a joint operator should account for the acquisition of an interest in a joint operation in which the activity of the joint operation constitutes a business.
- Amendments to IFRS 10 and IAS 28 'Sale or Contribution of Assets between an Investor and its Associate or Joint Venture', issued in September 2014 and effective for financial years beginning on or after 1 January 2016. The amendments address the conflict between IFRS 10 and IAS 28 in dealing with the loss of control of a subsidiary that is sold or contributed to an associate or joint venture.
- IFRS 9 'Financial Instruments', issued July 2014 and effective for financial years beginning on or after 1 January 2018. This standard replaces IAS 39 'Financial Instruments: Recognition and Measurement' and contains new requirements for the classification and measurement of financial assets and liabilities, the recognition of impairment, and hedge accounting. This standard is expected to have a significant impact on the Group in line with the wider industry.

  Classification and measurement

  The revised classification and measurement approach will lead to the Group's financial assets being classified as either amortised cost, fair value through other comprehensive income ("FVOCI"), or fair value through the income statement, dependant on the business model and cash flow characteristics of the financial asset. Financial liabilities will in most cases be accounted for as at present. One exception is where the Group opts to fair value a financial liability, where the movement in fair value due to own credit risk would be directly recognised in other comprehensive income. The Group is currently assessing the impact of these requirements.

  Recognition of impairment

  The impairment of financial assets under IFRS 9 will be based on an expected credit loss ("ECL") model, replacing the incurred loss methodology model under IAS 39.

2. Accounting policies (continued)

New accounting standards and interpretations not yet adopted (continued)

Recognition of impairment (continued)

The key changes in the Group's accounting policy for impairment of financial assets expected as a result of the implementation of IFRS 9 are listed below. The Group will apply a three-stage approach to measuring ECL on debt instruments accounted for at amortised cost and FVOCI. Assets migrate through the following three stages based on the change in credit quality since initial recognition:

i) Stage 1: 12 months ECL: for exposures where there has not been a significant increase in credit risk since initial recognition and that are not credit impaired upon origination, the portion of the lifetime ECL associated with the probability of default events occurring within the next 12 months is recognised

ii) Stage 2: Lifetime ECL – not credit impaired: for credit exposures where there has been a significant increase in credit risk since initial recognition but that are not credit impaired, a lifetime ECL is recognised

iii) Stage 3: Lifetime ECL – credit impaired: financial assets will be assessed as credit impaired when one or more events that have a detrimental impact on the estimated future cash flows of that asset have occurred. As this uses the same criteria as under IAS 39, the Group's methodology for specific provisions is expected to remain unchanged. For financial assets that have become credit impaired, a lifetime ECL is recognised and interest revenue is calculated by applying the effective interest rate to the amortised cost (net of provision) rather than the gross carrying amount.

At each reporting date, the Group will assess whether there has been a significant increase in credit risk for financial assets since initial recognition by comparing the risk of default occurring over the expected life between the reporting date and the date of initial recognition. In determining whether credit risk has increased significantly since initial recognition, the Group expects to use its internal credit risk grading system, external risk ratings and forecast information to assess deterioration in credit quality of a financial asset.

Consistent with the current impairment policy, the Group will assess whether the credit risk on a financial asset has increased significantly on an individual or collective basis. For the purposes of a collective evaluation of impairment, financial assets are grouped on the basis of shared credit risk characteristics, taking into account instrument type, credit risk ratings, date of initial recognition, remaining term to maturity, industry and other relevant factors.

The amount of ECL is measured as the probability weighted present value of all cash shortfalls over the expected life of the financial asset discounted at its original effective interest rate. The cash shortfall is the difference between all contractual cash flows that are due to the Group and all the cash flows that the Group expects to receive. In calculating the ECL the Group will consider its historical loss experience and adjust this for current observable data. In addition, the Group intends to uses reasonable and supportable forecasts of future economic conditions including experienced judgement to estimate the amount of an expected impairment loss. IFRS 9 introduces the use of macroeconomic factors which include, but are not limited to, unemployment, interest rates, gross domestic product, inflation and commercial property prices, and requires an evaluation of both the current and forecast direction of the economic cycle. Incorporating forward looking information increases the level of judgement as to how changes in these macroeconomic factors will affect ECL. If, in a subsequent period, credit quality improves and reverses any previously assessed significant increase in credit risk since origination, then the provision for doubtful debts reverts from lifetime ECL to 12 months ECL.

Overall, impairment under IFRS 9 will increase the complexity of the Group's impairment modelling and result in earlier recognition of credit losses than under IAS 39 which is likely to lead to an increase in total provisions.

The Group's ultimate parent, NAB, early adopted IFRS 9 in relation to the impairment of credit exposures from 1 October 2014. NAB produces impairment models for the Group on an IFRS 9 basis for NAB consolidated reporting. The Group does not plan to early adopt any of the requirements of IFRS 9. Prior to adoption by the Group, the methodology and models developed by NAB in relation to the Group are being developed and assessed for consistency with emerging European guidance and market practice.

The Group's governance processes and controls are being developed to integrate the revised ECL requirements into the Group's risk management and financial reporting processes.

2. Accounting policies (continued)

New accounting standards and interpretations not yet adopted (continued)

Recognition of impairment (continued)

NAB has produced an impairment provision calculation for the Group using an IFRS 9 ECL model, which is included in the NAB consolidated results from 1 October 2014. The day one impact of adopting the NAB ECL approach was to increase the Group's total impairment provisions on assets measured at amortised cost by £59m (unaudited). The collective impairment provision release for amortised cost assets in the current period calculated by the NAB ECL model was £16.5m (unaudited). These figures do not capture the impact of economic overlays which are applied at the NAB consolidated level, consequently they are not necessarily indicative of the expected adoption impact of the IFRS 9 ECL model on the Group.

As part of the planned demerger and IPO the Group will cease to book provisions on an IFRS 9 basis for NAB consolidated reporting, applying only the currently applicable credit loss standard, IAS 39. Accordingly, the Group will not report an IFRS 9 outcome in future periods until it has developed its own IFRS 9 ECL model closer to the EU adoption date of the standard.

Hedge accounting

The revised hedge accounting requirements are designed to create a stronger link with financial risk management. Accounting for dynamic risk management (macro hedge accounting) has been decoupled from IFRS 9 and is now subject to a separate IASB project. IFRS 9 allows for the option to continue to apply the existing hedge accounting requirements of IAS 39 until this separate project is completed. The Group are currently assessing the impact of these requirements.

Foreign currency

Functional and presentation currency

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

Transactions and balances

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 the associated gains or losses are recognised in the income statement, are also recognised in the income statement.

2. Accounting policies (continued)

Revenue recognition

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

Fees and commissions, not integral to the effective interest rate, arising from services provided to customers and third parties are recognised on an accruals basis when the service has been provided or on completion of the underlying transaction to which the fee relates.

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

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

- derivatives classified as held for trading;
- hedged assets, liabilities and derivatives designated in hedge relationships; and
- financial assets and liabilities designated at fair value through profit or loss.

For trading derivatives, the full change in fair value is recognised inclusive of interest income and expense arising on those derivatives. However, in cases where a trading derivative is economically offsetting movements in the fair value of a financial asset or liability designated at fair value through profit or loss, the interest income and expense attributable to the derivative is recognised within net interest income and not as part of the fair value movement of the trading derivative.

Hedged assets, liabilities and derivatives designated in hedge relationships result in: (i) the recognition of fair value movements on both the hedged item and hedging derivative in a fair value hedge relationship; and (ii) hedge ineffectiveness for both fair value and cash flow hedge relationships.

2. Accounting policies (continued)

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

Other assets and liabilities at fair value comprise fair value movements on those items designated as fair value through profit or loss.

Interest income and interest expense on hedged assets and liabilities and financial assets and liabilities designated as fair value through profit or loss are recognised in net interest income.

Dividend income

Dividend income is recorded in the income statement on an accruals basis when the Group's right to receive the dividend has been established.

Taxation

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.

Current tax

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

Deferred tax

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 substantively enacted by the balance sheet date and are expected to apply when the related deferred tax asset is realised or the deferred tax liability is settled.

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.

2. Accounting policies (continued)

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 to other banks (to the extent less than 90 days).

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. 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. Receivables due to the Group under reverse repo agreements are normally classified as deposits with other banks or cash and cash equivalents as appropriate.

The difference between the sale and repurchase price of repos and reverse repos is treated as interest and accrued over the life of the agreements using the effective interest method.

Financial instruments

Recognition and derecognition of financial instruments

A financial asset or a financial liability is recognised on the balance sheet when the Bank becomes party to the contractual provisions of the instrument. Loans and receivables are recognised when cash is advanced (or settled) to the borrowers.

The Bank classifies its financial assets in the following categories: financial assets at fair value through profit or loss, loans and receivables, financial assets held to maturity and financial assets available for sale. Management determines the classification of its financial assets at initial recognition.

The Bank classifies its financial liabilities in the following categories: financial liabilities at fair value through profit or loss and other financial liabilities which are measured at amortised cost subsequent to initial recognition.

The Bank derecognises a financial asset when the contractual cash flows from the asset expires or it transfers the right to receive contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership are transferred.

A financial liability is derecognised from the balance sheet when the Bank has discharged its obligation to the contract, or the contract is cancelled or expires.

2. Accounting policies (continued)

Financial Instruments (continued)

Offsetting financial instruments

A financial asset and a financial liability shall be offset and the net amount presented on 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.

Financial instruments designated at 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.

Upon initial recognition, financial assets and liabilities may be designated as held at fair value through profit or loss and 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. 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.

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 related 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.

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.

Financial assets held to maturity

Financial assets held to maturity 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 financial assets are initially recognised at fair value and subsequently recorded at amortised cost using the effective interest method.

2. Accounting policies (continued)

Financial instruments (continued)

Financial assets - Available for sale

Financial assets available for sale, can be listed or unlisted and are non-derivative financial assets that are designated as available for sale and are not classified 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 financial assets available for sale.

Financial assets available for sale 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. Financial assets available for sale are derecognised when the rights to receive cash flows have expired or the Group has transferred substantially all the risks and rewards of ownership.

Financial liabilities

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.

Fair value measurement

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

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 transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

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

The best evidence of the fair value of a financial instrument at initial recognition is the transaction price, which represents the fair value of the consideration 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 the transaction date.

2. Accounting policies (continued)

Financial instruments (continued)

Fair value measurement (continued)

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.

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 providing 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.

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 interest rate basis over the remaining life of the asset or liability.

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. Specifically, the separate component of equity is adjusted to the lesser of the cumulative gain or loss on the hedging instrument; and the cumulative change in fair value of the expected future cash flows on the hedged item from the inception of the hedge. Any remaining gain or loss on the hedging instrument is recognised in the income statement. The carrying value of the hedged item is not adjusted. Amounts accumulated in equity are transferred to the income statement in the period(s) in which the hedged item affects profit or loss.

2. Accounting policies (continued)

Financial instruments (continued)

Cash flow hedge (continued)

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 recognised in the income statement.

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 the inherent market risks (principally interest rate and option risk) are individually hedged using appropriate interest rate derivatives. The loan is designated as being carried at fair value through profit or loss to offset the movements in the fair value of the derivative within the income statement and therefore avoid accounting mismatch. 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.

2. Accounting policies (continued)

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.

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 financial assets, 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.

2. Accounting policies (continued)

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

If the originally contracted terms of loans and advances are amended, the amounts are classified as restructured and may also be disclosed as forbearance if the customer is experiencing, or is about to experience, difficulties in meeting their financial commitments to the Group. Such accounts accrue interest as long as the loan performs in accordance with the restructured terms.

Equity and debt instruments – classed as available for sale

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. Where evidence of impairment exists, the net loss that has been previously recognised directly in equity is recognised in the income statement. Reversals of impairment of debt securities classified as available for sale are recognised in the income statement.

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.

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.

2. Accounting policies (continued)

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).

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.

Intangible assets

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

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

Notes to the consolidated financial statements (continued)

2. Accounting policies (continued)

Impairment of non-financial assets

Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the carrying amount of an asset exceeds its recoverable amount.

The recoverable amount of an asset is the higher of its fair value less costs of disposal or its value in use.

For assets that do not generate largely independent cash inflows, the recoverable amount is determined for the cash generating unit to which that asset belongs. Management judgement is applied to identify cash generating units and they represent a group of assets that generate cash inflows that are largely independent from other assets or groups of assets.

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.

Investment properties

These are properties (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 the 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.

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.

2. Accounting policies (continued)

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.

Defined benefit pension scheme

The defined benefit scheme provides defined benefits based on years of service and career averaged revalued earnings for benefits accruing after 1 April 2006. A liability or asset in respect of the defined benefit scheme is recognised on the balance sheet and is measured as the present value of the defined benefit obligation less the fair value of the defined benefit scheme assets at the reporting date. The present value of the defined benefit obligation for the scheme is discounted by high quality corporate bond rates that have maturity dates approximating to the terms of the Group's defined benefit obligation.

Pension expense attributable to the Group's defined benefit scheme comprises current service cost, net interest on the net defined benefit obligation/(asset), past service cost resulting from a scheme amendment or curtailment, gains or losses on settlement and administrative costs incurred. The Group's policy where actuarial remeasurements arise is to fully recognise such amounts directly in retained earnings through the statement of comprehensive income, in the period in which they occur. Actuarial remeasurements arise from experience adjustments (the effects of differences between previous actuarial assumptions and what has actually occurred) and changes in actuarial assumptions.

The Group 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.

Subordinated liability and related entity balances

Subordinated liabilities and related entity balances, other than derivatives, are recorded at amortised cost. Subordinated liabilities comprise undated and dated loan capital which is exclusively provided to the Bank by CYB Investments Limited 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 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.

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.

2. Accounting policies (continued)

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.

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 on the balance sheet but are disclosed unless they are remote.

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.

Other equity instruments

Other equity instruments represent Additional Tier 1 (“AT1”) notes. These are perpetual capital notes with no fixed maturity or redemption date and are classified as equity instruments. Distributions of interest on the AT1 notes will be due and are deducted from equity on the interest payment date. The Bank has sole and absolute discretion at all times and for any reason to cancel (in whole or in part) any interest payment that would otherwise be payable on any interest payment date.

Preference shares

Preference shares are classified as an equity instrument if and only if the instrument includes no contractual obligation to:

- deliver cash or another financial asset to another entity; or
- exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the issuer.

Where preference shares do not satisfy the above conditions, they are classified as a financial liability. The Bank's preference shares which were repurchased on 20 December 2013 met the criteria for classification as equity.

Dividends on ordinary shares

Dividends on ordinary 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.

2. Accounting policies (continued)

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.

Securitisation

The Group has securitised certain loans (principally housing mortgage loans) by the transfer of the loans to structured entities ("SE's") controlled by the Group. The securitisation enables a subsequent issue of debt, either by the Bank or the SE's, to investors who gain the security of the underlying assets as collateral. Those SE's are fully consolidated into the Group's accounts. All such transferred loans 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.

Business combinations and disposals

i) Combination of businesses

The acquisition method of accounting is used for business combinations other than those under common control. Consideration is measured at fair value and is calculated as the sum of the acquisition date fair value of assets transferred, liabilities incurred to former owners of the acquiree and equity instruments issued. Any excess of the sum of the consideration and the amount of any non-controlling interest in the acquiree over the fair value of the identifiable assets acquired less liabilities assumed, is recognised as goodwill. Acquisition related costs are expensed as incurred.

When a non-controlling interest is present in an entity over which the Group gains control, the non-controlling interest is measured at either fair value or at the proportionate share of the acquiree's identifiable net assets. This choice of accounting treatment is applied on a transaction by transaction basis. Any put and call instruments transacted concurrently with a business combination to acquire the remaining non-controlling interest are assessed to determine whether there is creation of a forward purchase agreement to acquire the remaining outstanding equity at a future date.

Any contingent consideration to be transferred is recognised at fair value at the acquisition date. Subsequent changes to the carrying amount of contingent consideration are recognised either in the income statement or in equity depending on the nature of the payment.

2. Accounting policies (continued)

ii) Combination of businesses under common control

Business combinations involving entities under common control, where all combining entities are ultimately controlled by the same entity before and after the business combination, are accounted for using the predecessor values method of accounting. This involves recognising assets and liabilities of the acquired business at the predecessors' book value, without any change to reflect fair value of those assets and liabilities. Any difference between the cost of acquisition and the aggregate book value of the assets and liabilities as of the date of the transfer of the acquired entity is recorded as an adjustment to equity. No additional goodwill is created by the business combination.

Post-acquisition, income received and expenses incurred by the entity or entities acquired are included in the consolidated income statement on a line-by-line basis in accordance with the accounting policies set out herein.

A non-controlling interest is recognised by the Group in respect of any portion of the total assets less total liabilities of an acquired entity or entities that is not owned by the Group.

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:

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 input impacting the carrying value of the loans other than interest rates is the future expectation of credit losses. Sensitivity analysis indicating the impact of reasonable possible changes in this input on the fair value is included within note 38.

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

Impairment losses on loans and advances

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.

3. Critical accounting estimates and judgements (continued)

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 price indices, country risk and the performance of different individual groups). If the probabilities of default were to improve from those presently used within the Group's provisioning models by 5% the impairment provision on loans and advances would decrease by £4m. Alternatively, if probabilities of default deteriorate by 5%, the impairment provision on loans and advances would increase by £4m. 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 £10m. Alternatively, if recovery rates deteriorate by 5%, the impairment provision on loans and advances would increase by £19m. There are interactions between the various assumptions within the provisioning models, 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 impairment loss on loans and advances is disclosed in more detail in note 16.

Payment Protection Insurance redress provision and other conduct related matters

Disclosures in relation to the Group's PPI redress provision can be found in note 27 with the Group holding a provision of £774m at 30 September 2015 (2014: £515m). Significant judgement by management is required in determining the key assumptions used to estimate the quantum of the provision, including the level of complaint volumes, (both historic and estimated future complaint volumes), uphold rates (how many claims are, or may be, upheld in the customer's favour) and redress costs (the average payment made to customers). Also factored into the estimate is the effect of the past business review and the judgements required around customer mailing response rates. The provision is therefore subject to inherent uncertainties as a result of the subjective nature of the assumptions used in quantifying the overall estimated position at 30 September 2015. Consequently, the provision calculated 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. Sensitivity analysis indicating the impact of reasonable possible changes in key assumptions on the PPI provision is included within note 27.

There are similar uncertainties and judgements for other conduct risk related matters, including the Group's IRHP provision disclosed in note 27 however the level of liability is materially lower.

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, 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. Further details on the assumptions used and sensitivity analysis on the key assumptions are provided in note 29.

Deferred tax assets

Disclosures in relation to the Group's deferred tax assets of £389m (2014: £287m) can be found in note 23. The Group has assessed the recoverability of these deferred tax assets and considers it probable that sufficient future taxable profits will be available against which the underlying deductible temporary differences can be utilised. The Group has made this assessment with reference to the latest available profit forecasts. The largest deferred tax asset held within the Group relates to trading losses carried forward. These tax losses carried forward have been assessed for recoverability against the Group's forecasts which include 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; the Group expects the assets to be recovered in the reasonably foreseeable future.

4. Segment information

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

The Group's business is organised into two principal operating segments: SME Banking (formally referred to as "Business and Private") and Retail Banking. The Central Functions of the Group consist of: Customer Trust & Confidence, Finance, Risk, Operations & IT, Legal & Governance, CEO Office Support, Customer Experience, Products & Marketing, Strategy & Transformation, Treasury and People & Communications.

'Other' (which in previous years was incorporated into Central Functions) reflects certain elements of expenditure that are not recharged to the Group's two principal operating segments such as conduct related provisions and restructuring costs.

SME Banking

The Group's established regional SME franchise offers a full range of business banking products and services to meet their banking needs across its Business Direct, small business, commercial and specialist and acquisition finance segments.

The Group's SME franchise is comprised of micro businesses (which the Group defines as businesses with no lending outstanding and turnover of less than £120,000), Business Direct (which the Group defines as businesses with outstanding lending of less than £0.1m and turnover of less than £750,000), small businesses (which the Group defines as businesses with lending of £0.1m to £0.25m and greater than £750,000 but less than £2.0m in turnover) and commercial businesses (which the Group defines as businesses with lending of higher that £0.25m and greater than £2.0m in turnover). Across all business segments, the Group provides working capital solutions to business customers through asset finance, invoice finance, international trade, merchant acquiring and treasury services.

The Group offers a full range of lending products and services across a portfolio consisting of term lending, overdrafts and working capital solutions through its SME franchise:

- Term lending: the Group offers a wide variety of term loans, both secured and unsecured, and offers customers a range of repayment and interest rate options. The majority of the Group's business term lending is LIBOR based.
- Overdrafts: business overdrafts are the primary type of revolving variable rate credit facility offered by the Group to business customers.
- Invoice finance: the Group advances funds against the customer's trade receivables.
- Asset finance: these products provide a method of financing capital equipment purchases.
- International trade services: these products facilitate transactions between a buyer and seller located in different countries. The Group offers import loans, export loans, documentary collections and currency guarantees, together with letters of credit for securing trade.
- Private banking: a fee based service targeted at higher net worth customers, primarily business owners, providing tailored solutions to meet their financial requirements.

4. Segment information (continued)

Retail Banking

The Group has a comprehensive regional and national retail banking product proposition with a personal deposit portfolio comprising of PCAs, savings accounts, and term deposits. The Group's retail loan portfolio comprises of mortgages, personal loans, credit cards and overdrafts:

- PCA: a stable source of funding with a large number of PCA customers having a tenure with the Group of more than ten years.
- Savings accounts: the Group offers a variety of savings accounts that pay a variable rate of interest. It also offers cash ISAs with competitive rates that offer depositors tax free returns.
- Term deposits (sometimes referred to as "fixed rate savings accounts" or "time deposits"): offer a fixed interest rate for a fixed term.
- Mortgages: the Group provides mortgage loans on a capital repayment basis, where the loan is required to be repaid during its life, and on an interest-only basis, where the customer pays interest during the term of the mortgage loan with the principal balance required to be repaid in full at maturity. The Group offers both owner-occupied mortgage loans (pursuant to which the borrower is the owner and occupier of the mortgaged property) and buy-to-let ("BTL") loans (pursuant to which the borrower intends to let the mortgaged property).
- Personal loans: the Group provides unsecured personal loans through its branch network to retail and private banking customers and through its digital and telephone distribution channels.
- Credit cards: the Group currently offers three credit card products, Private MasterCard, Business MasterCard and Gold MasterCard.
- Overdrafts: the Group provides overdraft lending across a variety of PCA products, subject to the account holder's status. Overdrafts comprise both planned and unplanned borrowing.

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. Further information on the Group's geographical locations can be found in the other information section at the end of this annual report and consolidated financial statements.

Operating segments 2015	SME Banking £m	Retail Banking £m	Central Functions £m	Other £m	Total £m
Net interest income	274	461	54	-	789
Non-interest income	77	94	1	43	215
Operating income	351	555	55	43	1,004
Operating and administrative expenses	(82)	(116)	(539)	(497)	(1,234)
Impairment losses on credit exposures [1]	(45)	(33)	-	-	(78)
Segment operating profit/(loss) before tax	224	406	(484)	(454)	(308)
Average interest-earning assets	10,908	17,400	7,471	-	35,779

[1] The impairment losses on credit exposures figure of £33m (2014: £28m) for Retail Banking includes losses on certain retail products attributable to SME (private banking) customers.

4. Segment information (continued)

Operating segments 2014	SME Banking £m	Retail Banking £m	Central Functions £m	Other £m	Total £m
Net interest income	308	453	23	-	784
Non-interest income	75	105	12	-	192
Operating income	383	558	35	-	976
Operating and administrative expenses	(80)	(138)	(467)	(433)	(1,118)
Impairment losses on credit exposures	(46)	(28)	-	-	(74)
Segment operating profit/(loss) before tax	257	392	(432)	(433)	(216)
Average interest-earning assets	12,200	14,984	6,887	-	34,071

The presentation and allocation of impairment losses on credit exposures between segments has been amended from prior years to allocate impairment losses previously included for central functions to SME and Retail Banking. Prior year comparatives have been amended to conform with the current year's presentation.

Comparative disclosures have been amended to conform with current year's presentation by reclassifying the 30 September 2014 Financial Services Compensation Scheme ("FSCS") levy of £13m from net interest income to operating and administrative expenses.

The components of the 'Other' segment are £390m for PPI redress expense (2014: £420m), £21m for PPI handling fine (2014: £Nil), £75m for IRHP redress expense (2014: £Nil), £Nil for other conduct expenses (2014: £13m), £17m for restructuring expenses (2014: £Nil), £10m for separation costs (2014: £Nil), £43m for gains on capital and debt restructures (2014: £Nil) and £18m for pension increase exchange gain (2014: £Nil), £2m for loss on capital restructure (2014: £Nil).

5. Net interest income

	2015 £m	2014 £m
Interest income and similar income		
Loans and advances to other banks	28	25
Financial assets available for sale	8	8
Loans and advances to customers	1,033	1,052
Financial assets at fair value through profit or loss	37	45
Due from related entities (note 11)	3	4
Other interest income	1	1
Total interest income and similar income	1,110	1,135
Less: Interest expense and similar charges		
Due to other banks	5	5
Financial liabilities at fair value through profit or loss	1	1
Due to customers	195	212
Bonds and notes	82	81
Due to related entities (note 11)	38	51
Other interest expense	-	1
Total interest expense and similar charges	321	351
Net interest income	789	784

Comparative disclosures have been amended to conform with current year's presentation by reclassifying the 30 September 2014 FSCS levy of £13m from other interest expense to operating and administrative expenses.

6. Non-interest income

	2015 £m	2014 £m
Gains less losses on financial instruments at fair value		
Interest rate derivatives	29	47
Other assets and liabilities at fair value	(29)	(64)
Ineffectiveness arising from fair value hedges (note 14)	1	7
Ineffectiveness arising from cash flow hedges (note 14)	1	2
	2	(8)
Other operating income		
Fees and commission	144	164
Margin on foreign exchange derivative brokerage	20	19
Net fair value movement on investment properties	(1)	-
Gain on disposal of tangible fixed assets [1]	-	7
Other income	50	10
	213	200
Total non-interest income	215	192

(1) Tangible fixed assets include property, plant and equipment, investment properties and property inventory.

Margin on foreign exchange derivative brokerage has been included within other operating income. ATM fees have been moved from other income to fees and commission. Comparative disclosures have been amended to conform with the current year's presentation.

In December 2014, £601m of Tier 2 subordinated debt issued was redeemed. These instruments would have become progressively ineligible for Tier 2 treatment under CRD IV's transitional rules from 1 January 2015 as well as being impacted by the introduction of a 25% capital limit under Pillar 2A. These instruments were replaced by issues of £770m of ordinary shares and issues of Additional Tier 1 capital instruments of £450m to the Group's immediate parent. As a result of the redemptions in the year ended 30 September 2015, other income includes gains of £41m arising on capital restructures during the year and a further gain of £2m on early redemption of medium term funding on 30 September 2015, resulting in total gains of £43m. A loss of £2m arising on a capital restructure is included in related entity charges (notes 7 and 11).

The movement in 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 measured at fair value. The movements in fair value are taken through the income statement as part of non-interest income. The fair value of these loans is derived from the future loan cash flows using appropriate discount rates and includes adjustments for credit risk and credit losses. In general, as interest rates fall, the carrying value of the loan portfolio increases. Similarly, as interest rates increase, the carrying value of the loan portfolio decreases. The valuation technique used is reflective of current market practice.

7. Operating and administrative expenses

	2015 £m	2014 £m
Personnel expenses		
Salaries, wages and non-cash benefits	148	149
Related personnel expenses	14	13
Defined contribution pension expense	9	8
Defined benefit pension expense	9	28
Equity-based compensation	7	7
Other personnel expenses	11	11
	198	216
Restructuring		
Restructuring expenses (note 27)	17	-
Depreciation expense		
Depreciation of property, plant and equipment (note 18)	20	19
Other operating and administrative expenses		
Operating lease rental	32	31
Other occupancy charges	38	39
Related entity charges (note 11)	300	262
Payment Protection Insurance redress expense (note 27)	390	420
IRHP redress expense (note 27)	75	-
Other conduct expenses (note 27)	-	13
Other operating and administrative expenses	164	118
	999	883
Total operating and administrative expenses	1,234	1,118

Other operating and administrative expense includes the FSCS levy charge of £14m (2014: £13m). Comparative disclosures have been amended to conform with current year's presentation.

On 14 April 2015, the FCA issued the Bank with a fine of £21m (2014: £Nil) for failings in its PPI complaint handling processes between May 2011 and July 2013. This amount is recorded within other operating and administrative expenses.

Related entity charges include a loss on capital restructuring of £2m (2014: £Nil) (note 11).

During the year ended 30 September 2015, the Group's defined benefit pension plan arrangements were amended to offer certain members the option to participate in a pension increase exchange upon retirement. After taking independent financial advice the member can elect to take a higher rate of pension upon retirement in exchange for waiving their right to future inflation based increases. Accounting for this change has resulted in a credit to the income statement of £18m, resulting in a reduction in the defined benefit pension expense to £9m (2014: £28m) (note 29).

Separation costs of £8m and £2m (2014: £Nil and £Nil) are included within other operating and administrative expenses and personnel expenses respectively.

Auditors' remuneration

Included within other operating and administrative expenses:	2015 £'000	2014 £'000
Audit of the financial statements	1,048	1,231
Other fees to auditors:		
Audit of the Group pension scheme	58	58
Local statutory audits for subsidiaries	91	91
Other assurance including regulatory compliance based work	1,982	141
	3,179	1,521

Included within other assurance is £1,926k in respect of assurance work related to the proposed demerger and IPO (2014: £Nil) which has been paid by NAB.

8. Taxation

Current tax	2015 £m	2014 £m
UK corporation tax		
Current year	(14)	7
Adjustment in respect of prior years	(21)	4
	(35)	11
Deferred tax (note 23)		
Current year	(31)	(44)
Adjustment in respect of prior years	7	(5)
	(24)	(49)
Tax credit for the year	(59)	(38)

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

	2015 £m	2014 £m
Loss on ordinary activities before tax	(308)	(216)
Tax credit based on the standard rate of Corporation Tax in the UK of 20.5% (2014: 22%)	(63)	(47)
Effects of:		
Expenses not deductible for tax purposes	5	3
Non-deductible FCA fine	4	-
Regulatory capital and debt restructure	(8)	-
Deferred tax on losses not recognised	16	-
Chargeable gains	-	3
Rate differences	1	4
Adjustments in respect of prior years	(14)	(1)
Tax credit for the year	(59)	(38)

The net gain on capital and debt restructuring of £41m (2014: £Nil) (note 11) is not subject to taxation and has reduced the Group's effective tax rate for the year.

On 26 October 2015, legislation was substantively enacted to limit the tax-deductibility of payments by banks for compensation for mis-selling. The restrictions apply from 8 July 2015. The Finance Bill was not substantively enacted at the balance sheet date and therefore the restriction cannot be reflected in calculating the current period corporation tax credit. Had the legislation been substantively enacted, it is estimated that the impact of the non-deductibility of PPI and conduct charges incurred after 8 July 2015 would result in a reduction in the tax credit of approximately £17m.

9. Dividends paid

	2015 £m	2014 £m
Preference dividends paid – 12% per annum payable semi-annually (2015: Nil; 2014: 6p per share)	-	6
Preference dividends paid – 6 month LIBOR plus a margin of 779bps per annum payable semi-annually (2015: Nil; 2014: 4p per share)	-	8
	-	14

The preference shares were repurchased on 20 December 2013.

10. Cash and balances with central banks

	Group 2015 £m	Group 2014 £m	Bank 2015 £m	Bank 2014 £m
Cash assets	1,452	1,302	1,452	1,302
Balances with central banks (including EU payment systems)	4,979	4,669	4,979	4,669
	6,431	5,971	6,431	5,971
Less mandatory deposits with central banks [1]	(44)	(42)	(44)	(42)
Included in cash and cash equivalents (note 34)	6,387	5,929	6,387	5,929

[1] 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 on an arm's length basis, including the provision of banking facilities and standby financing arrangements. Other dealings include granting loans and accepting deposits, the provision of finance and foreign exchange and interest cover.

The Group receives a range of services from the ultimate parent and related parties, including loans and deposits, foreign exchange and interest rate cover and various administrative services.

Amounts due from related entities	Group 2015 £m	Group 2014 £m	Bank 2015 £m	Bank 2014 £m
Loans				
Ultimate parent	672	1,104	292	347
Controlled entities of the ultimate parent	1	8	1	8
Controlled entities of the Bank	-	-	1,549	1,441
	673	1,112	1,842	1,796
Other receivables				
Ultimate parent	110	367	110	383
Controlled entities of the ultimate parent	3	16	3	-
Controlled entities of the Bank	-	-	1,058	831
	113	383	1,171	1,214
Total amounts due from related entities	786	1,495	3,013	3,010
Interest income on the above amounts was as follows:				
Ultimate parent (note 5)	3	4	3	4
Controlled entities of the Bank	-	-	37	56
	3	4	40	60

11. Related party transactions (continued)

Amounts due to related entities	Group 2015 £m	Group 2014 £m	Bank 2015 £m	Bank 2014 £m
Deposits				
Ultimate parent	24	897	24	897
Immediate parent	34	-	34	-
Controlled entities of the Bank	-	9	8	29
	58	906	66	926
Bonds and notes				
Ultimate parent	382	410	-	-
Subordinated liabilities				
Ultimate parent	478	555	478	555
Controlled entities of the ultimate parent	-	526	-	526
	478	1,081	478	1,081
Other payables				
Ultimate parent	3	38	3	54
Immediate parent	48		-	-
Controlled entities of the ultimate parent	10	17	10	16
Controlled entities of the Bank	-	-	5,530	4,388
	61	55	5,543	4,458
Total amounts due to related entities	979	2,452	6,087	6,465
Interest expense on the above amounts was as follows (note 5)				
Ultimate parent	36	41	36	41
Immediate parent	2	10	2	10
Controlled entities of the Bank	-	-	116	127
	38	51	154	178

On 30 September 2015, the Bank redeemed £429m of medium term notes with NAB early, resulting in a gain of £2m. The gain is included within other income (note 6) along with other capital restructuring gains of £41m.

Derivatives

The following derivative positions are held with the ultimate parent:

	Group 2015 £m	Group 2014 £m	Bank 2015 £m	Bank 2014 £m
Derivative financial assets				
Designated as hedging instruments	86	13	37	13
Designated as held for trading	60	75	60	75
	146	88	97	88
Derivative financial liabilities				
Designated as hedging instruments	173	245	132	148
Designated as held for trading	263	278	248	278
	436	523	380	426

Subordinated liabilities

Subordinated liabilities comprise undated and dated loan capital which is provided to the Bank by CYB Investments Limited and NAB. Interest on the loans is payable at rates related to the 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 PRA. The loans are subordinated to the claims of other creditors and are unsecured. The loans are employed in the general business of the Bank.

11. Related party transactions (continued)

Subordinated liabilities (continued)

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

Group and Bank

The rates of interest stated below apply at 30 September:	2015 £m	2014 £m
10-year, non-call 5-year with a final maturity of 20 December 2023 - LIBOR +3.41%	300	300
10-year, non-call 5-year with a final maturity of 25 January 2021 - LIBOR + 4.42%	175	250
	475	550
Other subordinated debt	-	526
Accrued interest payable	3	5
Total subordinated liabilities	478	1,081

On 29 December 2014, the Group repaid £526m of subordinated liabilities to the immediate parent at a market value of £485m, resulting in a gain on capital restructure of £41m included within other income (note 6). The Group also repaid £75m of subordinated liabilities to its ultimate parent at a market value of £77m, resulting in a loss on capital restructure of £2m included within other operating and administrative expenses (note 7).

Securitisation

The Group has securitised part of its residential mortgage portfolio, and the cash raised from the issue of RMBS through structured entities forms part of the Group's medium term funding. A portfolio of buy to let mortgages has been securitised through the Lannraig Master Trust Issuer programme and a total of £382m (2014: £410m) of the securities issued are held by the Group's ultimate parent.

Other transactions with related entities	Group		Bank	
	2015 £m	2014 £m	2015 £m	2014 £m
Gain on debt and capital restructures				
Controlled entities of the ultimate parent	43	-	43	-
Non-interest income received				
Controlled entities of the ultimate parent	5	6	5	6
Administrative expenses (note 7)				
Ultimate parent	11	5	11	5
Controlled entities of the ultimate parent	289	257	289	257
	300	262	300	262

Offset within administrative expenses paid to the ultimate parent are amounts received by the Group in relation to expenses incurred in the provision of services to the NAB UK Commercial Real Estate ("CRE") portfolio. The amount received is reducing as the portfolio reduces.

Included within administrative expenses paid to controlled entities of the ultimate parent are recharges from CYB Services Limited, which was purchased by the Bank on 30 September 2015. Future results for CYB Services Limited will be consolidated into the Group results from 1 October 2015 and the Group's expense profile will change (refer to note 21).

11. Related party transactions (continued)

Compensation of key management personnel (“KMP”)

For the purposes of IAS 24 ‘Related Party Disclosures’, KMPs comprise Directors of the Bank, members of the CYB Leadership Team and PRA approved persons with a control function of 1 to 29.

Group	2015 £m	2014 £m
Salaries and other short-term benefits	10	10
Share based payments	1	2
	11	12

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	2015 £m	2014 £m
Loans and advances	11	1
Deposits	1	-

No provisions have been recognised in respect of loans provided to KMPs (2014: £Nil). There were no debts written off or forgiven during the year to 30 September 2015 (2014: £Nil). Included in the above are ten (2014: twelve) loans totalling £9.5m (2014: £0.1m) made to Directors.

In addition to the above, there are guarantees of £0.4m (2014: £Nil) made to Directors and their related parties.

Other related party transactions

The Group incurred costs in relation to pension scheme administration. These costs, which amounted to £0.6m in the year ended 30 September 2015 (2014: £0.5m) were charged to the Group sponsored Scheme. The Group has deposits of £2.1m (2014: £3.4m) at the year end placed by the Scheme at market rates.

Pension contributions of £51m (2014: £252m) were made during the year to the Yorkshire and Clydesdale Bank Pension Scheme sponsored by the Bank (note 29).

As announced on 7 May 2015 and confirmed on 28 October 2015, NAB intends to pursue a demerger and IPO of the Group (note 43).

Related party balances with non NAB related entities

In addition to the balances with NAB related entities, the Group and Bank also has a £3m (2014: £Nil) term deposit balance due to the Group's associated entity (note 21) on normal commercial terms. The balance is disclosed within due to customers (note 26).

12. Financial assets available for sale and held to maturity

	Group		Bank	
	2015	2014	2015	2014
	£m	£m	£m	£m
Available for sale – listed investments	1,447	1,161	1,447	1,161
Available for sale – unlisted investments	8	7	8	7
Available for sale – other financial assets	7	-	-	-
Total financial assets available for sale	1,462	1,168	1,455	1,168
Held to maturity – listed investments	-	-	1,060	993
Held to maturity – unlisted investments	-	-	380	490
Total financial assets held to maturity	-	-	1,440	1,483
	1,462	1,168	2,895	2,651

Included in the available for sale ("AFS") listed securities are £1.3bn (2014: £1.1bn) in UK Government Gilts and £0.1bn (2014: £0.1bn) in other banks' debt securities.

The other AFS financial asset of £7m represents deferred consideration receivable following the acquisition of CYB Intermediaries Holdings Limited from the ultimate parent on 30 September 2015 and consists of the rights to future commission. Further detail on the acquisition can be found in note 21.

The listed AFS investments are classified as Level 1 in the fair value hierarchy, with the unlisted AFS investments and other AFS financial assets classified as Level 3 (note 38).

Credit quality of investments	Group		Bank	
	2015	2014	2015	2014
	£m	£m	£m	£m
Available for sale				
Senior investment grade	1,447	1,161	1,447	1,161
Other	15	7	8	7
	1,462	1,168	1,455	1,168
Held to maturity				
Investment grade	-	-	846	854
Sub investment grade	-	-	594	629
	-	-	1,440	1,483

13. Other financial assets and liabilities at fair value

	Group		Bank	
	2015	2014	2015	2014
	£m	£m	£m	£m
Other financial assets at fair value through profit or loss				
Loans and advances	1,097	1,583	1,097	1,583
Other financial liabilities at fair value through profit or loss				
Due to customers – term deposits	67	91	67	91

Derivatives which do 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 held for trading derivative financial instruments (note 14).

13. Other financial assets and liabilities at fair value

Loans and advances

Included in other financial assets at fair value is a portfolio of loans. 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 £1,097m (2014: £1,583m). The cumulative loss in the fair value of the loans attributable to changes in credit risk amounts to £38m (2014: £74m) and the change for the current year is a decrease of £36m (2014: decrease of £3m).

The Group ceased further sales of this suite of loan products with effect from 30 April 2012 with the loans classified as Level 3 in the fair value hierarchy (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 (2014: £Nil). The Bank is contractually obligated to pay £4m (2014: £8m) less than the carrying amount at maturity to the deposit holder.

The term deposits are classified as Level 3 in the fair value hierarchy (note 38).

14. Derivative financial instruments

The Group uses derivatives for risk mitigation purposes and does not have a trading book. However, derivatives that do not meet the hedging criteria within IAS 39, or those for which hedge accounting is not desirable, are accounted for as held for trading (although they are used for risk mitigation purposes). The tables below analyse derivatives between those designated as hedging instruments and those classified as held for trading.

	Group		Bank	
	2015	2014	2015	2014
	£m	£m	£m	£m
Fair value of derivative financial assets				
Designated as hedging instruments	103	13	46	13
Designated as held for trading	182	207	182	207
	285	220	228	220
Fair value of derivative financial liabilities				
Designated as hedging instruments	244	245	191	148
Designated as held for trading	290	303	275	303
	534	548	466	451

14. Derivative financial instruments (continued)

The derivative financial instruments held by the Group and Bank are further analysed below with the notional contract amount being the amount from which the cash flows from the derivative contracts are derived. The notional contract amount is not an indication of the amounts at risk relating to these contracts.

Group Total derivative contracts as at 30 September 2015 Derivatives designated as hedging instruments	Notional contract amount £m	Fair value of assets £m	Fair value of liabilities £m
Cash flow hedges			
Interest rate swaps	16,655	46	76
Cross currency swaps	843	8	53
	17,498	54	129
Fair value hedges			
Interest rate swaps	1,452	35	115
Cross currency swaps	499	14	-
	1,951	49	115
Derivatives designated as held for trading			
Foreign exchange rate related contracts			
Spot and forward contracts	1,990	47	38
Cross currency swaps	150	5	5
Options	273	2	2
	2,413	54	45
Interest rate related contracts			
Swaps	2,084	105	217
Swaptions	67	-	1
Options	706	1	5
	2,857	106	223
Commodity related contracts	160	22	22
Total derivative contracts	24,879	285	534

Group Total derivative contracts as at 30 September 2014 Derivatives designated as hedging instruments	Notional contract amount £m	Fair value of assets £m	Fair value of liabilities £m
Cash flow hedges			
Interest rate swaps	29,355	13	86
Cross currency swaps	251	-	18
	29,606	13	104
Fair value hedges			
Interest rate swaps	1,458	-	91
Cross currency swaps	982	-	50
	2,440	-	141
Derivatives designated as held for trading			
Foreign exchange rate related contracts			
Spot, forward and futures contracts	2,423	55	40
Cross currency swaps	457	38	3
Options	520	4	4
	3,400	97	47
Interest rate related contracts			
Swaps	3,306	101	236
Swaptions	128	1	1
Options	601	4	15
	4,035	106	252
Commodity related contracts	120	4	4
Total derivative contracts	39,601	220	548

14. Derivative financial instruments (continued)

Bank Total derivative contracts as at 30 September 2015 Derivatives designated as hedging instruments	Notional contract amount £m	Fair value of assets £m	Fair value of liabilities £m
Cash flow hedges			
Interest rate swaps	16,655	46	76
Cross currency swaps	-	-	-
	16,655	46	76
Fair value hedges			
Interest rate swaps	753	-	115
Cross currency swaps	-	-	-
	753	-	115
Derivatives designated as held for trading			
Foreign exchange rate related contracts			
Spot, forward and futures contracts	1,990	47	38
Cross currency swaps	150	5	5
Options	273	2	2
	2,413	54	45
Interest rate related contracts			
Swaps	2,084	105	202
Swaptions	67	-	1
Options	706	1	5
	2,857	106	208
Commodity related contracts	160	22	22
Total derivative contracts	22,838	228	466

Bank Total derivative contracts as at 30 September 2014 Derivatives designated as hedging instruments	Notional contract amount £m	Fair value of assets £m	Fair value of liabilities £m
Cash flow hedges			
Interest rate swaps	29,355	13	86
Cross currency swaps	-	-	-
	29,355	13	86
Fair value hedges			
Interest rate swaps	758	-	62
Cross currency swaps	-	-	-
	758	-	62
Derivatives designated as held for trading			
Foreign exchange rate related contracts			
Spot, forward and futures contracts	2,423	55	40
Cross currency swaps	457	38	3
Options	520	4	4
	3,400	97	47
Interest rate related contracts			
Swaps	3,306	101	236
Swaptions	128	1	1
Options	601	4	15
	4,035	106	252
Commodity related contracts	120	4	4
Total derivative contracts	37,668	220	451

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

14. Derivative financial instruments (continued)

Derivative financial assets and liabilities include those designated as foreign currency hedges for the Group securitisations and interest rate hedges for covered bond programmes. The Group also macro hedges its interest rate exposure using cash flow hedges. The carrying value of the currency liabilities issued through securitisation entities fluctuates as a result of foreign exchange movements. There is a corresponding (and offsetting) movement in the value of the hedging derivatives.

Cash flow hedged derivatives include vanilla interest rate swaps within macro hedges and cross currency swaps within a structured entity. The Group has the following commitments in the time bands noted:

Nominal values per time period	2015 £m	2014 £m
0 to 6 months	4,310	14,305
6 to 12 months	1,448	1,133
1 to 2 years	8,318	6,165
2 to 5 years	3,330	8,003
Greater than 5 years	92	-
	17,498	29,606

The Group has hedged the following forecast future cash flows, which vary primarily with interest or foreign exchange rates. These cash flows are expected to impact the income statement in the following periods:

	Forecast receivable cash flows 2015 £m	Forecast payable cash flows 2015 £m	Forecast receivable cash flows 2014 £m	Forecast payable cash flows 2014 £m
Within 1 year	47	112	56	68
Between 1 and 2 years	38	235	71	95
Between 2 and 3 years	26	319	67	242
Between 3 and 4 years	21	57	15	23
Between 4 and 5 years	9	68	2	10
Greater than 5 years	-	96	-	-
	141	887	211	438

	2015 £m	2014 £m
Gain/(loss) arising from fair value hedges (note 6)		
Hedging instrument	109	14
Hedged item attributable to the hedged risk	(108)	(7)
	1	7

	2015 £m	2014 £m
Gain from cash flow hedges due to hedge ineffectiveness (note 6)	1	2

15. Loans and advances to customers

	Group		Bank	
	2015	2014	2015	2014
	£m	£m	£m	£m
Overdrafts	1,563	1,767	1,563	1,767
Credit cards	376	364	376	364
Lease finance	426	417	413	394
Mortgages	20,504	18,444	19,243	17,015
Other term lending – business	4,025	4,272	4,025	4,272
Other term lending – retail	763	824	763	824
Other lending	30	33	30	33
Gross loans and advances to customers	27,687	26,121	26,413	24,669
Accrued interest receivable	75	79	71	74
Unearned income	(26)	(27)	(24)	(26)
Deferred and unamortised fee income	(24)	(27)	(26)	(27)
Impairment provisions on credit exposures (note 16)	(230)	(245)	(226)	(240)
	27,482	25,901	26,208	24,450

The Group and Bank have transferred £5,923m (2014: £4,763m) 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 £3,413m (2014: £2,780m) (note 17).

Included within Group and Bank loans and advances to customers are £1,475m (2014: £2,007m) of mortgages assigned to a bankruptcy remote structured entity, Clydesdale Covered Bonds No 2 LLP (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 2015 there were £721m (2014: £1,063m) and £697m (2014: £1,097m) of covered bonds in issue under the covered bond programme, by the Group and Bank respectively (note 17).

The Group also has a portfolio of fair valued business loans and advances (note 13). Combined with the above this is equivalent to total loans and advances of £28,579m (2014: £27,484m).

Lease finance

The Group and Bank lease a variety of assets to third parties under finance lease arrangements, including vehicles and general plant and machinery. The cost of assets acquired by the Group and Bank during the year for the purpose of letting under finance leases and hire purchase contracts amounted to £2m (2014: £2m) and £297m (2014: £269m) respectively. The total receivables from finance leases for the Group and Bank were £6m and £Nil (2014: £8m and £Nil) respectively. The total receivables from hire purchase contracts in the Group and Bank were £395m and £390m (2014: £384m and £371m) respectively.

Finance lease and hire purchase receivables	Group		Bank	
	2015	2014	2015	2014
	£m	£m	£m	£m
Gross investment in finance lease and hire purchase receivables				
Due within 1 year	183	196	178	186
Due within 1 to 5 years	241	216	234	205
Due after more than 5 years	2	5	1	3
	426	417	413	394
Unearned income	(25)	(25)	(23)	(23)
Net investment in finance lease and hire purchase receivables	401	392	390	371

Comparative disclosures have been amended to conform with the current year's presentation.

15. Loans and advances to customers (continued)

Lease finance (continued)

Within the Group and Bank there are specific provisions of £1m (2014: £2m) in relation to finance lease and hire purchase receivables, with a collective provision of £1m (2014: £Nil) as at 30 September 2015 (note 16).

Maximum exposure to credit risk

The maximum exposure to credit risk in relation to loans and advances to customers is disclosed in note 39.

Distribution of loans and advances by credit quality

Group As at 30 September 2015	Retail overdrafts £m	Credit cards £m	Lease finance £m	Mortgages £m	Business lending [(1)] £m	Other retail lending £m	Total £m
Gross loans and advances:							
Neither past due nor impaired	70	363	418	20,170	5,277	668	26,966
Past due but not impaired	9	13	6	268	172	15	483
Impaired	-	-	2	66	170	-	238
	79	376	426	20,504	5,619	683	27,687

Group As at 30 September 2014	Retail overdrafts £m	Credit cards £m	Lease finance £m	Mortgages £m	Business lending [(1)] £m	Other retail lending £m	Total £m
Gross loans and advances:							
Neither past due nor impaired	84	349	405	18,045	5,577	713	25,173
Past due but not impaired	10	15	6	335	246	17	629
Impaired	-	-	6	64	249	-	319
	94	364	417	18,444	6,072	730	26,121

Bank As at 30 September 2015	Retail overdrafts £m	Credit cards £m	Lease finance £m	Mortgages £m	Business lending [(1)] £m	Other retail lending £m	Total £m
Gross loans and advances:							
Neither past due nor impaired	70	363	410	18,949	5,277	668	25,737
Past due but not impaired	9	13	3	239	172	15	451
Impaired	-	-	-	55	170	-	225
	79	376	413	19,243	5,619	683	26,413

Bank As at 30 September 2014	Retail overdrafts £m	Credit cards £m	Lease finance £m	Mortgages £m	Business lending [(1)] £m	Other retail lending £m	Total £m
Gross loans and advances:							
Neither past due nor impaired	84	349	389	16,676	5,577	713	23,788
Past due but not impaired	10	15	2	286	246	17	576
Impaired	-	-	3	53	249	-	305
	94	364	394	17,015	6,072	730	24,669

[(1)] Business lending includes business overdrafts.

Comparative disclosures have been amended to conform with the current year's presentation.

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 ("PD") 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.

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 and are derived in accordance with the Group's rating policy.

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

	Group		Bank	
	2015	2014	2015	2014
	£m	£m	£m	£m
Senior investment grade	1,174	1,225	1,172	1,222
Investment grade	1,615	1,721	1,613	1,716
Sub-investment grade	2,906	3,036	2,902	3,028
	5,695	5,982	5,687	5,966

Comparative disclosures have been amended to confirm with current year presentation.

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

Description	eCRS	PD
Senior investment grade	1 to 5	0 < 0.11
Investment grade	6 to 11	0.11 < 0.55
Sub-investment grade	12 to 23	0.55 < 99.99

The loan-to-value ratio of retail mortgage lending, coupled with the relationship of the debt to customers' income, is key to the credit quality of these loans. The table below sets out the indexed loan-to-value analysis of the Group's retail mortgages:

Loan to value ratio	2015	2014
	%	%
Less than 50%	34	27
50% to 75%	51	49
76% to 80%	5	6
81% to 85%	4	5
86% to 90%	2	4
91% to 95%	1	1
96% to 100%	-	1
Greater than 100%	-	1
Unknown	3	6
	100	100

15. Loans and advances to customers (continued)

Gross loans and advances past due but not impaired

Gross 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. Unsecured retail lending and credit cards are written off when they reach 180 days past due and are not designated as impaired.

The distribution of gross loans and advances that are past due but not impaired is analysed below:

Group 2015	Retail overdrafts £m	Credit cards £m	Lease finance £m	Mortgages £m	Business lending [1] £m	Other retail lending £m	Total £m
1 to 29 days past due	8	6	6	77	110	5	212
30 to 59 days past due	-	2	-	57	17	3	79
60 to 89 days past due	-	2	-	36	9	2	49
Past due 90 days and over	1	3	-	98	36	5	143
	9	13	6	268	172	15	483

Group 2014	Retail overdrafts £m	Credit cards £m	Lease finance £m	Mortgages £m	Business lending [1] £m	Other retail lending £m	Total £m
1 to 29 days past due	8	7	6	113	161	7	302
30 to 59 days past due	1	2	-	76	15	3	97
60 to 89 days past due	-	2	-	37	7	2	48
Past due 90 days and over	1	4	-	109	63	5	182
	10	15	6	335	246	17	629

Bank 2015	Retail overdrafts £m	Credit cards £m	Lease finance £m	Mortgages £m	Business lending [1] £m	Other retail lending £m	Total £m
1 to 29 days past due	8	6	3	62	110	5	194
30 to 59 days past due	-	2	-	53	17	3	75
60 to 89 days past due	-	2	-	34	9	2	47
Past due 90 days and over	1	3	-	90	36	5	135
	9	13	3	239	172	15	451

Bank 2014	Retail overdrafts £m	Credit cards £m	Lease finance £m	Mortgages £m	Business lending [1] £m	Other retail lending £m	Total £m
1 to 29 days past due	8	7	2	88	161	7	273
30 to 59 days past due	1	2	-	72	15	3	93
60 to 89 days past due	-	2	-	33	7	2	44
Past due 90 days and over	1	4	-	93	63	5	166
	10	15	2	286	246	17	576

(1) Business lending includes business overdrafts.

Comparative disclosures have been amended to confirm with current year presentation.

16. Impairment provisions on credit exposures

Group 2015	Retail overdrafts £m	Credit cards £m	Lease finance £m	Mortgages £m	Business lending [1] £m	Other retail lending £m	Total £m
Opening balance	8	10	2	27	185	13	245
Charge for the year	(2)	5	1	18	44	12	78
Amounts written off	(4)	(10)	(1)	(6)	(63)	(16)	(100)
Recoveries of amounts written off in previous years	3	2	-	-	5	2	12
Other [2]	-	-	-	-	(5)	-	(5)
Closing balance	5	7	2	39	166	11	230
Specific	-	-	1	22	69	-	92
Collective	5	7	1	17	97	11	138
	5	7	2	39	166	11	230

Group 2014	Retail overdrafts £m	Credit cards £m	Lease finance £m	Mortgages £m	Business lending [1] £m	Other retail lending £m	Total £m
Opening balance	10	12	3	31	218	15	289
Charge for the year	2	9	2	6	44	11	74
Amounts written off	(8)	(14)	(3)	(10)	(79)	(17)	(131)
Recoveries of amounts written off in previous years	4	3	-	-	5	4	16
Other [2]	-	-	-	-	(3)	-	(3)
Closing balance	8	10	2	27	185	13	245
Specific	-	-	2	16	92	-	110
Collective	8	10	-	11	93	13	135
	8	10	2	27	185	13	245

(1) Business lending includes business overdrafts.

(2) Other includes the unwind of net present value elements of specific provisions and other minor movements.

16. Impairment provisions on credit exposures (continued)

Bank 2015	Retail overdrafts £m	Credit cards £m	Lease finance £m	Mortgages £m	Business lending [1] £m	Other retail lending £m	Total £m
Opening balance	8	10	2	22	185	13	240
Charge for the year	(2)	5	1	19	44	12	79
Amounts written off	(4)	(10)	(1)	(6)	(63)	(16)	(100)
Recoveries of amounts written off in previous years	3	2	-	-	5	2	12
Other [2]	-	-	-	-	(5)	-	(5)
Closing balance	5	7	2	35	166	11	226
Specific	-	-	1	19	69	-	89
Collective	5	7	1	16	97	11	137
	5	7	2	35	166	11	226

Bank 2014	Retail overdrafts £m	Credit cards £m	Lease finance £m	Mortgages £m	Business lending [1] £m	Other retail lending £m	Total £m
Opening balance	10	12	2	21	218	15	278
Charge for the year	2	9	1	10	44	11	77
Amounts written off	(8)	(14)	(1)	(9)	(79)	(17)	(128)
Recoveries of amounts written off in previous years	4	3	-	-	5	4	16
Other [2]	-	-	-	-	(3)	-	(3)
Closing balance	8	10	2	22	185	13	240
Specific	-	-	2	13	92	-	107
Collective	8	10	-	9	93	13	133
	8	10	2	22	185	13	240

[1] Business lending includes business overdrafts.

[2] Other includes the unwind of net present value element of specific provisions and other minor movements.

	Group 2015 £m	Group 2014 £m	Bank 2015 £m	Bank 2014 £m
Amounts included in				
Loans and advances to customers (note 15)	230	245	226	240
Non-accrual loans				
Loans and advances to customers	238	319	225	305
Specific provisions	(92)	(110)	(89)	(107)
	146	209	136	198

17. Securitisations and covered bonds

Securitisations

The Group has securitised a proportion of its retail mortgage loan portfolio under the Group's master trust securitisation programmes. The securitised mortgage loans have been assigned at principal value to bankruptcy remote structured entities. These structured entities have been funded through the issue of residential mortgage backed debt to third party institutional debt investors. The Group is entitled to any residual income from the vehicles after the debt obligations and senior expenses of the programmes have been met. The securitised debt holders have no recourse to the Group other than the principal and interest (including fees) generated from the securitised mortgage portfolio. The Group continues servicing these mortgage assets in return for an administration fee.

The loans do not qualify for derecognition from the balance sheet because the Group and Bank remain exposed to the majority of the risks and rewards of the mortgage portfolio, principally the credit risk associated with the underlying mortgage portfolio. The securitisation structured entities are consolidated and the securitised mortgage loans retained on the Group's and Bank's balance sheet. The securitised notes in issue are included within bonds and notes (note 28).

Covered bonds

A subset of the Group and Bank's retail mortgage portfolio has been ring fenced and assigned to a bankruptcy remote Limited Liability Partnership, associated with the covered bond programme, to provide a guarantee for the obligations payable on the covered bonds issued by the Group and Bank. Similar to the securitisation programmes, the Group and Bank is entitled to any residual income after all payment obligations due under the terms of the covered bonds and senior programmes expenses have been met.

The residential mortgages do not qualify for derecognition from the balance sheet because the Group and Bank retain all of the risks and rewards associated with these mortgage loans. The covered bond partnership is fully consolidated with the loans 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; first to the Bank on an unsecured basis and second to the guarantee secured against the covered pool mortgage assets. The Group continues servicing these mortgage assets in return for an administration fee.

The balances of assets and liabilities in relation to securitisation and covered bonds in issue at 30 September 2015 within the Group and Bank balance sheets are as follows:

2015	Group			Bank		
	Securitisation £m	Covered bonds £m	Total £m	Securitisation £m	Covered bonds £m	Total £m
At 1 October 2014	2,370	1,063	3,433	-	1,097	1,097
Issuance of debt	1,207	-	1,207	-	-	-
Repayments	(521)	(400)	(921)	-	(400)	(400)
Other movements	(25)	58	33	-	-	-
At 30 September 2015	3,031	721	3,752	-	697	697
Securitised assets	5,923	1,475	7,398	5,923	1,475	7,398

17. Securitisations and covered bonds (continued)

2014	Group			Bank		
	Securitisation £m	Covered bonds £m	Total £m	Securitisation £m	Covered bonds £m	Total £m
At 1 October 2013	2,030	1,041	3,071	-	1,096	1,096
Issuance of debt	601	-	601	-	-	-
Repayments	(216)	-	(216)	-	-	-
Other movements	(45)	22	(23)	-	1	1
At 30 September 2014	2,370	1,063	3,433	-	1,097	1,097
Securitised assets	4,763	2,007	6,770	4,763	2,007	6,770

The carrying amounts of covered bonds differ between Group and Bank due to fair value hedging adjustments which form part of the Group but not the Bank. Further information on the liabilities relating to the Group's securitisation and covered bond programmes can be found in note 28.

Other movements consist of exchange rate movements on currency denominated bonds and fair value hedge accounting adjustments.

The Bank securitises mortgages which includes those originated by Yorkshire Bank Home Loans Limited ("YBHL"), a subsidiary of the Group. A legal sale agreement between the Bank and YBHL has been put in place to ensure that the title of such mortgages are transferred to the Bank prior to the completion of any securitisation transactions and these mortgages are included in the securitised asset balances disclosed in the table above and are recognised on the Bank balance sheet.

In addition to the securitisation notes disclosed above, there are £382m (2014: £410m) of Lannraig debt securities (including accrued interest) which are held by NAB and disclosed as a related party transaction (note 11). Assets which support the Lannraig debt are disclosed in the table above.

The following table sets out the carrying amount of financial assets that do 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	2015		2014	
	Securitisation £m	Covered bonds £m	Securitisation £m	Covered bonds £m
Carrying amount of transferred assets	5,923	1,475	4,763	2,007
Carrying amount of associated liabilities	3,413	721	2,780	1,063

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

Group	2015		2014	
	Securitisation £m	Covered bonds £m	Securitisation £m	Covered bonds £m
Fair value of transferred assets	5,923	-	4,763	-
Fair value of associated liabilities	3,413	-	2,780	-
	2,510	-	1,983	-

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

17. Securitisations and covered bonds (continued)

The Group and Bank have contractual and non-contractual arrangements which may require them to provide financial support to the following types of consolidated structured entities:

Securitisation vehicles

The Bank provides credit support to the structured entities via reserve funds through subordinated loan arrangements. Exposures totalled £Nil at the reporting date (2014: £17m). The Bank has a beneficial interest in the securitised mortgage portfolio held by the structured entities as at the reporting date of £1,308m (2014: £690m).

The Bank has an obligation to repurchase mortgage exposures if certain representations and warranties are breached. The Bank has made no such repurchases in the current year (2014: none).

Looking forward through future reporting periods there are a number of date based calls and put options on the notes issued by the structured entities which could be actioned by them as issuer. These could require the Bank, as sponsor, to provide additional liquidity support.

Covered bonds

The Group has a regulated covered bond programme. A Limited Liability Partnership was established and a ring fenced mortgage portfolio assigned to provide a guarantee under the terms of the covered bonds. At the reporting date the nominal level of over-collateralisation was £855m (2014: £1,249m) of the outstanding covered bonds. From time-to-time the obligations of the Group to provide over-collateralisation may increase due to the formal requirements of the programme.

The Bank has an obligation to repurchase mortgage exposures if certain representations and warranties are breached. The Bank has made no such repurchases in the current year (2014: none).

18. Property, plant and equipment

Group	Freehold land and buildings £m	Long-term leasehold land and buildings £m	Building improvements £m	Fixtures and equipment £m	Total £m
Cost or valuation					
At 1 October 2013	19	3	156	84	262
Additions	-	-	11	5	16
Disposals	(8)	-	(6)	(6)	(20)
At 30 September 2014	11	3	161	83	258
Additions	-	-	10	36	46
Disposals	(1)	-	(7)	(7)	(15)
Transfers	-	-	7	(7)	-
At 30 September 2015	10	3	171	105	289
Accumulated depreciation					
At 1 October 2013	1	-	83	58	142
Charge for the year	-	-	13	6	19
Disposals	-	-	(4)	(5)	(9)
At 30 September 2014	1	-	92	59	152
Charge for the year (note 7)	-	-	14	6	20
Accumulated depreciation on purchase	-	-	-	18	18
Disposals	-	-	(4)	(6)	(10)
Transfer			3	(3)	-
At 30 September 2015	1	-	105	74	180
Net book value					
At 30 September 2015	9	3	66	31	109
At 30 September 2014	10	3	69	24	106

Additions of £31m and the accumulated depreciation on purchase relate to the fixtures and equipment acquired in connection with the purchase of CYB Services Limited on 30 September 2015 as disclosed in note 21.

18. Property, plant and equipment (continued)

Bank	Freehold land and buildings £m	Long-term leasehold land and buildings £m	Building improvements £m	Fixtures and equipment £m	Total £m
Cost or valuation					
At 1 October 2013	19	3	156	84	262
Additions	-	-	11	5	16
Disposals	(8)	-	(6)	(6)	(20)
At 30 September 2014	11	3	161	83	258
Additions	-	-	10	5	15
Disposals	(1)	-	(7)	(7)	(15)
Transfers	-	-	7	(7)	-
At 30 September 2015	10	3	171	74	258
Accumulated depreciation					
At 1 October 2013	1	-	83	58	142
Charge for the year	-	-	13	6	19
Disposals	-	-	(4)	(5)	(9)
At 30 September 2014	1	-	92	59	152
Charge for the year	-	-	14	6	20
Disposals	-	-	(4)	(6)	(10)
Transfers	-	-	3	(3)	-
At 30 September 2015	1	-	105	56	162
Net book value					
At 30 September 2015	9	3	66	18	96
At 30 September 2014	10	3	69	24	106

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 Directors' valuations. Fair values are determined in accordance with guidance published by the Royal Institution of Chartered Surveyors, including adjustments to observable market inputs reflecting any specific characteristics of the land and buildings (Level 3 of the fair value hierarchy as defined in note 38). Valuations are performed annually in July.

There has been no change to the valuation technique during the year. There were no transfers between levels of the fair value hierarchy during the year.

A comparison of the carrying value under the revaluation basis and if the historical cost basis had been used is shown below:

Group	2015 £m	2014 £m
Carrying value as included under the revaluation basis	12	13
Carrying value if the historical cost basis had been used	10	11

19. Investment properties

Group and Bank

	2015 £m	2014 £m
At 1 October	44	63
Disposals	(11)	(19)
Revaluations	(1)	-
At 30 September	32	44

Investment properties are stated at fair value, which has been determined based on valuations performed by independent valuers and the Group's own Directors' valuations.

Investment property is compared to property for which there is observable market data about its realisable value on disposal. Adjustments to this observable data are applied for specific characteristics of the property such as the nature, location or condition of the specific asset. Investment properties are classified in Level 3 of the fair value hierarchy as defined in note 38. There has been no change to the valuation technique during the year. There were no transfers between levels of the fair value hierarchy during the year

During the year 99% (2014: 99%) of the investment properties generated total rental income of £2m (2014: £2m) and incurred operating and administrative expenses of £1m (2014: £2m). The operating and administrative expenses of the investment properties that did not generate rental income were £Nil (2014: £Nil).

20. Property inventory

	Group		Bank	
	2015 £m	2014 £m	2015 £m	2014 £m
At 1 October	2	6	2	6
Disposals	(2)	(4)	(2)	(4)
At 30 September	-	2	-	2

All properties within property inventory are complete and available for sale. No properties are under construction (2014: none).

21. Investment in controlled entities and associates

	Group		Bank	
	2015	2014	2015	2014
	£m	£m	£m	£m
At 30 September	2	2	16	12

On 30 September 2015, the Bank acquired CYB Services Limited from its immediate parent for £2 and CYB Intermediaries Holdings Limited for a purchase price of £4m from its ultimate parent.

As described in note 2, business combinations involving entities under common control, where all combining entities are ultimately controlled by the same entity before and after the business combination, are accounted for using the predecessor values method of accounting. This involves recognising assets and liabilities of the acquired business at book values. Any difference between the cost of acquisition and the aggregate book value of the assets and liabilities as of the date of the transfer of the acquired entity is recorded as an adjustment to equity. No additional goodwill is created by the business combination.

CYB Services Limited provides a range of information technology services to the Group. These costs are then recharged to the relevant CYB Investments Limited Group entity (including and principally Clydesdale Bank PLC). Consequently, as the results for CYB Services Limited will be consolidated into the Group results from 1 October 2015, the Group's expense profile will change; with the related entity recharge expense figure of £300m reducing and being replaced with increases in the relevant individual expense line items principally other operating and administrative expenses and amortisation of intangible assets as disclosed in note 7.

As at 30 September 2015, CYB Services Limited had total assets of £422m and total liabilities of £418m. The resultant £4m excess of net assets over the purchase price has been recorded as an adjustment to equity.

The main impact of the transaction on the Group and Bank balance sheet is the addition of £265m of intangible assets (note 22).

CYB Intermediaries Holdings Limited is an insurance intermediary business, operated through its subsidiary CYB Intermediaries Limited. It acts as an intermediary for a number of third party providers of insurance and investment products. The Group distributes these products through its retail mortgage and retail banking advisers to its customers.

As at 30 September 2015, CYB Intermediaries Holdings Limited had total tangible assets of £8m and total tangible liabilities of £4m. The purchase price paid to the Group's ultimate parent of £4m represented the full net book value of the company's tangible assets with no subsequent adjustment to equity required.

The main impacts of the transaction on the Group balance sheet is the addition of £7m of deferred consideration (note 12), with £1m of other receivables along with £3m of tax liabilities and £1m of other payables.

The effect on the Group and Bank results had the acquisition taken place on 1 October 2014 would have been an increase to the income statement before tax of £16m.

21. Investment in controlled entities and associates (continued)

Wholly owned subsidiary undertakings	Nature of business	Class of share held	Proportion held	Country of incorporation
Yorkshire Bank Home Loans Limited	Mortgage finance	Ordinary	100%	England
Clydesdale Bank Asset Finance Limited	Leasing	Ordinary	100%	Scotland
CGF No 9 Limited	Leasing	Ordinary	100%	Scotland
St Vincent (Equities) Limited	Investment company	Ordinary	100%	England
Shadwell Holdings (UK) Limited	Investment company	Ordinary	100%	England
Craig Yr Haul Management Company Limited	Property management	Ordinary	100%	England
CB Nominees Limited	Dormant	Ordinary	100%	Scotland
11 Tudor Hill Residential Management Company Limited	Dormant	Ordinary	100%	England
Fairway Views (Compton Avenue) Management Company Limited	Dormant	Ordinary	100%	England
Linton Springs Residential Management Company Limited	Dormant	Ordinary	100%	England
St Johns Place Residential Management Company Limited	Dormant	Ordinary	100%	England
Yorkshire and Clydesdale Bank Foundation	Charitable foundation	Ordinary	100%	England
Gracechurch Commercial Investments Limited	In liquidation	Ordinary	50%	England
Plaza Ventures Limited	Property management	Ordinary	100%	Scotland
Yorkshire and Clydesdale Bank Pension Trustee Limited	Pension trustee	Ordinary	100%	Scotland
CYB Services Limited	IT and Group services	Ordinary	100%	Scotland
CYB Intermediaries Holdings Limited (formerly known as National Wealth Management Europe Holdings Limited)	Insurance intermediary	Ordinary	100%	England
CYB Intermediaries Limited (formerly known as National Australia Insurance Services Limited)	Insurance intermediary	Ordinary	100%	England

Structured entities

The Group sponsors the formation of structured entities, primarily for the purpose of facilitation of asset securitisation and covered bond transactions to accomplish certain narrow and well defined objectives. Although the Bank has no direct or indirect ownership interest in these entities, where it is exposed, or has rights to, variable returns from its involvement with the entities and has the ability to affect those returns through its power over the entity, they are regarded as controlled entities as described in note 2 and are consolidated in the Group's financial statements.

In the current and prior year all structured entities which the Group sponsors, or in which the Group holds an interest, are consolidated. Detail of the Group's interests in consolidated structured entities are set out in note 17.

The following companies are consolidated structured entities:

Other controlled entities as at 30 September 2015	Nature of business	Country of incorporation
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

21. Investment in controlled entities and associates (continued)

With the exception of Craig Yr Haul Management Company Limited which has a 31 January financial year end, 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 2015. The associated undertaking is The Scottish Agricultural Securities Corporation PLC. It is registered and operates in 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.

Significant restrictions

As is typical for a Group of its size, there are restrictions on the ability of certain subsidiary entities to make distributions of cash or other assets to the parent company. These are considered below:

Contractual requirements - asset encumbrance

The Group uses its financial assets to raise finance in the form of securitisations and through the sale of securities subject to repurchase agreements ("repos"). Once encumbered, the assets are not available for transfer around the Group. The assets affected are disclosed in the Strategic Report and note 17.

22. Intangible assets

Group

	2015	2014
Capitalised software costs	£m	£m
Cost		
At 1 October	-	-
Additions	427	-
At 30 September	427	-
Accumulated amortisation		
At 1 October	-	-
Accumulated amortisation on purchase	162	-
At 30 September	162	-
Net book value at 30 September	265	-

The additions and accumulated amortisation on purchase relate to the capitalised software acquired in connection with the purchase of CYB Services Limited on 30 September 2015 as disclosed in note 21.

Capitalised software costs include internally developed software, including work in progress and represents the Group's investment in systems and related infrastructure to meet the requirements of the business.

23. Deferred tax

Movement in net deferred tax asset	Group 2015 £m	Group 2014 £m	Bank 2015 £m	Bank 2014 £m
At 1 October	277	220	271	214
Transferred in on purchase of other group entities	75	-	-	-
Recognised in the income statement (note 8)	24	49	24	49
Recognised directly in equity	3	2	3	2
Other	-	6	-	6
At 30 September	379	277	298	271

The Group recognises deferred tax attributable to the following items:

	Group 2015 £m	Group 2014 £m	Bank 2015 £m	Bank 2014 £m
Deferred tax assets				
Impairment provision on credit exposures	3	8	3	8
Employee equity based compensation	1	1	1	1
Tax losses carried forward	273	223	273	223
Provisions	-	25	-	25
Accelerated capital allowances	108	26	27	20
Cash flow hedge reserve	4	4	4	4
	389	287	308	281
Deferred tax liabilities				
Defined benefit pension asset	10	10	10	10
Net deferred tax asset	379	277	298	271

In addition to the deferred tax assets recognised above, the Group and Bank has an unrecognised deferred tax asset in respect of losses of £80m gross (£16m tax). A deferred tax asset has not been recognised in respect of these losses as the Directors have less certainty over their recoverability in the foreseeable future.

The statutory rate of UK corporation tax reduced to 20% on 1 April 2015 (Finance Act 2013). Under IAS 12 deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted by the balance sheet date. Accordingly, the deferred tax balances at 30 September 2015 have been reflected at the tax rates they are expected to be realised or settled.

On 8 July 2015 the Chancellor announced the introduction of a Bank Surcharge, being an 8% charge on taxable profits above £25m before the offset of brought forward losses or group relief. Additionally, it was announced that the mainstream UK rate of corporation tax would fall from 20% to 19% from 1 April 2017 and to 18% from 1 April 2020. The legislation incorporating these changes is contained in Finance Bill 2015-2016 which was not enacted until after the balance sheet date and accordingly the impact is not reflected in the charges or balances above. It is estimated that the changes would result in an overall reduction in the value of the deferred tax asset of approximately £20m.

From 1 April 2015, a maximum of 50% of taxable profits in an accounting period can be covered by tax losses brought forward from earlier periods. The utilisation of the deferred tax assets referred to above takes account of all substantively enacted legislation as at 30 September 2015 including the new loss utilisation rules.

24. Other assets

	Group 2015 £m	Group 2014 £m	Bank 2015 £m	Bank 2014 £m
Prepayments and accrued income	35	20	23	27
Other (including items in the course of collection)	142	217	129	177
	177	237	152	204

25. Due to other banks

	Group 2015 £m	Group 2014 £m	Bank 2015 £m	Bank 2014 £m
Transaction balances with other banks	-	4	-	4
Securities sold under agreements to repurchase*	-	644	-	644
Deposits from other banks	393	266	393	266
	393	914	393	914

* The underlying securities sold under agreements to repurchase have a fair value of £Nil (2014: £646m)

26. Due to customers

	Group 2015 £m	Group 2014 £m	Bank 2015 £m	Bank 2014 £m
Non-interest bearing demand deposits	1,986	1,849	1,986	1,849
Interest bearing demand deposits	18,786	16,346	18,786	16,346
Term deposits	5,416	5,587	5,416	5,587
Other wholesale deposits	94	119	94	119
	26,282	23,901	26,282	23,901
Accrued interest payable	125	172	125	172
	26,407	24,073	26,407	24,073

Included within term deposits is £3m (2014: £Nil) relating to the Group's associated entity (notes 11 and 21).

27. Provisions

	Group		Bank	
	2015	2014	2015	2014
	£m	£m	£m	£m
Payment Protection Insurance redress provision				
Opening balance	515	152	515	152
Charge to the income statement (note 7)	390	420	390	420
Provision utilised	(131)	(57)	(131)	(57)
Closing balance	774	515	774	515
Customer redress and other provisions				
Opening balance	413	118	413	118
Charge to the income statement [(1)] (note 7)	76	376	76	376
Provision utilised	(275)	(81)	(275)	(81)
Closing balance	214	413	214	413
Restructuring provision [(2)]				
Opening balance	24	45	24	45
Charge to the income statement (note 7)	17	-	17	-
Provision utilised	(23)	(21)	(23)	(21)
Closing balance	18	24	18	24
Total provisions	1,006	952	1,006	952

(1) In the year ended 30 September 2014, the income statement effect of the interest rate hedging products provisioning was £Nil as it was offset by a receivable from NAB. The charge of £75m taken in the year ended 30 September 2015 has not been offset.

(2) Restructuring provision includes surplus lease space provision.

A provision is recognised when there is a present obligation as a result of a past event, it is probable that the obligation will be settled and it can be reasonably estimated. The most significant of the provisions held at 30 September 2015 are in relation to conduct risk related liabilities.

The Group has provided its best estimate of conduct risk related liabilities at 30 September 2015 which have arisen as a result of its historical products and past sales practices.

To arrive at best estimates, management have exercised significant judgement around the key assumptions that underpin the estimates and used estimation techniques to quantify them. Ongoing regulatory review and input, as well as rulings from the Financial Ombudsman Service ("FOS") over time, and the Group's internal reviews and assessments of customer complaints will continue to impact upon the nature and extent of conduct related customer redress and associated costs for which the Group may ultimately become liable in future periods. Accordingly the total cost associated with such conduct related matters remains inherently uncertain.

Payment Protection Insurance ("PPI") redress

The Group has reassessed the level of provision that is considered appropriate to meet current and future expectations in relation to the mis-selling of PPI policies and has concluded that additional provisions of £390m (2014: £420m) should be recognised for the year ended 30 September 2015. This incorporates provision for a proactive customer contact and redress programme following a past business review, increased costs of administering the remediation programme and higher than expected customer initiated complaint volumes.

The total provision raised to date in respect of PPI is £1,196m (2014: £806m); with £774m of this remaining as at 30 September 2015 (2014: £515m), comprised of £301m for customer initiated complaints and proactive customer contact; £270m for the remediation of complaints closed prior to August 2014; and £203m for costs of administering the redress programme.

27. Provisions (continued)

In common with the wider UK retail banking sector, the Group continues to deal with complaints and redress issues arising out of historic sales of PPI. To 30 September 2015, the Group has received 226,000 complaints and expects an estimated further 175,000 claims including 114,000 proactive customer mailings. On 14 April 2015, the FCA issued Clydesdale Bank PLC with a fine of £21m for failings in its PPI complaint handling processes between May 2011 and July 2013. The PPI redress provisions above relate solely to customer redress and processing costs. The fine is included in other operating expenses (note 7).

The Group implemented a comprehensive new PPI complaint handling process from August 2014 which involved making a number of significant changes to the PPI operations, which have resulted in an increase in operational and administrative costs, in addition to committing to undertake a full review of PPI complaints that were closed prior to August 2014 (approximately 180,000). The Group plans to reopen these complaints and review the original decision reached in light of the new PPI complaint handling processes currently in operation. The provision at 30 September 2015 includes a redress provision of £270m for this review.

In addition to the above activity, the Group has also undertaken a past business review ("PBR") of certain PPI sales to determine if there was actual or potential customer detriment in the sales process leading to a risk of mis-sale and the potential for proactive redress. The Group has concluded that the provision increase should incorporate the estimated cost of contacting and redressing, where appropriate, customers who have faced actual detriment or may have experienced potential detriment but who have not actually raised a claim. Proactive customer mailings have not commenced and so key inputs to the calculation such as the level of customer response to mailings are not known but have been based on relevant historical experience and related industry data.

The increase in provisions takes into account all of the above factors as well as a higher than previously expected level of new customer initiated complaints with the overall provision based on a number of assumptions derived from a combination of past experience, estimated future experience, industry comparison and the exercise of judgement in the key areas identified. There remain risks and uncertainties in relation to these assumptions and consequently in relation to the ultimate costs of redress and related costs, including: (i) the number of PPI claims (and the extent to which this is influenced by the activity of claims management companies); (ii) the number of those claims that ultimately will be upheld,; (iii) the amount that will be paid in respect of those claims; (iv) any additional amounts that may need to be paid in respect to previously handled claims; (v) the response rates to the proactive customer contact; and (vi) the costs of administering the remediation programme.

As such, the factors discussed above mean there is a risk that existing provisions for PPI customer redress may not cover all potential costs. In light of this, the eventual costs of PPI redress and complaint handling may therefore differ materially from that estimated and further provision could be required. Accordingly, the final amount required to settle the Group's potential PPI liabilities remains uncertain.

The table below sets out the key assumptions and the effect on the provision of future, potential, changes in key assumptions:

Assumptions	Change in assumption	Sensitivity [1]
Number of expected future customer initiated complaints	+/-10%	£9m
Uphold rates:		
Future complaints	+/-1%	£4m
Pre August 2014 complaints review	+/-1%	£8m
Customer contact response rate		
Pre August 2014 complaints review	-1%	£(3)m
PBR customer contact response rate	+/-1%	£5m
Average redress costs [2]	+/-1%	£8m

(1) There are inter-dependencies between several of the key assumptions which add to the complexity of the judgements the Group has to make. This means that no single factor is likely to move independently of others, however, the sensitivities disclosed above assume all other assumptions remain unchanged. The sensitivities disclosed do not incorporate the impact, if any, on the administrative cost element of the provision.

(2) Sensitivity to a change in average redress across customer initiated complaints, pre August 2014 complaints review and PBR customer populations.

27. Provisions (continued)

The number of complaints received is monitored against past experience and future expectations and the Group will continue to reassess the adequacy of the provision for this matter and the assumptions underlying the provision calculation based upon experience and other relevant factors as matters develop, including the FCA announcement on 2 October 2015 to consult on proposals to introduce a time limit for complaints and the impact of complaints arising from the "Plevin" judgement. Further commentary on the contingent nature of the PPI provision can be found in note 33.

Customer redress and other provisions

A provision for customer redress is held in those instances where the Group expects 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 can incorporate the costs of skilled persons, independent reviewers, and where appropriate other elements of administration. The most significant of these relates to the Group's IRHPs.

In 2012 the FSA announced that it had reached agreement with a number of UK banks, including the Group, in relation to a review and redress exercise on sales of certain interest rate hedging products to small and medium sized businesses. The Group implemented a programme to identify small and medium sized customers that may have been affected and where due, pay financial redress. On 31 March 2015 the FCA confirmed the closure of the formal industry wide redress programme to new entrants.

The Group also undertook a secondary review of all past FRTBL complaints not in scope of the formal review. Where the secondary complaint assessment identified a different outcome, the customer has been contacted and, if appropriate, redress offered. The Group is also dealing with a number of new complaints from customers in relation to FRTBLs. Any new complaints from January 2014 have been assessed on a consistent basis.

The Group has reassessed the level of provision considered necessary in light of the current and future expected claims for all of these matters and concluded that a further provision of £75m (2014: £364m) is appropriate with the charge included within the Group's operating and administrative expenses for the year (note 7). This brings the total provisions raised in respect of IRHPs to £506m (2014: £431m); with £192m of this remaining as at 30 September 2015 (2014: £362m).

The ultimate cost to the Group of the IRHP provision is driven by a number of factors relating to offers of redress, compensation, offers of alternative products, consequential loss claims and administrative costs for IRHP. These factors could result in the total cost of the review and redress exercise and associated costs varying materially from the Group's estimate. The final amount required to settle the Group's potential IRHP liabilities in this matter is therefore uncertain and further provision could be required.

In previous years, the income statement effect of the IRHP provision has been £Nil due to the recognition of an offsetting receivable from NAB. As noted above, a £75m charge to the income statement has been raised this year with NAB contributing additional capital to offset the cost of this matter and PPI as part of the conduct mitigation package it publicly announced on 7 May 2015.

Other provisions include provisions in respect of legal proceedings, a number of individually less significant conduct related matters and claims arising in the ordinary course of the Group's business. The charge in respect of these other provisions in the year to 30 September 2015 is £1m (2014: conduct £13m, other £(1)m).

Restructuring provision

Restructuring within the Group is currently ongoing and a provision is held to cover redundancy payments, property vacation costs and associated enablement costs. In the year to 30 September 2015 the total provision decreased by £6m to £18m with a charge to the income statement (net of any write backs) of £17m (2014:£Nil) (note 7).

Also included within the restructuring provision is an amount for committed rental expense on surplus lease space consistent with the expected years' exposure on individual leases where the property is unoccupied. This element of the provision will be utilised over the remaining life of the leases or until the leases are assigned and is measured at present values by discounting anticipated future cash flows.

28. Bonds and notes

	Group 2015 £m	Group 2014 £m	Bank 2015 £m	Bank 2014 £m
Residential mortgage backed securities	3,017	2,421	-	-
Covered bonds	697	1,097	697	1,097
	3,714	3,518	697	1,097
Fair value hedge adjustments	38	(85)	-	-
Total securitised notes and covered bonds (note 17)	3,752	3,433	697	1,097
Accrued interest payable	14	20	10	11
	3,766	3,453	707	1,108

On 11 December 2014, €550m and £275m of residential mortgage backed securities were issued through Lanark 2014-2. On 6 August 2015, £300m and €280m of residential mortgage backed securities were issued through Lanark 2015-1. In May 2015, the Lanark 2012-1 EUR issuance of €615m was redeemed. In June 2015, the £400m floating rate covered bond (2012-1) was redeemed. Both redemptions were in line with the scheduled programme terms.

Details of the terms and conditions of the notes issued by Clydesdale Bank PLC to parties outside of the NAB Group as at 30 September 2015 were as follows:

Issue date	Currency	Carrying value £m	Coupon rate	Maturity/call date
Class A residential mortgage backed securities				
27 July 2012	USD	343	3M USD LIBOR + 1.40%	22 February 2016
27 July 2012	GBP	522	3M GBP LIBOR + 1.63%	22 November 2017
13 July 2013	USD	166	3M USD LIBOR + 0.50%	22 August 2016
13 July 2013	GBP	296	3M GBP LIBOR + 0.45%	22 August 2016
19 March 2014	EUR	206	3M EURIBOR + 0.40%	22 August 2017
19 March 2014	GBP	335	3M GBP LIBOR + 0.50%	22 November 2018
11 December 2014	EUR	384	3M EURIBOR + 0.40%	22 August 2018
11 December 2014	GBP	274	3M GBP LIBOR + 0.60%	22 February 2020
6 August 2015	GBP	299	3M GBP LIBOR + 0.50%	22 August 2018
6 August 2015	EUR	206	3M EURIBOR + 0.45%	21 May 2021
		3,031		
Covered bonds				
31 May 2012	GBP	721	4.63%	8 June 2026
		3,752		

29. Retirement benefit obligations

The Group operates both defined benefit and defined contribution arrangements. The Bank is the sponsoring employer in one funded defined benefit pension scheme, the Yorkshire and Clydesdale Bank Pension Scheme ("the Scheme"). The Scheme was established under trust on 30 September 2009 as the result of the merger of the Clydesdale Bank Pension Scheme and the Yorkshire Bank Pension Fund. The assets of the Scheme are held in a trustee administered fund, the trustee is responsible for the operation and governance of the Scheme, including making decisions regarding the Scheme's funding and investment strategy.

The Scheme is subject to the funding legislation outlined in the Pensions Act 2004 which came into force on 30 December 2005. This, together with documents issued by the Pensions Regulator, sets out the framework for funding defined benefit occupational pension plans in the UK.

The Group 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 £0.3m (2014: £0.3m) and would have no material impact upon service costs and interest costs.

The following table provides a summary of the present value of the defined benefit obligation and fair value of plan assets for the Scheme:

	2015 £m	2014 £m
Active members defined benefit obligation	(891)	(775)
Deferred members defined benefit obligation	(1,299)	(1,160)
Pensioner and dependent members defined benefit obligation	(1,323)	(1,285)
Total defined benefit obligation	(3,513)	(3,220)
Fair value of scheme assets	3,565	3,269
Net defined benefit pension asset	52	49
Post-retirement medical benefits obligations	(4)	(4)
Retirement benefits obligation	(4)	(4)

IAS19 allows the recognition of an asset, which reflects the Group's ability to recover a surplus either through reduced contributions in the future or through refunds from the Scheme following the settlement of plan assets once all members have left the Scheme.

The Bank has implemented a number of reforms to the Scheme to manage 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 a defined contribution scheme, "Total Pension". The Total Pension income statement charge for the year is shown in note 7.

The Bank 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 accruals and introducing member based 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 last scheme funding valuation was at 30 September 2013 and revealed a deficit of £450m. In the recovery plan dated 7 May 2014 the Group agreed to make the following contributions to eliminate the deficit: £65m on 1 October 2013; £150m by 30 June 2014; £50m on 1 October 2017; thereafter £50m annually until 1 October 2021; and £55m on 1 October 2022.

29. Retirement benefit obligations (continued)

Reconciliation of the net defined benefit pension asset/(liability)	2015 £m	2014 £m
Opening net defined benefit pension scheme asset/(liability)	49	(197)
Service cost	(11)	(23)
Interest on net defined benefit asset/(liability)	3	(3)
Remeasurement effects recognised in SOCI	(36)	24
Employer contributions	51	252
Administrative expenses	(4)	(4)
Closing fair value of net defined benefit pension scheme asset	52	49

Reconciliation of the defined benefit pension scheme assets	2015 £m	2014 £m
Opening fair value of defined benefit pension scheme assets	3,269	2,718
Interest income on scheme assets at discount rate	133	129
Return on scheme assets greater than discount rate	206	254
Employer contributions (note 11)	51	252
Benefits paid	(84)	(77)
Transfer payments	(6)	(3)
Administrative costs paid	(4)	(4)
Closing fair value of defined benefit pension scheme assets	3,565	3,269

Reconciliation of the defined benefit pension scheme obligations	2015 £m	2014 £m
Opening defined benefit pension scheme obligations	(3,220)	(2,915)
Current service cost	(27)	(21)
Past service credit/(cost)	16	(2)
Interest expense on the defined benefit obligation	(130)	(132)
Actuarial gain - experience adjustments	40	31
Actuarial (loss) – demographic assumptions	-	(23)
Actuarial (loss) – financial assumptions	(282)	(238)
Benefits paid from scheme assets	84	77
Transfer payments	6	3
Closing defined benefit pension scheme obligations	(3,513)	(3,220)

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

	2015 £m	2014 £m
Quoted		
Equities	862	853
Government bonds	1,611	1,346
Global sovereign bonds	49	102
Corporate bonds	767	699
Other [1]	45	70
Cash	32	27
Secure income alternatives	67	62
Unquoted		
Property	132	110
Fair value of defined benefit pension scheme assets	3,565	3,269

(1) Includes amounts held in an Emerging Market Currency fund

29. Retirement benefit obligations (continued)

The Scheme is not invested in any of the Group's own financial instruments. The property value includes £16m (2014: £16m) in respect of the Group's offices at Merrion Way, Leeds.

Through its defined benefit pension plan and post-employment medical plan, the Group is exposed to a number of risks. The main risk to the Bank is that additional contributions are required if the Scheme's assets are not sufficient to pay for the benefits (which will be influenced mainly by inflation and the longevity of members). The level of equity returns will be a key factor in the overall investment return. The investment portfolio is also subject to a range of other risks typical of the assets held, in particular credit risk on bonds and exposure to the property market.

The Trustee has implemented an investment structure (including physical assets and derivatives) that seeks to reduce the Scheme's exposure to inflation and interest rate risks. The current hedge ratio is 50% of liabilities when measured on a self-sufficiency basis. This strategy reflects the Scheme's liability profile and the Trustee's and the Group's attitude to risk. The Trustee monitors the investment objectives and asset allocation policy on a regular basis.

Amounts recognised in the income statement	2015 £m	2014 £m
Current service cost	27	21
Past service (credit)/cost	(16)	2
Net interest on net defined benefit liability/asset	(3)	3
Defined benefit expense for the year	8	26
Administration costs incurred	4	4
Cost recognised in the income statement	12	30

During the period the Bank's defined benefit pension plan arrangements were amended to offer certain members the option to participate in a pension increase exchange upon retirement. After the taking of independent financial advice the member can elect to take a higher rate of pension upon retirement in exchange for waiving their right to future inflation based increases. Accounting for this change has resulted in a credit to the income statement of £18m shown within past service costs.

In the current and prior year past service cost of £2m (2014: £2m) relates to pension enhancements, which were agreed as part of redundancy and early retirement entitlements and in both years these were fully offset in the income statement by a corresponding release from the restructure provision.

Amounts recognised in the statement of comprehensive income	2015 £m	2014 £m
Opening cumulative actuarial losses	(634)	(658)
Actuarial gain due to liability experience adjustments	40	31
Actuarial loss due to liability assumption changes	(282)	(261)
Return on scheme assets greater than discount rate	206	254
Cumulative actuarial losses recognised in the statement of comprehensive income	(670)	(634)

29. Retirement benefit obligations (continued)

Actuarial assumptions	2015	2014
	% p.a.	% p.a.
Financial assumptions		
Discount rate	3.80	4.10
Inflation ("RPI")	3.25	3.15
Inflation ("CPI")	2.25	2.15
Career average revalued earnings ("CARE") revaluations:		
Pre 31 March 2012 benefits (RPI)	3.25	3.15
Post 31 March 2012 benefits (CPI capped at 5% per annum)	2.25	2.15
Pension increases (capped at 2.5% per annum)	2.10	2.10
Pension increases (capped at 5% per annum)	3.15	3.00
Rate of increase for pensions in deferment	2.25	2.15

Demographic assumptions

	2015	2014
Post retirement mortality:	years	years
Current pensioners at 60 – male	27.6	27.5
Current pensioners at 60 – female	29.5	29.4
Future pensioners at 60 – male	29.1	29.0
Future pensioners at 60 – female	31.0	30.9

The table below sets out the sensitivity of the defined benefit obligation and pension cost to realistic changes in the key actuarial assumptions:

Assumption change	Impact on defined benefit obligation £m	Impact on pension cost £m
Discount rate		
+0.25%	(178)	(8)
-0.25%	192	10
Inflation		
+0.25%	162	8
-0.25%	(152)	(6)
Life expectancy		
+1 year	113	6
-1 year	(113)	(4)

The above sensitivity analyses are based on a change in an assumption while holding all other assumptions constant. In practice, changes in some of the assumptions may be correlated.

The discounted mean term of the defined benefit obligation at 30 September 2015 is 22 years. The expected contributions for the year ended 30 September 2016 are £32m and expected benefit payments for the year ended 30 September 2016 are £90m.

30. Other liabilities

	Group 2015 £m	Group 2014 £m	Bank 2015 £m	Bank 2014 £m
Accruals and deferred income	136	48	84	48
Notes in circulation	1,791	1,831	1,791	1,831
Other	146	178	135	138
	2,073	2,057	2,010	2,017

31. Called up share capital

Group and Bank

Allotted, called up and fully paid	2015 Number of shares	2014 Number of shares	2015 £m	2014 £m
Ordinary shares of £1 each				
Opening ordinary share capital	2,041,538,864	1,441,538,864	2,042	1,442
Issued during the year	770,000,000	600,000,000	770	600
Closing ordinary share capital	2,811,538,864	2,041,538,864	2,812	2,042
Ordinary B shares of £1 each				
Opening ordinary share capital	-	-	-	-
Issued during the year	337,500,000	-	338	-
Cancelled during the year	(337,500,000)	-	(338)	-
Closing ordinary B share capital	-	-	-	-
Preference shares of £1 each				
Opening preference share capital	-	300,000,000	-	300
Repurchased during the year	-	(300,000,000)	-	(300)
Preference shares of £1 each	-	-	-	-
Closing called up share capital	2,811,538,864	2,041,538,864	2,812	2,042

In accordance with the Articles of Association ("Articles") of the Bank, and with the non-objection of the PRA, the Bank obtained the consent of CYB Investments Limited ("the Holder") to repurchase:

- 100,000,000 non-cumulative preference shares of £1 issued by the Bank on 11 December 2008 and held by the Holder; and
- 200,000,000 non-cumulative preference shares of £1 issued by the Bank on 20 December 2010 and held by the Holder.

The aforementioned preference shares were repurchased on 20 December 2013.

On 19 June 2015, 50,000,000 ordinary shares of £1 were issued, on 24 September 2015, 620,000,000 ordinary shares of £1 were issued and on 30 September 2015, 100,000,000 ordinary shares of £1 were issued. All ordinary shares issued in the period were at par and fully paid up.

On 25 March 2015, 337,500,000 B shares of £1 were issued. All B shares issued in the year were at par and fully paid up and issued for £Nil consideration as part of the merger reserve capitalisation (note 32). On 28 May 2015, the 337,500,000 shares were cancelled for £Nil consideration.

The holders of ordinary shares are entitled to dividends as declared from time to time and are entitled to one vote per share at meetings of the shareholders of the Bank. The holders of the B shares had no right to receive notice of or to attend, speak or vote at any General Meeting of the Bank. All shares in issue at 30 September 2015 rank equally with regard to the Bank's residual assets.

32. Total equity

	Group		Bank	
	2015	2014	2015	2014
	£m	£m	£m	£m
Share capital (note 31)	2,812	2,042	2,812	2,042
Share premium account	-	243	-	243
Total share capital and share premium	2,812	2,285	2,812	2,285
Other equity instruments	450	-	450	-
Merger reserve	-	338	-	338
Share option reserve	3	2	3	2
Asset revaluation reserve	2	2	2	2
Available for sale reserve	12	8	12	8
Cash flow hedge reserve	(13)	(16)	(16)	(16)
Total other reserves	4	334	1	334
Retained earnings	192	(114)	167	(144)
Total equity	3,458	2,505	3,430	2,475

Share premium account

The share premium account was cancelled in the year and the balance outstanding was transferred to retained earnings.

Other equity instruments

Other equity instruments represent Additional Tier 1 ("AT1") notes. On 29 December 2014, Perpetual Capital Notes (6m LIBOR + 690bps) were issued with a principal amount of £350m to the Bank's immediate parent, CYB Investments Limited. On 30 September 2015, a further £100m of Perpetual Capital Notes (6m LIBOR + 655bps) were issued to CYB Investments Limited. These are perpetual securities with no fixed maturity or redemption date and are structured to qualify as AT1 instruments under CRD IV.

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. On 24 March 2015, the merger reserve was capitalised through the issue of a new class of bonus shares (ordinary B shares) (note 31).

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 reserve

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

32. Total equity (continued)

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.

As at 30 September 2015 the Group cash flow hedge reserve comprises the crystallised net fair value losses arising from de-designated cash flow hedges (£2m) and net deferred losses on derivatives in ongoing cash flow hedges (£15m). The balance on the cash flow hedge reserve is net of tax.

£17m (2014: £48m) was recycled into the income statement in relation to de-designated hedges in the year. £1m (2014: £2m) was transferred to the income statement due to ineffectiveness arising from cash flow hedges.

33. Contingent liabilities and commitments

The table below sets out the contractual amounts of contingent liabilities and commitments which are not recorded on the balance sheet. 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		Bank	
Contingent liabilities (note 39)	2015	2014	2015	2014
	£m	£m	£m	£m
Guarantees and assets pledged as collateral security:				
At call	-	-	-	-
Due in less than 3 months	25	32	25	32
Due between 3 months and 1 year	13	25	13	25
Due between 1 year and 3 years	9	9	9	9
Due between 3 years and 5 years	2	3	2	3
Due after 5 years	52	61	52	61
No specified maturity	8	6	8	6
	109	136	109	136
Other credit commitments (note 39)				
Undrawn formal standby facilities, credit lines and other commitments to lend at call	7,886	8,463	7,855	8,424

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 2015 of £1.9m and £0.1m respectively (2014: £2.2m and £2.2m).

33. Contingent liabilities and commitments (continued)

Operating lease commitments

Group and Bank

	2015	2014
Leases as lessor	£m	£m
Future minimum lease payments under non-cancellable operating leases are:		
Within 1 year	2	2
Between 1 year and 5 years	6	6
Over 5 years	2	2
	10	10
Leases as lessee		
Future minimum lease payments under non-cancellable operating leases are:		
Within 1 year	31	30
Between 1 year and 5 years	95	94
Over 5 years	122	121
	248	245

Other contingent liabilities

Financial Services Compensation Scheme ("FSCS")

The 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, claims were triggered against the FSCS, initially to pay interest on borrowings which the FSCS has raised from the UK Government to support the protected deposits. During 2015, the FSCS levy was also invoiced to institutions for the third of three annual levies to cover capital repayments to the UK Government. The principal of these borrowings, which remains after the three annual levies have been paid, is anticipated to be repaid from the realisation of the assets of the defaulted institutions. The FSCS has however confirmed that the size of the future levies will be kept under review in light of developments from the insolvent estates.

The FSCS has estimated levies due to 31 March 2016 and an accrual of £9m (2014: £7m) is held for the Group's calculated liability to that date. The ultimate FSCS levy as a result of the failures is uncertain.

Conduct risk related matters

There continues to be a great deal of uncertainty and significant judgement is required in determining the quantum of conduct risk related liabilities with note 27 to the annual report and consolidated financial statements reflecting the Group's current position in relation to redress provisions for PPI and IRHPs.

As at 30 September 2015, a provision of £774m is held with respect to complaints and redress issues arising out of historic sales of PPI. This provision is based on a number of assumptions derived from a combination of past experience, estimated future experience, industry comparison and the exercise of judgement. There remain risks and uncertainties in relation to these assumptions and consequently in relation to ultimate costs of redress and related costs, including: (i) the number of PPI claims (including the extent to which this is influenced by the activity of claims management companies); (ii) the number of those claims that ultimately will be upheld; (iii) the amount that will be paid in respect of those claims; (iv) the impact of the Supreme Court decision in Plevin v Paragon Personal Finance Ltd ("Plevin") referenced below (including the impact of any new FCA rules or guidance issued further to that decision); (v) any additional amounts that may need to be paid in respect of previously handled claims; (vi) the costs of administering the remediation programme and; (vii) the response rates to proactive customer contact. The requirement for further proactive customer contact has been determined by the Group undertaking a past business review and is included in the charge of £390m which also incorporates changes in complaint levels, changes in the cost of redress and uphold rates, and increased costs of administering the programme. Further detail is provided in note 27.

33. Contingent liabilities and commitments (continued)

The November 2014 Supreme Court case of Plevin held that, judged on its own facts, non-disclosure of the amount of commission payable in that case in connection with the sale of single premium PPI to a customer created an unfair relationship under s140A of the Consumer Credit Act 1974.

On 2 October 2015, the FCA announced its intention to issue a consultation, before the end of the calendar year, in relation to the introduction of a deadline by which consumers would need to make their PPI complaints and also in relation to how firms should handle PPI complaints fairly in the light of the Plevin case. The principal elements of the consultations include a deadline for PPI complaints falling two years from the date the proposed rule comes into force (not anticipated to be before spring 2016) and a proposal that a failure to disclose a commission of 50% or more gave rise to an unfair relationship under s.140A in respect of sums payable under the underlying credit agreement on sales on or after 6 April 2008. The proposed PPI complaint deadline would also apply to the handling of these complaints. Noting that the consultation documents have not been published and that the final rules and guidance may therefore change from that proposed, it is too early to estimate the impact of these matters which may impact the level of walk in complaints the Group experiences as well as the activity of claims management companies amongst other factors. Accordingly, no adjustment to the PPI provision has been recorded in relation to these matters.

Therefore the final amount required to settle the Group's potential liabilities for these matters is materially uncertain. The Group will continue to reassess the adequacy of provisions for these matters and the assumptions underlying the calculations at each reporting date based upon experience and other relevant factors at that time.

The Group's provision for IRHPs at 30 September 2015 is £192m. In common with PPI, the IRHP provision and ultimate final amount required to settle the Group's potential IRHP liability is uncertain and is driven by a number of factors relating to offers of redress, compensation, offers of alternative products, consequential loss claims and administrative costs. These factors could result in the total cost of the review and redress exercise and associated costs varying materially from the Group's estimate. The final amount required to settle the Group's potential IRHP liability in this matter is therefore uncertain and further provision could be required.

As part of the demerger and IPO announced on 7 May 2015, NAB confirmed its intention to provide support to the Group against potential losses related to legacy conduct costs, including those relating to PPI and IRHPs. Further detail can be found in note 43.

In addition to PPI and IRHPs, UK retail banks have been recently experiencing an increase in the number of complaints in relation to sale of packaged bank accounts. Whilst the activity in this area is not material at present, the Group continues to monitor complaint volumes (initiated from both customer and claims management companies) and the final customer outcomes of these complaints and will review its position going forward as matters develop.

Legal claims

The Group is named in and is defending a number of legal claims arising in the ordinary course of business. No material adverse impact on the financial position of the Group is expected to arise from the ultimate resolution of these legal actions.

34. Notes to the statements of cash flows

	Group 2015 £m	Group 2014 £m	Bank 2015 £m	Bank 2014 £m
Adjustments included in the loss before tax				
Interest receivable	(1,110)	(1,135)	(1,124)	(1,126)
Interest payable	335	364	390	445
Depreciation (note 7)	20	19	20	19
Net gain on capital and debt restructure (note 6)	(41)	-	(41)	-
Loss/(profit) on sale of tangible fixed assets [1]	1	(7)	1	(7)
Deficit on revaluation of investment properties	(1)	-	(1)	-
Transfer from cash flow hedge reserve	(1)	(2)	(1)	(2)
Derivative financial instruments fair value movements	(2)	(9)	(8)	(2)
Impairment losses on credit exposures (note 16)	78	74	79	77
Dividends received from subsidiaries	-	-	(32)	(26)
	(721)	(696)	(717)	(622)
Changes in operating assets				
Net decrease/(increase) in:				
Balances with supervisory central banks	(2)	1	(1)	1
Due from other banks	(113)	171	(21)	171
Derivative financial instruments	1	(26)	17	(9)
Financial assets at fair value through profit or loss	478	585	478	585
Intangible assets	(265)	-	-	-
Loans and advances to customers	(1,663)	(2,001)	(1,816)	(5,065)
Due from customers on acceptances	1	(1)	1	(1)
Defined benefit pension assets	(39)	-	(39)	-
Other assets	(235)	80	(141)	59
	(1,837)	(1,191)	(1,522)	(4,259)
Changes in operating liabilities				
Net increase/(decrease) in:				
Due to other banks	(567)	395	(567)	395
Derivative financial instruments	(39)	(135)	(17)	(146)
Financial liabilities at fair value through profit or loss	(23)	(31)	(23)	(31)
Due to customers	2,380	(245)	2,380	(245)
Liabilities on acceptances	(1)	1	(1)	1
Provisions	54	637	54	637
Defined benefit pension obligations	-	(223)	-	(223)
Other liabilities	217	164	207	140
	2,021	563	2,033	528

[1] Tangible fixed assets include property, plant and equipment, investment properties and property inventory.

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 2015 £m	Group 2014 £m	Bank 2015 £m	Bank 2014 £m
Cash and balances with central banks (note 10)	6,387	5,929	6,387	5,929
Other assets	86	143	86	143
Due to other banks	(72)	(26)	(72)	(26)
Due to related entities	(33)	(108)	(33)	(108)
Other liabilities	(31)	(58)	(31)	(58)
	6,337	5,880	6,337	5,880

35. Employees

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

	2015 Number	2014 Number
Managers	1,419	1,381
Clerical staff	3,197	3,140
	4,616	4,521

All staff are contracted employees of CYB Investments Limited and its subsidiary undertakings. The numbers above disclose the staff remunerated directly by the Group. As CYB Services Limited was acquired on 30 September 2015 (note 21) these employees who provide support services to the Group do not impact the disclosure. The Group's immediate parent had average contracted employees of 6,816. Comparative disclosures have been amended to conform with the current year's presentation.

36. Equity based compensation

Share incentive plans, share offers, performance options and performance rights 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. All UK awards are made in accordance with the principles set out within the PRA's Remuneration Code.

The plans described below involve the provision of shares, performance options and performance rights to employees, senior management and Directors of the Group.

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, rights or cash. The deferred amount is subject to forfeiture conditions including forfeiture as a result of resignation, termination by NAB or failure to meet compliance 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 and retention 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 Principal Board Remuneration Committee 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 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 requirements.

36. Equity based compensation (continued)

UK Share Incentive Plan

The UK Share Incentive Plan is an approved HM Revenue and Customs share plan. Employees are entitled to purchase up to £1,800 worth of NAB shares each year through the Partnership Share Plan. Participants contribute each month and the trustee uses the contributions to purchase shares on the 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 may be awarded by the employer to employees per annum.

General employee shares

NAB free shares are not expected be granted to employees of the Group for the year ended 30 September 2015. Alternative awards in relation to the year are being finalised as part of the planned demerger and IPO.

NAB long-term incentives (“NAB LTI”)

NAB LTI taking the form of shares, performance options or performance rights, help to drive management decisions focused on the long-term prosperity of the NAB Group through the use of challenging performance hurdles. The Executive NAB LTI programme is awarded to senior executives across the Group. A NAB LTI target is set with reference to external and internal relativities for each executive who must also meet minimum performance and compliance thresholds. Performance hurdles (both internal and external) are measured at the end of a four to five year restriction period and during the restriction period an executive’s performance rights or performance options will lapse (or their shares will be forfeited) for cessation of employment (if the Board so determines) or if compliance requirements or performance hurdles are not met.

For historical awards a variety of performance measures are used for different grants of long-term incentives 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 of an NAB LTI award 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 six years from the effective date, if they remain unexercised.

Each performance option or performance right is exchanged for one fully paid ordinary share in NAB Limited upon exercise, subject to standard adjustments for capital actions. The exercise price for performance options is generally the market price for NAB Limited’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.

NAB LTI awards are not expected be granted to Directors of the Group for the year ended 30 September 2015. Alternative long-term incentive awards in relation to the year are being finalised as part of the planned demerger and IPO.

36. Equity based compensation (continued)

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

Performance options	2015 Number	2015 Weighted average exercise price A$	2014 Number	2014 Weighted average exercise price A$
Outstanding at 1 October	-	-	85,715	19.89
Granted during the year	-	-	-	-
Forfeited and lapsed during the year	-	-	(4,947)	19.89
Exercised during the year	-	-	(80,768)	19.89
Expired during the year	-	-	-	-
Outstanding at 30 September	-	-	-	
Exercisable at 30 September	-		-	

There were no share options carried over from 2014 and no share options granted during 2015.

Performance rights	2015 Number	2014 Number
Outstanding at 1 October	259,093	186,119
Granted during the year	136,812	197,835
Forfeited and lapsed during the year	(103,965)	(124,861)
Exercised during the year	(10,874)	-
Outstanding at 30 September	281,066	259,093
Exercisable at 30 September	18,480	-

Unvested performance rights of 103,965 (2014: 124,861) were forfeited.

The number of performance rights exercised during the year was 10,874 (2014: Nil). For performance rights outstanding at 30 September 2015, the weighted average remaining contractual life is 3.38 years (2014: 4.04 years). No exercise price is payable by the holder on exercise of performance rights.

Fair value of share options and performance rights

No performance options were granted during the year ended 30 September 2015 (2014: Nil). 136,812 performance rights were granted during the year ended 30 September 2015 (2014: 197,835). Included within personnel expenses (note 7) is a fair value of goods or services to the value of £1.2m, which was measured indirectly by reference to the fair value of the performance rights granted during the year (2014: £2.1m).

37. Directors' emoluments

2015 £'000	Salary and fees (1)	Benefits and allowances (2)	Short term incentives (3)	Commencement awards (4)	Variable pay	Emoluments
Executive Directors						
David Duffy (5)	318	78	450	500	950	1,346
Ian Smith (6)	253	53	253	-	253	559
Debbie Crosbie	367	119	450	-	450	936
Richard Sawers (9)	-	-	-	-	-	-
David Thorburn (10)	460	952	-	-	-	1,412
John Hooper (11)	248	609	-	-	-	857
Total Executive	1,646	1,811	1,153	500	1,653	5,110
Non-executive Directors						
David Allvey	92	-	-	-	-	92
David Browne	80	-	-	-	-	80
Adrian Grace (7)	47	-	-	-	-	47
Richard Gregory OBE	140	-	-	-	-	140
Jim Pettigrew	300	-	-	-	-	300
Barbara Ridpath	70	-	-	-	-	70
Dr Teresa Robson-Capps (8)	67	-	-	-	-	67
Alex Shapland	70	-	-	-	-	70
Total Non-executive	866	-	-	-	-	866
Total Directors	2,512	1,811	1,153	500	1,653	5,976

2014 £'000	Salary and fees (1)	Benefits and allowances (2)	Short term incentives (3)	Commencement awards (4)	Variable pay	Emoluments
Executive Directors						
Debbie Crosbie	127	28	61	-	61	216
John Hooper	400	63	200	-	200	663
David Thorburn	450	99	180	-	180	729
Total Executive	977	190	441	-	441	1,608
Non-executive Directors						
David Allvey	82	-	-	-	-	82
David Browne	80	-	-	-	-	80
Richard Gregory OBE	140	-	-	-	-	140
Barbara Ridpath	70	-	-	-	-	70
Jim Pettigrew	119	-	-	-	-	119
Alexander Shapland	70	-	-	-	-	70
Total Non-executive	561	-	-	-	-	561
Total Directors	1,538	190	441	-	441	2,169

Performance related pay - long term incentive schemes

NAB LTI awards are not expected be granted to Directors of the Group for the year ended 30 September 2015. Alternative long term incentive awards in relation to the year are being finalised as part of the planned demerger and IPO.

Accordingly, in addition to the amounts shown in the above table, £120,000 has been recognised in the income statement for the year ended 30 September 2015 in respect of estimated Directors' long term incentive award costs, including £75,000 in relation to the highest paid Director. Note that the total amount of the award, if granted, will be recognised over the vesting period of the award (typically three years). As a result, this estimate is not directly comparable with the total award values detailed below in respect of the year ended 30 September 2014 which represents the total value of the awards granted. Further details will be disclosed as part of the planned demerger and IPO transaction.

In relation to the year ended 30 September 2014 Directors were granted awards under the NAB LTI (12) with a value of £263,000, including £225,000 in relation to the highest paid Director.

37. Directors' emoluments (continued)

Social security costs

In addition to the amounts shown in the above table, Social security costs were payable in respect of emoluments for Directors amounting to £617,000 (2014: £305,000) and in respect of emoluments for the highest paid Director of £185,000 (2014: £130,118).

Notes

(1) Salary costs include salaries paid to Executive Directors and fees paid to Non-executive Directors.

(2) Benefits and allowances include cash payments in lieu of pension contributions, other taxable allowances, benefits and compensation for loss of office. Retirement benefits accrued to two Directors (2014: two) under a defined benefit pension plan. Pension contributions amounting to £33,666 (2014: £50,013) were paid during the year. The highest paid Director is not a member of the defined benefit or defined contribution pension plans.

(3) The short-term incentive figures include a cash element to be paid in the forthcoming year and the deferred amount represents rights and shares deferred for six months to two years. The highest paid Director received £450,000 performance related pay in respect of 2015.

(4) The commencement figure of £500,000 awarded to David Duffy was in NAB shares which will vest over a 3 year period.

(5) David Duffy was appointed as an Executive Director on 5 June 2015 and accordingly the figures in the table above represent his emoluments from this date.

(6) Ian Smith was appointed as an Executive Director on 11 March 2015 and accordingly the figures in the table above represent his emoluments from this date and not from the date of his appointment as Chief Financial Officer.

(7) Adrian Grace was appointed as a Non-executive Director on 23 December 2014 and accordingly the figures in the table above represent his emoluments from this date.

(8) Dr Teresa Robson-Capps was appointed as a Non-executive Director on 8 October 2014 and accordingly the figures in the table above represent her emoluments from this date.

(9) Richard Sawers is remunerated as an employee of NAB and did not receive incremental remuneration in respect of his duties as a Director of the Company. The Directors believe it would be appropriate to apportion A$930,000 (2014: A$618,000) of his remuneration as being in respect of his duties to the Company.

(10) David Thorburn left the organisation on 28 February 2015 and accordingly the figures in the table above represent his emoluments to this date. No performance related pay is payable. Note that for the purpose of identifying the highest paid Director, compensation for loss of office and pension contributions are excluded.

(11) John Hooper left the organisation on 31 October 2014 and accordingly the figures in the table above represent his emoluments to this date. No performance related pay is payable.

(12) Long term incentive awards include deferred cash, deferred performance rights and deferred shares.

37. Directors' emoluments (continued)

The tables below show, 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). The awards granted during the year relate to performance rights and share in respect of the previous year.

2015 Number	Share options	Performance rights	Short term incentive shares	Long term incentive shares	Commencement shares	Other employee share plans
Outstanding at 1 October	-	-	-	-	-	-
Granted during the year	-	-	-	-	31,357	-
Exercised/disposed during the year	-	-	-	-	-	-
Expired during the year	-	-	-	-	-	-
Forfeited during the year	-	-	-	-	-	-
Restrictions ceased	-	-	-	-	-	-
Outstanding at 30 September	-	-	-	-	31,357	-

2014 Number	Share options	Performance rights	Short term incentive shares	Long term incentive shares	Commencement shares	Other employee share plans
Outstanding at 1 October	-	47,894	-	9,205	-	76
Granted during the year	-	51,322	1,657	-	-	26
Exercised/disposed during the year	-	-	(1,657)	(3,953)	-	-
Expired during the year	-	-	-	-	-	-
Forfeited during the year	-	(36,016)	-	(5,252)	-	-
Restrictions ceased	-	-	-	-	-	-
Outstanding at 30 September	-	63,200	-	-	-	102

38. Fair value of financial instruments

(a) Fair value of financial instruments recognised on the balance sheet at amortised cost

The tables below show a comparison of the carrying amounts of financial assets and liabilities measured at amortised cost, as reported on the balance sheet, and their fair values where these are not approximately equal.

Analysis of the fair value disclosures uses a hierarchy that reflects the significance of inputs used in measuring fair value. The level in the fair value hierarchy within which a fair value measurement is categorised is determined on the basis of the lowest level input that is significant to the fair value measurement in its entirety. The fair value hierarchy is as follows:

- Level 1 fair value measurements - quoted prices (unadjusted) in active markets for an identical financial asset or liability.
- Level 2 fair value measurements - inputs other than quoted prices within Level 1 that are observable for the financial asset or liability, either directly (as prices) or indirectly (derived from prices).
- Level 3 fair value measurements - inputs for the financial asset or liability that are not based on observable market data (unobservable inputs).

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The estimated fair values are based on relevant information available at the reporting date and involve judgement. The methodologies and assumptions used in the fair value estimates are described in the footnotes to the tables.

There are various limitations inherent in this fair value disclosure particularly where prices may not represent the underlying value due to dislocation in the market. Not all of the Group's financial instruments can be exchanged in an active trading market. The Group obtains the fair values for investment securities from quoted market prices where available. Where securities are unlisted and quoted market prices are not available, the Group obtains the fair value by means of discounted cash flows and other valuation techniques that are commonly used by market participants. These techniques address factors such as interest rates, credit risk and liquidity. The difference between carrying value and fair value is relevant in a trading environment, but is not relevant to assets held to maturity and loans and advances.

Group	30 September 2015					30 September 2014				
			Fair value measurement using:					Fair value measurement using:		
	Carrying value £m	Fair value £m	Level 1 £m	Level 2 £m	Level 3 £m	Carrying value £m	Fair value £m	Level 1 £m	Level 2 £m	Level 3 £m
Financial assets										
Loans and advances to customers	27,482	27,537	-	1,111	26,426	25,901	25,734	-	1,293	24,441
Financial liabilities										
Due to customers	26,407	26,423	-	26,423	-	24,073	24,083	-	24,083	-
Due to related entities	979	999	-	999	-	2,452	2,435	-	2,435	-
Bonds and notes	3,766	3,869	-	3,869	-	3,453	3,534	-	3,534	-

38. Fair value of financial instruments (continued)

(a) Fair value of financial instruments recognised on the balance sheet at amortised cost (continued)

Bank	30 September 2015					30 September 2014				
			Fair value measurement using:					Fair value measurement using:		
	Carrying value £m	Fair value £m	Level 1 £m	Level 2 £m	Level 3 £m	Carrying value £m	Fair value £m	Level 1 £m	Level 2 £m	Level 3 £m
Financial assets										
Investments - held to maturity	1,440	1,448	-	853	595	1,483	1,505	-	874	631
Loans and advances to customers	26,208	26,297	-	1,111	25,186	24,450	24,324	-	1,293	23,031
Financial liabilities										
Due to customers	26,407	26,423	-	26,423	-	24,073	24,083	-	24,083	-
Due to related entities	6,087	6,094	-	6,094	-	6,465	6,427	-	6,427	-
Bonds and notes	707	831	-	831	-	1,108	1,196	-	1,196	-

The Group and Bank's fair values disclosed for financial instruments at amortised cost are based on the following methodologies and assumptions:

(a) *Cash and balances with central banks, Due from and to other banks, Due from customers on acceptances, Liabilities on acceptances, Other assets and Other liabilities* – carrying values approximate fair value as they are short term in nature and or receivable or payable on demand.

(b) *Amounts due from related entities* – amounts due from related entities are repayable on demand or within twelve months. As a result, the carrying value approximates the fair value.

(c) *Investments held to maturity* – the Bank obtains the fair value by means of a discounted cash flow model based upon observable market data and non-observable inputs as appropriate to the nature and type of the underlying instrument.

(d) *Loans and advances to customers* – the fair value of loans and advances are determined by firstly segregating them into portfolios of similar characteristics. Contractual cashflows are then adjusted for expected credit losses and expectations of customer behaviour based on observed historic data. The cashflows are then discounted using current market rates for instruments of similar terms and maturity to arrive at an estimate of their fair value. Certain variable rate loan portfolios are discounted using market rates on similar loans offered by the Group at the valuation date.

(e) *Due to customers* – the fair value of deposits is determined from a discounted cash flow model using current market rates for instruments of similar terms and maturity.

(f) *Amounts due to related entities* – the fair value of subordinated loans; and notes issued to related entities is determined from a discounted cash flow model using current market rates for instruments of similar terms and maturity. All other amounts due to related entities are repayable under varying maturities but are materially repriced every 3-6 months relative to market rates.

(g) *Bonds and notes* – the fair value is determined from a discounted cash flow model using current market rates for instruments of similar terms and maturity.

38. Fair value of financial instruments (continued)

(b) Fair value of financial instruments recognised on the balance sheet at fair value

The following tables provide an analysis of financial instruments that are measured at fair value, subsequent to initial recognition, using the fair value hierarchy described in note 38(a) above.

Group	Fair value measurement as at 30 September 2015				Fair value measurement as at 30 September 2014			
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets								
Derivative financial assets	-	285	-	285	-	220	-	220
Available for sale – investments - listed	1,447	-	-	1,447	1,161	-	-	1,161
Available for sale - investments – unlisted	-	-	8	8	-	-	7	7
Available for sale – other	-	-	7	7	-	-	-	-
Other financial assets at fair value	-	-	1,097	1,097	-	-	1,583	1,583
Total financial assets measured at fair value	1,447	285	1,112	2,844	1,161	220	1,590	2,971
Financial liabilities								
Derivative financial liabilities	-	534	-	534	-	548	-	548
Other financial liabilities at fair value	-	-	67	67	-	-	91	91
Total financial liabilities measured at fair value	-	534	67	601	-	548	91	639

38. Fair value of financial instruments (continued)

(b) Fair value measurements recognised on the balance sheet (continued)

Bank	Fair value measurement as at 30 September 2015				Fair value measurement as at 30 September 2014			
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets								
Derivative financial assets	-	228	-	228	-	220	-	220
Available for sale – investments - listed	1,447	-	-	1,447	1,161	-	-	1,161
Available for sale - investments – unlisted	-	-	8	8	-	-	7	7
Other financial assets at fair value	-	-	1,097	1,097	-	-	1,583	1,583
Total financial assets measured at fair value	1,447	228	1,105	2,780	1,161	220	1,590	2,971
Financial liabilities								
Derivative financial liabilities	-	466	-	466	-	451	-	451
Other financial liabilities at fair value	-	-	67	67	-	-	91	91
Total financial liabilities measured at fair value	-	466	67	533	-	451	91	542

The Group and Bank's fair values for financial instruments, that are measured subsequent to initial recognition at fair value, are based on the following methodologies and assumptions:

(a) *Derivative financial assets and liabilities* – 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.

(b) *Available for sale – investments* – the fair values of listed investments are based on quoted closing market prices. For unlisted equity investments the Group's share of the net asset value of the undertaking is considered the best representation of the fair value of the investment.

(c) *Available for sale – other* – the fair value of deferred consideration is determined from a discounted cash flow model incorporating estimated attrition rates and investment growth rates appropriate to the underlying funds under management.

(d) *Other financial assets and liabilities at fair value* – fair values are derived from data or valuation techniques based upon observable market data and non-observable inputs as appropriate to the nature and type of the underlying instrument.

There were no transfers between Level 1 and 2 in the year.

38. Fair value of financial instruments (continued)

Assets and liabilities measured at fair value based on valuation techniques for which any significant input is not based on observable market data (Level 3):

Level 3 movements analysis: Group	2015		
	Financial assets available for sale £m	Other financial assets at fair value £m	Other financial liabilities at fair value £m
Balance at the beginning of the year	7	1,583	(91)
Total gains/(losses)			
In profit or loss [1]	-	2	2
Purchases	8	-	-
Settlements	-	(488)	22
Balance at the end of the year	15	1,097	(67)

Level 3 movements analysis: Group	2014		
	Financial assets available for sale £m	Other financial assets at fair value £m	Other financial liabilities at fair value £m
Balance at the beginning of the year	7	2,171	(123)
Total gains/(losses)			
In profit or loss [1]	-	(56)	4
Settlements	-	(532)	28
Balance at the end of the year	7	1,583	(91)

Level 3 movements analysis: Bank	2015		
	Financial assets available for sale £m	Other financial assets at fair value £m	Other financial liabilities at fair value £m
Balance at the beginning of the year	7	1,583	(91)
Total gains/(losses)			
In profit or loss [1]	-	2	2
Purchases	1	-	-
Settlements	-	(488)	22
Balance at the end of the year	8	1,097	(67)

Level 3 movements analysis: Bank	2014		
	Financial assets available for sale £m	Other financial assets at fair value £m	Other financial liabilities at fair value £m
Balance at the beginning of the year	7	2,171	(123)
Total gains/(losses)			
In profit or loss [1]	-	(56)	4
Settlements	-	(532)	28
Balance at the end of the year	7	1,583	(91)

(1) Net gains or losses were recorded in other operating income, interest income or interest expense and impairment losses as appropriate.

There were no transfers out of Level 3 in the year ended 30 September 2015 (2014: £Nil).

Settlements for the year ended 30 September 2015 include a realised loss of £33m (2014: loss of £12m) relating to financial assets that are measured at fair value. Such fair value gains or losses are included in non-interest income (note 6).

38. Fair value of financial instruments (continued)

The table below lists key unobservable inputs to Level 3 financial instruments, and provides the range of those inputs as at 30 September 2015.

Group	Fair value £m	Valuation technique	Unobservable inputs	Low range	High range
Financial assets					
Available for sale – investments - unlisted	8	Underlying/net asset value	Price	Nil	Market value on disposal
Available for sale – other	7	Discounted cash-flow	Customer attrition rate	10%	30%
Other financial assets at fair value	1,097	Discounted cash-flow	Portfolio lifetime probability of default	4.4%	11.3%

The unlisted available for sale investments primarily relates to the Group's holding of shares in Vocalink Limited, an unquoted company registered in England and Wales which operates the BACS and direct debits schemes in the UK as well as connecting ATMs using the LINK network. This represents the Group's percentage holding in this entity. The valuation is based on the net asset value in the most recent set of publically available financial statements for the company and represents the fair value of the investment.

The other available for sale financial asset represents deferred consideration receivable following the purchase of CYB Intermediaries Holdings Limited from the ultimate parent on 30 September 2015 and consists of the rights to future commissions. The valuation is determined from a discounted cash flow model incorporating estimated attrition rates and investment growth rates appropriate to the underlying funds under management.

The Group has £67m (2014: £91m) of financial liabilities at fair value classed as Level 3 which represent a portfolio of term deposits that are directly linked to the customer loans, which are also held at fair value and classed as Level 3. Their relationship to the fair value assets is such that should the liability be settled, the amount payable would be net of the fair value asset.

Sensitivity of Level 3 fair value measurements to reasonably possible alternative assumptions

Where valuation techniques use non-observable inputs that are significant to a fair value measurement in its entirety, changing these inputs will change the resultant fair value measurement.

The most significant exposure to Level 3 fair value measurements is in respect of 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. If lifetime expected losses were 20% greater than predicted, the carrying value of the loans would decrease by £8m and vice versa. The most significant input impacting the carrying value of the available for sale – other asset is the Funds Under Management Attrition rate. If this rate was 30% the carrying value would reduce by £3m, if it was 10% the carrying value would increase by £2m. The Group currently assumes a 15% attrition rate.

Other than these significant Level 3 measurements, the Group has a limited remaining exposure to Level 3 fair value measurements, and changing one or more of the inputs for fair value measurements in Level 3 to reasonable alternative assumptions would not change the fair value significantly with respect to profit or loss, total assets, total liabilities or equity on these remaining Level 3 measurements.

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 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, resulting from potential movements in the fair value of fixed rate assets and liabilities, attributable to both interest rate and foreign currency risk using interest rate and cross currency swaps. The 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 and foreign currency risk arising from variable interest rate assets and liabilities using cross currency and interest rate swaps. There were no transactions for which cash flow hedge accounting had to be discontinued in the year as a result of the highly probable cash flows no longer being expected to occur. The fair value of derivatives entered into is also 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.

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, corporate, and personal guarantees where appropriate.

Derivatives

The Group maintains control limits on net open derivative positions 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.

Master netting agreements and collateral arrangements

The Group further restricts its exposure to credit losses by entering into master netting arrangements with counterparties with which it undertakes a significant volume of transactions. Master netting arrangements do not generally result in an offset of balance sheet assets and liabilities, as transactions are usually settled on a gross basis. However, the credit risk associated with the favourable contracts is reduced by a master netting arrangement to the extent that if a counterparty failed to meet its obligations in accordance with the agreed terms, all amounts with the counterparty are terminated and settled on a net basis. Derivative financial instrument contracts are typically subject to International Swaps and Derivatives Association ("ISDA") master netting agreements, as well as Credit Support Annexes ("CSA"), where relevant, around collateral arrangements attached to those ISDA agreements, or derivative exchange or clearing counterparty agreements if contracts are settled via an exchange or clearing house.

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. In the event of a deterioration of a customer's circumstances lending can often be withdrawn. 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

Identification and classification

Forbearance is considered to take place when the Group grants concessions to assist customers who are experiencing, or who are about to experience, difficulties in meeting their financial commitments to the Group.

A concession refers to either of the following actions:

- a modification of the previous terms and conditions of a debt; and/or
- a total or partial refinancing of a contract.

Typically, concessions will include the granting of more favourable terms and conditions than those provided either at drawdown of the facility or which would not ordinarily be available to others with a similar risk profile. Loans that have been renegotiated and/or restructured for solely commercial reasons where there is no financial difficulty are not treated as forborne.

The Group continues to develop its forbearance policies and practices. During the year the policy guidance for non-retail forbearance has been revised such that financial or non-financial covenant breaches (whether waived or rights reserved) and financial covenant resets, are now considered to require an assessment for forbearance concessions where customers are experiencing, or are about to experience, difficulties in meeting their financial commitments to the Group. Comparative non-retail forbearance disclosures presented for 30 September 2014 have been restated.

The Group recognises that forbearance alone is not necessarily an indicator of impaired status but is a trigger for the review of the customer's credit profile. The Group grants forbearance when it believes that there is a realistic prospect of the customer continuing to be able to repay all facilities in full. If there is any concern over future cash flows and the Group incurring a loss, then forborne loans will also be classified as impaired in accordance with the Group's impairment policy.

39. Financial risk management (continued)

Credit risk (continued)

Forbearance (continued)

Identification and classification (continued)

Depending on circumstances and when operated within robust parameters and controls, the Group believes forbearance can help support the customer in the short to medium-term.

A range of parameters are considered when the Group looks to identify those customers to whom forbearance would be applicable and these parameters are regularly reviewed and refined as necessary to ensure they are consistent with the latest industry guidance and prevailing practice as well as ensuring that they adequately capture and reflect the most recent customer behaviours and market conditions. The Group continues to make every effort to follow its principles of treating customers fairly and aligns its forbearance practices to those principles.

The Group operates a range of forbearance measures depending on the type of customer and exercises forbearance in two distinct areas: retail and non-retail.

Exit from forbearance

Exposures classified as forborne and performing at the date forbearance measures are granted, continue to be reported as subject to forbearance for a minimum period of two years from that date (the 'probation period').

In addition, each of the following requirements need to be met at the end of the two year probation period referred to above for the exposure to exit from being classified as forborne:

- none of the exposures to the customer are more than 30 days past due at the end of the probation period; and
- regular payments of more than an insignificant aggregate amount of principal or interest have been made during at least half of the probation period. This assessment is based on the forbearance terms for repayment.

When the conditions are not met at the end of the probation period, the exposure shall continue to be identified as a performing forborne exposure until all of the conditions are met.

Exposures classified as forborne and which are non-performing when, or after, customers were granted forbearance cannot exit non-performing status for a minimum of twelve months from the date forbearance was granted, and cannot exit forbearance status for a further two years from the date of returning to performing status (three years in total).

Retail forbearance

Forbearance may be extended to retail customers (primarily on residential mortgages) when they have been identified as experiencing, or are about to experience, difficulties in meeting their financial commitments to the Group. The Group makes every effort to work with customers in times of financial difficulty in order to find a solution that brings customer facilities back into a sustainable position which, for residential mortgages, also means keeping customers in their homes.

Forbearance is exercised on retail customers in a number of different ways and is specific to the individual customer and their circumstances. Customers may potentially be subject to more than one forbearance strategy at any one time where this is considered to be the most appropriate course of action. The Group has implemented appropriate policies and procedures to ensure consistent application of forbearance. The operation, maintenance and governance surrounding these policies are regularly reviewed to confirm they remain relevant, appropriate and, most importantly, of value to our retail customers who have been identified as requiring forbearance.

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39. Financial risk management (continued)

Credit risk (continued)

Forbearance (continued)

Retail forbearance (continued)

At an operational level, the majority of forbearance measures are granted by Mortgage Collections who seek to negotiate positive outcomes for customers who have fallen into arrears. Forbearance is also exercised from within a dedicated Financial Management and Customer Solutions Team ("FMCST"), part of whose remit is to assist retail customers in financial difficulty to manage their finances more effectively on a case by case basis. The support provided by FMCST is tailored specifically for individual customers and includes an income and expenditure assessment along with other relevant financial management support.

The Group classifies the forbearance measures offered to retail customers into the following categories:

- *Formal arrangements:* A permanent change which could include capitalisation of arrears, or arrangement with the customer to repay arrears over a shorter period than capitalisation would involve.
- *Temporary arrangements:* Short term measures that allow a period of relief for customers in financial difficulty, these can include short-term payment holidays.
- *Interest only conversion:* A permanent or temporary conversion to interest only repayments, allowing the customer to maintain payments with the intention that the capital balance outstanding would be recovered at the end of the term.
- *Term extension:* A permanent change to the loan term allowing the customer to make lower repayments whilst still repaying the outstanding balance in full, over a longer period.
- *Other:* A segment of forbearance exposures specifically dealt with through FMCST, which includes product switches.
- *Legal:* Court mandated forbearance exposures.

Where the Group has made a demand for repayment, the customers facilities have been withdrawn or where a debt repayment process has been initiated, the exposure is classified as forborne if the debt is subject to any of the forbearance concessions above.

Retail forbearance - mortgage lending

The tables below summarise the number of arrangements in place and the loan balances and impairment provisions associated with those arrangements. The Group reports retail forbearance at the exposure level. Where a customer is subject to more than one forbearance measure, they have been categorised into the primary method of forbearance:

39. Financial risk management (continued)

Credit risk (continued)

Forbearance (continued)

Retail forbearance (continued)

As at 30 September 2015 [1]

	Total loans and advances subject to forbearance measures			Impairment allowance on loans and advances subject to forbearance measures	
	Number of loans	Gross carrying amount £m	% of total portfolio	Impairment allowance £m	Coverage %
Formal arrangements	2,115	179	0.87	4.0	2.22
Temporary arrangements	985	99	0.48	1.5	1.57
Interest only conversion	88	12	0.06	-	0.15
Term extension	131	11	0.06	0.1	0.84
Other	11	1	0.01	-	0.39
Legal	216	23	0.11	1.5	6.56
	3,546	325	1.59	7.1	2.19

(1) All forbearance reporting is at the balance sheet date.

As at 30 September 2014

	Total loans and advances subject to forbearance measures			Impairment allowance on loans and advances subject to forbearance measures	
	Number of loans	Gross carrying amount £m	% of total portfolio	Impairment allowance £m	Coverage %
Formal arrangements	2,282	189	1.03	3.7	1.97
Temporary arrangements	581	49	0.27	1.1	2.24
Interest only conversion	40	7	0.04	-	0.02
Term extension	72	6	0.03	-	0.03
Other	6	1	-	-	0.61
Legal	221	25	0.14	2.0	7.90
	3,202	277	1.51	6.8	2.46

39. Financial risk management (continued)

Credit risk (continued)

Forbearance (continued)

Retail forbearance (continued)

The Group also has a number of customers with interest only mortgages past maturity, not subject to forbearance. The Group has formal processes embedded to pro-actively track and facilitate pre-maturity customer engagement to bring the cases to a formal conclusion which is generally aimed to be achieved within six months after the loan has reached maturity. Complex cases can take longer than this to reach conclusion. At 30 September 2015, the Group had 116 (2014: 162) customers with interest only mortgages not subject to forbearance and which were post six month maturity with a total value of £12m (2014: £20m).

A further forbearance reserve of £4.0m (2014: £4.0m) is presently held within the overall collective provision. The effect of this on the above tables would be to increase the impairment allowance noted above to £11.1m (2014: £10.8m) and to increase overall coverage to 3.42% (2014:3.90%).

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 2015 there were 87 repossessions of which 17 were voluntary (2014: 155 including 53 voluntary).

Retail forbearance – consumer credit

The Group currently exercises limited forbearance strategies in relation to other types of consumer credit, including money transmission accounts, unsecured loans and credit cards. Forbearance strategies implemented on consumer credit are of low financial significance in the context of the Group's overall lending operations. The Group reports consumer credit forbearance at the exposure level.

The Group has assessed the total loan balances subject to forbearance on other types of consumer credit to be £18.4m at 30 September 2015 (2014: £22.0m), representing 1.62% of the total portfolio (2014: 1.87%). Impairment provisions on forborne balances totalled £5.5m at 30 September 2015 (2014: £6m), providing overall coverage of 29.90% (2014: 27.03%).

39. Financial risk management (continued)

Credit risk (continued)

Forbearance (continued)

Non-retail forbearance

Forbearance may be extended to non-retail customers for reasons relating to the actual, or apparent, financial stress of the customer or when they have been identified as experiencing, or are about to experience, difficulties in meeting their financial commitments to the Group. Authority to grant forbearance measures for non-retail customers is held by the Group's Strategic Business Services unit and is exercised, where appropriate, on the basis of detailed consideration of a customer's financial position and prospects.

The Group reports non-retail forbearance at a customer level, with customers that have forbearance granted on one or more facilities recorded as a single customer, but at a value which incorporates all facilities and the related impairment allowance irrespective of whether each individual facility is subject to forbearance. Where a customer is part of a larger group, forbearance is exercised and reported across the Group at the individual entity level. Forbearance is considered to exist where one or more of the following occurs, on a non-commercial basis, for reasons relating to the actual or apparent stress of a customer:

- *Term extension* - Extending the loan facility payment term or the term of an overdraft which is not fluctuating (e.g. where a term loan has matured and the balance passed to an overdraft which is then extended on a non-commercial basis, then forbearance is considered to exist).
- *Deferral of contracted capital repayments* – Includes capital repayment holiday, conversion to interest only for an extended period, or rescheduling, but still repaying within the remaining contracted term.
- *Reduction in the contracted interest rate* – Includes a reduction in the level of accrued interest or amendment to original fee structure.
- *Alternative forms of payment* - Including debt for equity, asset transfer and repayment made by taking possession of collateral.
- *Debt forgiveness* – Total or partial debt forgiveness by write-off of the debt.
- *Refinancing*- A complete or partial repayment of a loan with a new contract granted on or up to 3 months after the day when the original contract expires. In the case of partial repayment both the original and new loans shall be classified as forborne.
- *Covenant breach/waiver/reset* – Financial or non-financial covenant breach (whether waived or rights reserved) and financial covenant resets.

Where the Group has made a demand for repayment, where the customer's facilities have been withdrawn or where a debt repayment process has been initiated this will be classified as forbearance if the debt is subject to any of the forbearance concessions above.

Where modification of the terms and conditions of an exposure meeting the criteria for classification as forbearance results in derecognition of loans and advances from the balance sheet and the recognition of a new exposure, the new exposure shall be treated as forborne.

The Group has identified a number of situations that in isolation are not considered to be forbearance:

- Facilities that have been temporarily extended pending review and no concession has been granted for reasons relating to the actual or apparent financial stress of a customer.
- A reduction in asset quality to a level where actual, or apparent, financial stress is not evident.
- Where changes are made to the terms of a borrower's interest structure or repayment arrangement on a commercial basis.
- Late provision of financial information, in the absence of other indicators of financial difficulty, is not in all cases considered a "non-commercial" breach of non-financial covenants.

39. Financial risk management (continued)

Credit risk (continued)

Forbearance (continued)

Non-retail forbearance (continued)

The tables below summarise the total 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:

As at 30 September 2015 [(1)]

	Total loans and advances subject to forbearance measures			Impairment allowance on loans and advances subject to forbearance measures	
	Number of loans	Gross carrying amount £m	% of total portfolio	Impairment allowance £m	Coverage %
Term extension	491	429	6.00	42.9	10.02
Deferral of contracted capital repayments	166	152	2.12	18.6	12.23
Reduction in contracted interest rate	17	29	0.40	6.8	23.64
Alternative forms of payment	3	16	0.22	4.5	28.76
Debt forgiveness	24	55	0.78	14.2	25.61
Refinancing	33	61	0.86	4.7	7.56
Covenant breach/reset/waiver	62	166	2.32	6.0	3.64
	796	908	12.70	97.7	10.77

(1) All forbearance reporting is at the balance sheet date.

As at 30 September 2014

	Total loans and advances subject to forbearance measures			Impairment allowance on loans and advances subject to forbearance measures	
	Number of loans	Gross carrying amount £m	% of total portfolio	Impairment allowance £m	Coverage %
Term extension	573	466	5.76	51.5	11.03
Deferral of contracted capital repayments	192	264	3.26	39.1	14.83
Reduction in contracted interest rate	23	17	0.20	3.4	20.34
Alternative forms of payment	11	27	0.33	12.7	47.07
Debt forgiveness	43	82	1.02	19.5	23.64
Refinancing	49	48	0.60	2.3	4.81
Covenant breach/reset/waiver	75	297	3.67	7.6	2.55
	966	1,201	14.84	136.1	11.32

Included in other financial assets at fair value is a portfolio of loans which are included in the above table. The total of fair value loans subject to forbearance at 30 September 2015 is £162m (2014: £133m), representing 2.27% of the total non-retail portfolio (2014: 1.65%). Impairment allowances on these amounts totalled £14m (2014: £29m), a coverage of 8.68% (2014: 21.69%).

Prior year comparatives have been amended to conform with the current year's presentation.

39. Financial risk management (continued)

Credit risk (continued)

Maximum exposure to credit risk

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 the 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.

	Group		Bank	
	2015	2014	2015	2014
	£m	£m	£m	£m
Cash and balances with central banks (note 10)	6,431	5,971	6,431	5,971
Due from related entities (note 11)	786	1,495	3,013	3,010
Due from other banks	128	13	36	13
Financial assets available for sale (note 12)	1,462	1,168	1,455	1,168
Financial assets held to maturity (note 12)	-	-	1,440	1,483
Other financial assets at fair value (note 13)	1,097	1,583	1,097	1,583
Derivative financial assets (note 14)	285	220	228	220
Loans and advances to customers (note 15)	27,482	25,901	26,208	24,450
Due from customers on acceptances	4	5	4	5
	37,675	36,356	39,912	37,903
Contingent liabilities (note 33)	109	136	109	136
Other credit commitments (note 33)	7,886	8,463	7,855	8,424
Maximum credit risk exposure	45,670	44,955	47,876	46,463

39. Financial risk management (continued)

Credit risk (continued)

Offsetting of financial assets and liabilities

The Group and Bank do not have any financial assets or financial liabilities that are offset with the net amount presented on the balance sheet as IAS 32 "Financial Instruments – Presentation" states that there should be both an enforceable right to set-off and the intention either to settle on a net basis or to realise the asset and settle the liability simultaneously. Neither of these conditions is met by the Group or Bank. The table below illustrates the amounts for financial instruments that are covered by enforceable netting arrangements (i.e. offsetting agreements and any related financial collateral). The table excludes financial instruments not subject to offset and that are only subject to collateral arrangements (e.g. loans and advances).

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

The offsetting and collateral arrangements and other credit risk mitigation strategies are further explained within this note.

Group - 2015

	Amounts subject to enforceable netting arrangements					
		Related amounts not offset				
	Gross and net amount reported on balance sheet £m	Financial instruments (1) (2) (3) £m	Cash collateral (2) (3) £m	Net amount £m	Amounts not subject to enforceable netting arrangements £m	Total recognised on balance sheet £m
Assets						
Derivative financial instruments (4)	149	(149)	-	-	136	285
Liabilities						
Derivative financial instruments (4)	492	(149)	(246)	97	42	534

Group - 2014

	Amounts subject to enforceable netting arrangements					
		Related amounts not offset				
	Gross and net amount reported on balance sheet £m	Financial instruments (1) (2) (3) £m	Cash collateral (2) (3) £m	Net amount £m	Amounts not subject to enforceable netting arrangements £m	Total recognised on balance sheet £m
Assets						
Derivative financial instruments (4)	88	(88)	-	-	132	220
Liabilities						
Derivative financial instruments (4)	522	(88)	(317)	117	26	548
Securities sold under repurchase agreements (5)	644	(644)	-	-	-	644
Total liabilities	1,166	(732)	(317)	117	26	1,192

39. Financial risk management (continued)

Credit risk (continued)

Offsetting of financial assets and liabilities (continued)

Bank - 2015

	Amounts subject to enforceable netting arrangements					
		Related amounts not offset				
	Gross and net amount reported on balance sheet £m	Financial instruments (1) (2) (3) £m	Cash collateral (2) (3) £m	Net amount £m	Amounts not subject to enforceable netting arrangements £m	Total recognised on balance sheet £m
Assets						
Derivative financial instruments (4)	92	(92)	-	-	136	228
Liabilities						
Derivative financial instruments (4)	424	(92)	(246)	86	42	466

Bank - 2014

	Amounts subject to enforceable netting arrangements					
		Related amounts not offset				
	Gross and net amount reported on balance sheet £m	Financial instruments (1) (2) (3) £m	Cash collateral (2) (3) £m	Net amount £m	Amounts not subject to enforceable netting arrangements £m	Total recognised on balance sheet £m
Assets						
Derivative financial instruments (4)	88	(88)	-	-	132	220
Liabilities						
Derivative financial instruments (4)	426	(88)	(317)	21	25	451
Securities sold under repurchase agreements (5)	644	(644)	-	-	-	644
Total liabilities	1,070	(732)	(317)	21	25	1,095

(1) Financial instruments includes both recognised financial instruments on the balance sheet.

(2) Amounts relate to master netting and collateral agreements which have been determined to be legally enforceable but do not meet all criteria required for net presentation within the consolidated balance sheet.

(3) Collateral amounts (cash and non-cash financial collateral) are reflected at their fair value; however this amount is limited to the net balance sheet exposure in order to exclude any over-collateralisation.

(4) Derivative financial instruments comprise of both trading and hedging derivative assets and liabilities.

(5) Securities sold under repurchase agreements are reported on the Group and Bank's balance sheet within due to other banks.

39. Financial risk management (continued)

Credit risk (continued)

Offsetting of financial assets and liabilities (continued)

Derivative assets and liabilities

Derivative financial instrument contracts are typically subject to ISDA master netting agreements, as well as CSAs, where relevant, around collateral arrangements attached to those ISDA agreements, or derivative exchange or clearing counterparty agreements if contracts are settled via an exchange or clearing house. The amounts included in the Financial Instruments column refer to amounts that are subject to relevant close out netting arrangements under a relevant ISDA agreement.

Repurchase agreements

Repurchase agreements will typically be subject to Global Master Repurchase Agreements ("GMRAs") or similar agreements whereby all outstanding transactions with the same counterparty can be offset and closed out upon a default or insolvency event (i.e. close out netting).

Where the Group has a right of offset on default or insolvency only, the related financial instruments comprise of highly liquid securities pledged, which can be realised in the event of a default or insolvency by the counterparty.

Credit quality of financial assets

An assessment of the credit quality of loans and advances to customers can be found in note 15 with an assessment of the credit quality of investments contained in note 12.

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.

Residential mortgages

Residential property is the Group's main source of collateral and means of mitigating loss in the event of default credit risk inherent in its residential mortgage portfolios. All lending activities are supported by an appropriate form of valuation using either professional valuers or indexed valuation subject to business rules and confidence levels. The loan to value ratio of the Group's mortgage portfolio is disclosed in note 15.

Commercial property

Commercial property is the Group's main source of collateral on commercial lending and means of mitigating loss in the event of default credit risk inherent in its commercial portfolios. Collateral for the majority of commercial loans comprises first legal charges over freehold or long leasehold property (including formal Companies House registration where appropriate).

39. Financial risk management (continued)

Non-property related collateral

Apart from residential and commercial property based security, the Group also takes other forms of collateral when lending and this can involve obtaining security against the underlying loan through the use of cash collateral and/or netting agreements, both of which reduce the original exposure by the amount of collateral held, subject to volatility and maturity adjustments where applicable.

The Group also operates a policy of obtaining security against the underlying loan via the use of guarantees, which can be either limited or unlimited, making the guarantor liable for only a portion or all of the debt.

The following table shows the total non-property collateral held by sector at 30 September 2015 in terms of cash, guarantees (these guarantors are predominantly other financial institutions who are considered to be of a high quality) and netting. The exposure amount shown below is the total gross exposure (before any Credit Risk Mitigation and Credit Conversion Factors have been applied where applicable) for arrangements which have some form of associated collateral held against them and is not the total exposure for each asset class, as disclosed in the Strategic Report.

2015	Cash £m	Guarantee £m	Netting £m	Total £m	Exposure £m
Central Governments or Central Banks	-	-	-	-	-
Corporates	64	53	57	174	205
Financial institutions	-	-	-	-	-
Past due items	-	-	-	-	4
Regional Governments or local authorities	-	-	114	114	114
Secured by mortgages on commercial real estate	4	-	31	35	86
Secured by mortgages on residential property	2	-	7	9	18
	70	53	209	332	427

2014	Cash £m	Guarantee £m	Netting £m	Total £m	Exposure £m
Central Governments or Central Banks	49	-	-	49	51
Corporates	91	68	80	239	298
Financial institutions	910	-	-	910	966
Past due items	1	-	1	2	13
Regional Governments or local authorities	-	-	138	138	144
Secured by mortgages on commercial real estate	35	-	34	69	165
Secured by mortgages on residential property	6	-	7	13	33
	1,092	68	260	1,420	1,670

Comparative disclosures have been amended to conform with the current year's presentation.

Corporates is the largest sector for other risk mitigation techniques, with all three methods utilised dependent on credit quality. The extent to which these will be used will be dependent on the specific circumstances of the customer.

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 any Eurozone countries (2014: Nil). The Group and Bank had an exposure to the European Investment Bank of £100m at 30 September 2015 (2014: £100m).

39. Financial risk management (continued)

Credit risk (continued)

Industry concentration of assets

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

Gross loans and advances to customers including loans designated at fair value through profit or loss	Group		Bank	
	2015 £m	2014 £m	2015 £m	2014 £m
Government and public authorities	27	55	27	55
Agriculture, forestry, fishing and mining	1,515	1,677	1,515	1,677
Financial, investment and insurance	659	421	659	421
Property – construction	260	394	260	394
Manufacturing	576	733	576	733
Instalment loans to individuals and other personal lending (including credit cards)	1,477	1,712	1,477	1,712
Property – mortgage	20,504	18,444	19,243	17,015
Asset and lease financing	426	417	413	394
Other commercial and industrial	3,340	3,851	3,340	3,851
	28,784	27,704	27,510	26,252

Contingent liabilities and credit related commitments (note 33)	Group		Bank	
	2015 £m	2014 £m	2015 £m	2014 £m
Government	-	8	-	8
Agriculture, forestry, fishing and mining	1,004	1,031	1,004	1,031
Financial, investment and insurance	413	44	413	44
Property – construction	45	75	45	75
Manufacturing	149	189	149	189
Instalment loans to individuals and other personal lending (including credit cards)	3,442	3,759	3,442	3,759
Property – mortgage	1,814	2,107	1,783	2,068
Other commercial and industrial	1,128	1,386	1,128	1,386
	7,995	8,599	7,964	8,560

39. Financial risk management (continued)

Credit risk (continued)

Financial assets available for sale and held to maturity	Group 2015 £m	Group 2014 £m	Bank 2015 £m	Bank 2014 £m
Government and public authorities	1,447	1,161	1,447	1,161
Financial, investment and insurance	15	7	1,448	1,490
	1,462	1,168	2,895	2,651

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 the 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 minimis 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 including parallel rate movements and twists in the yield curve to explore risks around exposures to movements in short or long term interest rates;
- 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 statistical basis: 99% confidence level; three month holding period;
- economic capital is allocated for IRRBB based on a higher confidence interval and a longer holding period;
- EaR utilises a twelve month forecast period;
- eight years of business day historical data;
- VaR methodology is based on proportional rather than absolute changes in historical interest rates;
- investment term for capital is modelled with an established benchmark term of between one and five years; and
- investment term for core "non-interest" bearing assets and liabilities is modelled on a behavioural basis with an established benchmark term of between one and five years.

39. Financial risk management (continued)

Market risk (continued)

Model parameters and assumptions are reviewed and updated on at least an annual basis. Material changes require the approval of UK Asset & Liability Committee.

Interest rate risk	Value at risk		Earnings at risk	
	2015 £m	2014 £m	2015 £m	2014 £m
As at 30 September	27	36	9	2
Average value during the year	25	37	5	3
Minimum value during the year	19	32	2	2
Maximum value during the year	29	48	9	8

The following table shows the Group's principal financial assets and liabilities and the main non-traded market risk types they are exposed to:

	2015 £m	Liquidity risk	Interest rate risk	Foreign exchange risk	Credit risk
Assets					
Cash and balances with central banks	6,431				✔
Available for sale financial assets	1,462	✔	✔		✔
Loans and advances to customers	27,482	✔	✔	✔	✔
Derivative financial instruments	285	✔	✔	✔	✔
Other financial assets at fair value	1,097	✔	✔		✔
Liabilities					
Due to customers	26,407	✔	✔	✔	
Due to other banks	393	✔	✔	✔	
Derivative financial instruments	534	✔	✔	✔	
Other financial liabilities at fair value	67	✔	✔		
Bonds and notes	3,766	✔	✔	✔	

Prepayment risk

Customers may prepay certain loans and advances ahead of the contractual repayment schedule. This form of optionality gives rise to prepayment risk for the Group whereby the expected timing of cashflows from loan repayments differs from the actual experience. The impact on the Group would differ according to changes in the level of interest rates.

The Group assesses the risks arising from prepayment behaviour in order to show the potential impact on future cashflows. The impact is also managed through terms and conditions within loans and advances.

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 behavioural 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 2015	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	4,978	-	-	-	-	1,453	6,431
Due from related entities	772	-	-	-	14	-	786
Due from other banks	36	92	-	-	-	-	128
Financial assets available for sale	-	-	100	782	565	15	1,462
Other financial assets at fair value	1	11	78	731	276	-	1,097
Derivative financial instruments	3	27	48	70	137	-	285
Loans and advances to customers	2,221	203	701	3,844	20,137	376	27,482
Due from customers on acceptances	-	4	-	-	-	-	4
All other assets	86	54	47	-	-	839	1,026
Total assets	8,097	391	974	5,427	21,129	2,683	38,701
Liabilities							
Due to other banks	-	390	3	-	-	-	393
Other financial liabilities at fair value	-	1	1	65	-	-	67
Derivative financial instruments	3	28	41	248	214	-	534
Due to customers	20,370	1,505	2,045	2,487	-	-	26,407
Liabilities on acceptances	-	4	-	-	-	-	4
Due to related entities	115	8	-	381	475	-	979
Bonds and notes	-	14	852	1,973	927	-	3,766
All other liabilities	1,822	117	114	-	-	1,040	3,093
Total liabilities	22,310	2,067	3,056	5,154	1,616	1,040	35,243
Off balance sheet items							
Contingent liabilities	-	25	13	11	52	8	109
Other credit commitments	7,886	-	-	-	-	-	7,886
Total off balance sheet items	7,886	25	13	11	52	8	7,995

39. Financial risk management (continued)

Maturity analysis of assets and liabilities (continued)

Group 2014	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	4,670	-	-	-	-	1,301	5,971
Due from related entities	1,495	-	-	-	-	-	1,495
Due from other banks	13	-	-	-	-	-	13
Financial assets available for sale	-	2	1	101	1,058	6	1,168
Other financial assets at fair value	3	33	105	589	853	-	1,583
Derivative financial instruments	2	29	59	47	83	-	220
Loans and advances to customers	2,519	293	769	4,063	17,893	364	25,901
Due from customers on acceptances	-	5	-	-	-	-	5
All other assets	143	70	33	-	-	481	727
Total assets	8,845	432	967	4,800	19,887	2,152	37,083
Liabilities							
Due to other banks	-	664	250	-	-	-	914
Other financial liabilities at fair value	-	2	6	65	18	-	91
Derivative financial instruments	2	36	60	170	280	-	548
Due to customers	17,872	2,039	2,464	1,698	-	-	24,073
Liabilities on acceptances	-	5	-	-	-	-	5
Due to related entities	183	9	346	838	1,076	-	2,452
Bonds and notes	-	20	730	2,039	664	-	3,453
All other liabilities	1,888	130	42	-	-	982	3,042
Total liabilities	19,945	2,905	3,898	4,810	2,038	982	34,578
Off balance sheet items							
Contingent liabilities	-	32	25	12	61	6	136
Other credit commitments	8,463	-	-	-	-	-	8,463
Total off balance sheet items	8,463	32	25	12	61	6	8,599

39. Financial risk management (continued)

Maturity analysis of assets and liabilities (continued)

Bank 2015	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	4,978	-	-	-	-	1,453	6,431
Due from related entities	3,000	-	-	-	13	-	3,013
Due from other banks	36	-	-	-	-	-	36
Financial assets available for sale	-	-	100	782	565	8	1,455
Financial assets held to maturity	-	-	-	-	1,440	-	1,440
Other financial assets at fair value	1	11	78	731	276	-	1,097
Derivative financial instruments	3	27	33	70	95	-	228
Loans and advances to customers	2,204	201	694	3,792	18,941	376	26,208
Due from customers on acceptances	-	4	-	-	-	-	4
All other assets	86	77	47	-	-	469	679
Total assets	10,308	320	952	5,375	21,330	2,306	40,591
Liabilities							
Due to other banks	-	390	3	-	-	-	393
Other financial liabilities at fair value	-	1	1	65	-	-	67
Derivative financial instruments	3	13	42	194	214	-	466
Due to customers	20,370	1,505	2,045	2,487	-	-	26,407
Liabilities on acceptances	-	4	-	-	-	-	4
Due to related entities	157	8	-	5,447	475	-	6,087
Bonds and notes	-	-	-	-	707	-	707
All other liabilities	1,822	116	114	-	-	978	3,030
Total liabilities	22,352	2,037	2,205	8,193	1,396	978	37,161
Off balance sheet items							
Contingent liabilities	-	25	13	11	52	8	109
Other credit commitments	7,855	-	-	-	-	-	7,855
Total off balance sheet items	7,855	25	13	11	52	8	7,964

39. Financial risk management (continued)

Maturity analysis of assets and liabilities (continued)

Bank 2014	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
Cash and balances with central banks	4,670	-	-	-	-	1,301	5,971
Due from related entities	3,010	-	-	-	-	-	3,010
Due from other banks	13	-	-	-	-	-	13
Financial assets available for sale	-	2	1	101	1,058	6	1,168
Financial assets held to maturity	-	-	-	399	1,084	-	1,483
Other financial assets at fair value	3	33	105	589	853	-	1,583
Derivative financial instruments	2	29	59	47	83	-	220
Loans and advances to customers	2,476	292	762	4,002	16,554	364	24,450
Due from customers on acceptances	-	5	-	-	-	-	5
All other assets	143	70	33	-	-	452	698
Total assets	10,317	431	960	5,138	19,632	2,123	38,601
Liabilities							
Due to other banks	-	664	250	-	-	-	914
Other financial liabilities at fair value	-	2	6	65	18	-	91
Derivative financial instruments	2	18	36	145	250	-	451
Due to customers	17,872	2,039	2,464	1,698	-	-	24,073
Liabilities on acceptances	-	5	-	-	-	-	5
Due to related entities	217	9	346	4,816	1,077	-	6,465
Bonds and notes	-	11	-	399	698	-	1,108
All other liabilities	1,865	130	42	-	-	982	3,019
Total liabilities	19,956	2,878	3,144	7,123	2,043	982	36,126
Off balance sheet items							
Contingent liabilities	-	32	25	12	61	6	136
Other credit commitments	8,424	-	-	-	-	-	8,424
Total off balance sheet items	8,424	32	25	12	61	6	8,560

39. Financial risk management (continued)

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 funding and liquidity 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.

Cash flows payable under financial liabilities by contractual maturities

Group 2015	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	-	390	3	-	-	-	393
Other financial liabilities at fair value	-	2	3	75	-	-	80
Trading derivative financial instruments	3	16	35	52	226	-	332
Due to customers	20,370	1,517	2,074	2,516	-	-	26,477
Liabilities on acceptances	-	4	-	-	-	-	4
Bonds and notes	-	27	918	2,152	1,123	-	4,220
All other financial liabilities	1,791	-	-	-	-	-	1,791
Hedging derivative liabilities							
Contractual amounts payable	-	49	106	669	41	-	865
Contractual amounts receivable	-	(28)	(50)	(518)	-	-	(596)
	22,164	1,977	3,089	4,946	1,390	-	33,566

Group 2014	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	-	665	250	-	-	-	915
Other financial liabilities at fair value	-	3	9	79	20	-	111
Trading derivative financial instruments	2	36	24	74	275	-	411
Due to customers	17,873	2,050	2,487	1,721	-	-	24,131
Liabilities on acceptances	-	5	-	-	-	-	5
Bonds and notes	-	40	782	2,214	880	-	3,916
All other financial liabilities	1,504	-	-	-	-	-	1,504
Hedging derivative liabilities							
Contractual amounts payable	-	85	481	840	34	-	1,440
Contractual amounts receivable	-	(55)	(429)	(705)	-	-	(1,189)
	19,379	2,829	3,604	4,223	1,209	-	31,244

39. Financial risk management (continued)

Liquidity risk (continued)

Bank 2015	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	-	390	3	-	-	-	393
Other financial liabilities at fair value	-	2	3	75	-	-	80
Trading derivative financial instruments	3	16	35	52	226	-	332
Due to customers	20,370	1,517	2,074	2,516	-	-	26,477
Liabilities on acceptances	-	4	-	-	-	-	4
Bonds and notes	-	-	43	130	894	-	1,067
All other financial liabilities	1,791	-	-	-	-	-	1,791
Hedging derivative liabilities						-	
Contractual amounts payable	-	17	47	93	32	-	189
	22,164	1,946	2,205	2,866	1,152	-	30,333

Bank 2014	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	-	665	250	-	-	-	915
Other financial liabilities at fair value	-	3	9	79	20	-	111
Trading derivative financial instruments	2	47	24	74	275	-	422
Due to customers	17,873	2,050	2,487	1,721	-	-	24,131
Liabilities on acceptances	-	5	-	-	-	-	5
Bonds and notes	-	21	28	530	917	-	1,496
All other financial liabilities	1,504	-	-	-	-	-	1,504
Hedging derivative liabilities							
Contractual amounts payable	-	20	34	89	6	-	149
	19,379	2,811	2,832	2,493	1,218	-	28,733

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.

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 ultimate parent entity NAB. The key components of the Group's risk management strategy are detailed below:

Risk control and management

Risk culture

Establishing and maintaining an appropriate risk framework within the Group is a key objective. Culture is shaped by many aspects including tangible components such as: the Group's code of conduct; operating principles; policies; standards; the risk management operating model; and an approved articulation of risk appetite that aligns to, and supports, the strategic objectives of the Group. The Group strives to instil a culture that supports compliance with all relevant laws, codes and policies and builds constructive regulatory relationships, to which end they seek to establish effective risk governance, a sound risk appetite framework, clearly defined enterprise behaviour and compensation practices that promote appropriate risk taking behaviour.

Initiatives that support the appropriate risk culture include: the performance management framework, which incorporates an assessment of factors including risk management, behaviour and a transparent compliance gateway rating; training; and escalation procedures (both through the management hierarchy and anonymously through the Group's whistle-blower facility) allowing staff to raise concerns; messaging from the Chief Executive Officer and members of the CYB Leadership Team of the Group, which has been delegated authority by the Board.

The Board and senior management are responsible for providing a clear view of risk culture through their actions and words, and proactively address any identified areas of weakness or concern. They must ensure:

- all employees understand and adhere to the core components of the Risk Management Framework; and
- failures in risk culture, either internal or external, are reviewed at all levels of the organisation and are seen as an opportunity to strengthen our risk culture and make it more robust.

Underpinning the risk management operating model, and at the heart of the Group's risk culture, is the concept of personal accountability for risk management at source. This is enabled through a risk management accountability model (which articulates specific accountabilities for core elements of risk management across the Group) and a formal delegation framework through which staff are able to make risk based decisions.

Strategic planning and risk appetite

'Risk Appetite' is defined as the level and types of risk the Group is willing to assume within the boundaries of its risk capacity to achieve its strategic objectives. The Board formally approve the Group's Risk Appetite Statement ("RAS"), in line with the strategic planning process.

Tolerances for appropriate levels of risk for each category, as well as the other risks to which the Group is exposed, are set regularly through the RAS process. More broadly, the RAS articulates and helps communicate risk appetite incorporating the broad direction of risk taking activity; physical capital available; limits on capital use; and quantitative and qualitative measures put in place to restrict or moderate risk taking activities. An understanding of risk appetite, and its overarching tone, provides direction to the level of risk the Group is prepared to take which is ultimately reflected in changes to the Group's risk profile. As such it operates as a defence against excessive risk taking beyond the Board approved appetite thresholds and supports the delivery of the Group's strategic initiatives.

To further embed risk appetite top down through the organisation, individual Business Units have supporting Risk Setting Statements ("RSS"). RSSs are defined as supplementary measures which are Business Unit specific and are intrinsically linked to RAS settings, support the Group's strategy and drive management decisions.

Monthly reporting to Asset & Liability Committee, Risk Committee and the Board includes details of performance against relevant RAS and RSS settings (breaches and trends).

40. Management of risk (continued)

Risk control and management (continued)

Risk Management Framework

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:

- commercial decisions should be made on the basis of proactive consideration of risk and the impact on customers;
- business managers use the Risk Management Framework which assists in the appropriate balancing of both the risk and reward components; and
- employees are responsible for risk management in their day-to-day activities.

Control is exercised through clearly defined delegation of authority, with clear and rapid communication and escalation channels throughout the organisation. Within this context, the Group manages risk within a "three lines of defence" framework. 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 responsible for ensuring that the risk and control environment is actively and appropriately managed through the provision of risk insight, appetite and oversight. The third line of defence is the internal audit team, which provides independent assurance and reporting on the effectiveness of the risk management and internal control environment.

Risk Governance

The Group's risk governance structure strengthens risk evaluation and management, while also positioning the Group to manage the changing regulatory environment in an efficient and effective manner.

The NAB Group Risk and Reward Management Committee, chaired by the NAB 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 four sub-committees - the NAB Group Credit and Market Risk Committee, the NAB Group Asset and Liability Committee, the NAB Group Regulatory Compliance & Operational Risk Committee and the NAB Group Capital Committee - each with a specialised focus.

Within the UK, Board oversight of risk management is facilitated by the Boards' Risk and Audit Committees, the Boards approve the Group's overall governance, risk and control frameworks and risk appetite. Refer to the Group's Corporate Governance statement on the Group's website (www.cbonline.co.uk) for further information on Board committees. The table below details the Bank's Governance and Management Assurance Committees and their risk focus.

40. Management of risk (continued)

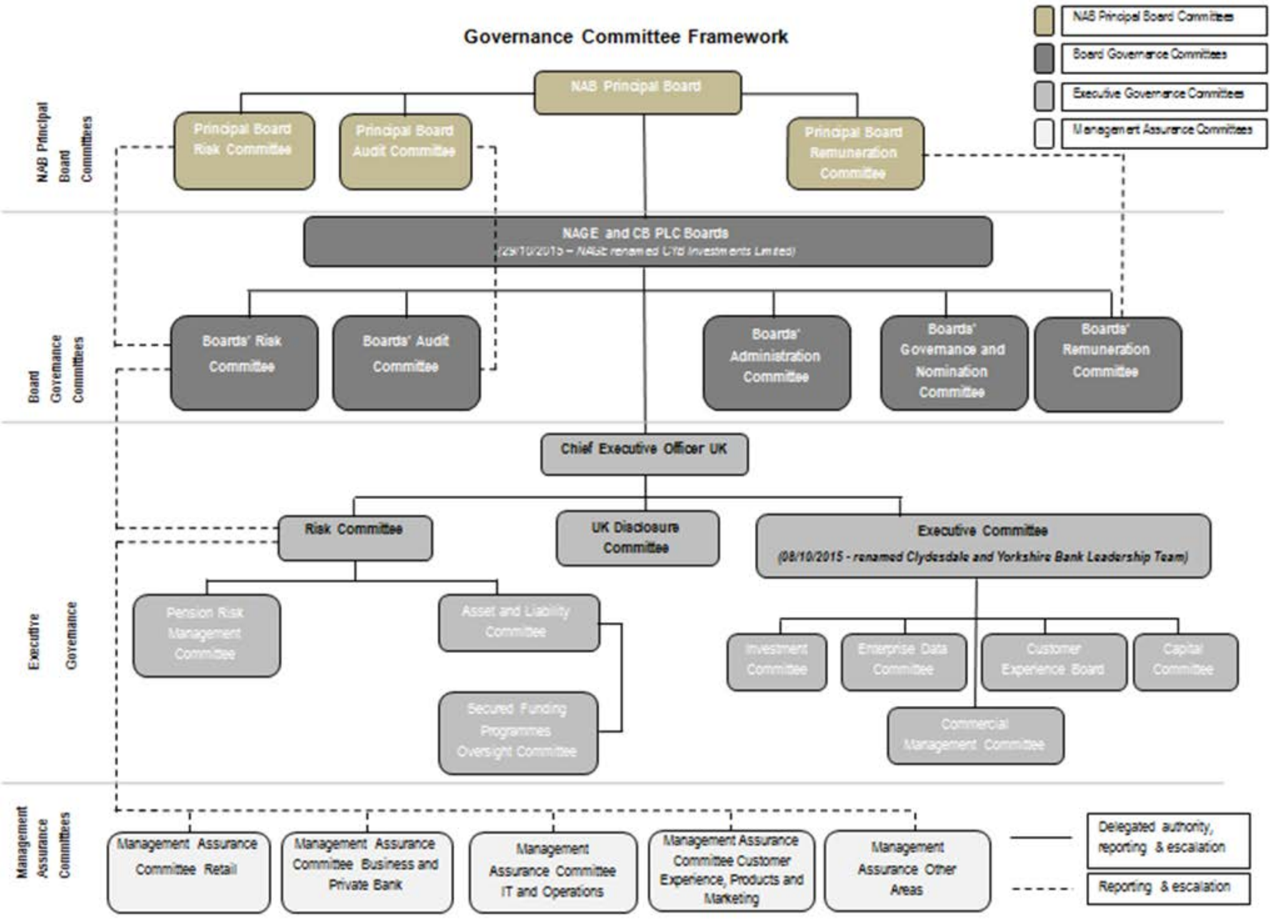
The following Governance Committees have been established under the authority of the Chief Executive Officer UK (CEO)	
Committees	Risk Focus
Risk Committee	The Risk Committee supports the CEO in respect of his risk and control accountabilities and serves to provide leadership focus on key risk issues including: • Devising the Risk Appetite Statement for approval by the Boards; • Overseeing and challenging the enterprise wide risk performance and control environment of the Bank and business units, including the effective use of policy, frameworks and tools; • Monitoring the status of regulatory relationships, the reputation of the Bank in relation to its regulators and the changing state of the regulatory landscape including the impacts for and readiness of the Bank; • Monitoring the strength of risk capability and capacity, including risk training and education plans to ensure an effective risk and control framework; and • Reviewing and endorsing risk policies, frameworks and tools for use across the Bank.
UK Disclosure Committee	The UK Disclosure Committee is responsible for ensuring the Group complies with its continuous disclosure obligations of the exchange(s) on which it has securities listed.
Clydesdale and Yorkshire Bank Leadership Team	The Clydesdale and Yorkshire Bank Leadership Team supports the CEO to lead the Group to be a strong, customer focused bank for its communities by focusing on four business priorities; customers, risks and controls, sustainable returns and people.
The Risk Committee is supported by the following Committees:	
Pension Risk Management Committee	The Pension Risk Management Committee is responsible for overseeing pension risk management and strategy. This committee also oversees and governs interaction with UK pension scheme trustees.
Asset and Liability Committee	The Asset and Liability Committee is responsible for monitoring the performance of the Bank against the Boards' approved capital and funding plans. The Committee focuses on the Bank's non-traded market risks including capital, funding, liquidity, interest rate risk and pension risk to ensure that the Bank's activity complies with regulatory and corporate governance requirements and also delivers Group policy objectives.
Secured Funding Programmes	The Secured Funding Programmes Oversight Committee is responsible for supporting the Asset and Liability Committee in relation to its risk monitoring and oversight responsibilities of all secured funding programmes and supporting the CEO in relation to the compliance of the Regulated Covered Bond ("RCB") Programme with FCA regulations and the RCB Sourcebook.
The Clydesdale and Yorkshire Bank Leadership Team is supported by the following Committee:	
Enterprise Data Committee	The Enterprise Data Committee is responsible for providing direction and oversight of information and data practices, including oversight of management's resolution of data issues.
Commercial Management Committee	The Commercial Management Committee supports the Executive Committee with management of pricing decisions, sales performance, mortgage and term deposit product balance sheet maturities, review of customer funding plan and visibility of external environment.
Capital Committee	The Capital Committee is responsible for ensuring effective governance of UK capital usage and performance. This includes monitoring key capital and related performance metrics; development of infrastructure to deliver key capital measures out to business functions; and optimising capital efficiencies.
Customer Experience Board	The Customer Experience Board is responsible for championing the end to end customer experience. This included 'Treating Customers Fairly' principles, management actions for insight, culture, capability and complaints policy management and reporting.
Investment Committee	The Investment Committee is responsible for prioritising, approving and reviewing execution of the approved Group strategy via an investment portfolio of projects that align to strategic outcomes, fair customer outcomes, balanced risk outcomes and provide sustainable and appropriate returns.

40. Management of risk (continued)

First line responsibility for risk management resides with the business unit director supported by the Management Assurance Committees which provide reports to the Risk Committee based on the Board's risk profile

Management Assurance Committee (Retail; Business and Private Bank; IT & Operations; Customer Proposition; Other Areas)	Each major first line business unit has established a Management Assurance Committee, which supports the business unit director to lead the business unit in respect of risk matters and provides advice, guidance, challenge and recommendations. This includes recommending risk setting statements to the Risk Committee; monitoring performance against risk settings and tolerances; reviewing the strength of the control environment and risk capability; and monitoring the effectiveness of risk culture and on-going compliance with regulatory requirements.

The Group's risk management structure as at 30 September 2015 is diagrammatically represented below:



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 and strategies and work with the business units to promote awareness of the need to manage risk.

Stress testing within the Group's risk governance and capital framework

Stress testing within the Group has been developed to inform future business and risk planning initiatives, strategic risk management (including risk appetite setting) and capital management. Specifically, stress testing is used or considered in informing the following management decisions:

Risk appetite and strategic business planning - As part of an annual assessment of future opportunities for, and threats to, the Group, stress testing outputs are used to inform the strategic planning process and to develop risk appetite settings.

Capital planning ("ICAAP") - Stress testing informs the assessment and quantification of risk exposures in the course of calculating capital requirements as part of the ICAAP process.

40. Management of risk (continued)

Liquidity management ("ILAA") - Scenarios provide insight into potential vulnerabilities in the Group's funding strategies. Regular stress tests are undertaken to understand and monitor exposure to liquidity risk with their regularity being aligned to the nature of, and exposure to, the risk type.

Recovery plan ("RP") – the RP (including the Contingency Funding Plan) helps inform both stress testing and reverse stress testing scenario development. Reverse stress testing explores circumstances, or a set of circumstances, that render the Group's business model unviable, moving the Group into a resolution by the authorities. As a result, these stresses are recognised as a required risk management tool in the form of an early warning indicator of potential stress events.

*Strategic risk management - s*tress testing informs the nature and level of risk carried by the Group arising from opportunistic assessments such as investments, divestments and acquisitions through emerging material risks posed by trends in, or changes to, the business environment.

Stress Testing Oversight and Governance

The CYB Leadership Team are responsible for ensuring that the outcome of the capital stress testing is subject to robust challenge and endorsement prior to Board approval.

Asset and Liability Committee ("ALCO") - The ALCO reviews the scenarios, assumptions and results of liquidity stress testing. The results of liquidity stress scenarios are reported to the ALCO monthly. These scenarios are the liquidity stress scenarios approved by the Board as part of the individual liquidity adequacy assessment.

Clydesdale and Yorkshire Bank Leadership Team - The CYB Leadership Team are engaged in stress testing to provide review, discussion and debate into the scenario selection process, based on their experience and knowledge as heads of each business unit. The CYB Leadership Team also consider and assess results in the context of future strategic decision-making, contingency planning, capital and business planning.

Board of Directors – The Board engages at critical points of the stress testing cycle to provide a robust and strategic challenge in relation to scenario selection and development. In addition, the Board considers how the results are integrated into the future strategic decision-making, contingency planning, capital and business planning and risk appetite.

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 and Market Risk Committee. Through such policies the NAB Board establishes the NAB Group's tolerance for risk. For complex credit products and services, the NAB 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 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.

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 ("conduct risk") – 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 and fairly. 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 zero 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. This includes ensuring there is adequate capacity of resource, with clearly defined objectives and an effective and efficient management structure in place. The Group also recognises the importance of ensuring colleagues have access to industry bench marked training and education material to ensure resources have the required skills and competencies.

40. Management of risk (continued)

- 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. A specific example of a Systems and infrastructure risk that is recognised across the industry is Cyber Attack. Dealing with cyber attacks is an ongoing challenge for the financial services industry and presents a constant risk to the Group as the motivations constantly change, the techniques become more sophisticated and the resources used in the attacks become more readily available as a commodity service. The Group has implemented industry standard tools and internal controls to help prevent external intrusions of the Group's systems and loss of sensitive information; these controls ensure compliance with regulation. The Group takes steps to ensure its systems and controls remain appropriate to mitigate against the risks faced.
- 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.

Responsibility for the management of operational risk rests with the business managers with oversight from the risk management function with additional guidance and functional oversight provided by Policy Owners and technical specialists e.g. Information Security, Supplier Management. Independent assurance activities are undertaken by Internal Audit. The Group has an established Operational Risk Framework which operates across the Group. It 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 and 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 Boards' Risk Committee to provide visibility and understanding of the Group's overall risk profile.

Balance sheet risks

Balance sheet 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 balance sheet 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 balance sheet risks are approved by the Board of the NAB Group. The consistent application of NAB Group polices across the Group is the responsibility of the Group's Board with the support of executive management governance committees. In relation to balance sheet risks, the primary management committee is UK ALCO.

Risk appetite and limits are approved for balance sheet risks by the Group's Board, with authority delegated to UK ALCO for their subsequent implementation and monitoring.

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 UK Risk.

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.

40. Management of risk (continued)

Liquidity within the Group is managed in accordance with the ILAA that is approved by the Board. The ILAA documents the manner in which the Group meets its Overall Liquidity Adequacy Rule which covers all regulatory and internal liquidity requirements. In addition the Group has a Liquidity Policy that details, amongst other items, the control standards and risk measurement requirements for liquidity and authorities and responsibilities. Oversight of liquidity risk is undertaken by UK ALCO. In recognition of the global nature of liquidity risk the liquidity position of entities across the NAB Group is also monitored by NAB Group ALCO. To meet the requirements of local regulatory authorities the liquidity of the Group is managed on a daily basis as a stand-alone undertaking using a combination of cumulative cash flow mismatch, scenario and gap analysis and stress tests to ensure that normal daily cash requirements are met and to ensure adequate sources of liquidity are available to support unforeseen cash outflows. UK ALCO delegates daily management responsibilities to the Group's Treasury division within agreed tolerances.

A Contingency Funding Plan has been established for management of an escalated liquidity requirement if the Group 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.

The Group has a number of different sources of funding which are considered to be well diversified in terms of the type of instrument and product, counterparty, term structure and market.

The Group can source funding through a range of channels including the following:

- Retail, SME, corporate deposits;
- Commercial paper programme;
- Access to money markets through cash deposits and certificates of deposit;
- "Lanark" residential mortgage securitisation programme (owner occupied);
- "Lannraig" buy-to-let mortgage securitisation programme;
- Regulated Covered Bond programme; and
- Access to the facilities within the Bank of England Sterling Monetary Framework.

These sources are focused on a range of different investors and depositors with a range of maturities. Funding is typically raised in GBP, USD and EUR and is swapped back to GBP to fund the predominantly GBP balance sheet. The Group's securitisation and covered bond programmes offer investors the opportunity to purchase mortgage backed debt.

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.

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.

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
- basis risk, for example, the inability of the pricing 'basis' for customer asset and liability products to be replicated in the financial markets or the risk arising from changing relationships between different interest rate yield curves.

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.

40. Management of risk (continued)

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, limits and Board requirements.

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

A key feature of the risk management and oversight framework is the use of VaR as a measure of interest rate risk, along with EaR to measure the impact on future earnings. Limits for VaR and EaR are complemented by sensitivity and scenario analysis.

Oversight of interest rate risk is conducted by the Group's Balance Sheet & Liquidity Risk Oversight team that is independent of the Treasury division.

Foreign exchange risk

Exposures arise if future cash flows can only be converted to GBP at a rate different to that prevailing 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 from wholesale funding transactions 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 Risk Management Committee reports to the UK Risk Committee on pension risks.

41. Capital management overview

Capital is held by the Group to protect its depositors, to cover inherent risks in a normal and stressed operating environment and to support its business strategy against losses, inherent risks and stress events. In assessing the adequacy of its capital resources, the Group considers its risk appetite, the material risks to which it is exposed and the appropriate strategies required to manage those risks. The Group is committed to maintaining a strong capital base.

The Group is currently governed by NAB Group's Capital Management Policy. The objectives of the 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 UK Capital Plan is approved by the UK Boards on an annual basis. UK ALCO monitors the capital plan and forecast positions on a monthly basis. This ensures that in the event that further capital is deemed necessary to meet regulatory requirements or support future strategy, the issue is proactively escalated to senior management and the UK Boards to determine the most appropriate strategy for the Group to achieve the desired capital outcome.

The Group manages capital in accordance with prudential rules issued by the PRA and FCA, which implemented CRD IV legislation with effect from 1 January 2014.

41. Capital management overview (continued)

CRD IV also provides for new regulatory capital buffers including a Capital Conservation Buffer ("CCB") and Counter-Cyclical Buffer ("CCyB") to replace the existing Capital Planning Buffer ("CPB"). The CCB will, when fully adopted in 2019, equate to 2.5% of RWAs, whilst the level of the CCyB is dependent upon the authorities' view of credit conditions in the economy. With effect from May 2014, the Financial Policy Committee ("FPC") at the Bank of England assumed formal responsibility for setting the CCyB each quarter. At its September 2015 meeting, the FPC maintained the CCyB rate for UK exposures at 0%. Further detail on the Group's regulatory capital is included on pages 21 to 24 of the Strategic Report.

The PRA announced further changes to their approach to assessing Pillar 2A capital requirements in July 2015 (PRA Policy Statement PS17/15) and the Basel Committee on Banking Supervision is currently consulting on potential changes to the standardised approach for credit risk (issued in December 2014). The Group is currently assessing the potential impacts of these proposals.

The Financial Services (Banking Reform) Act 2013 received Royal Assent in December 2013. The Act seeks to protect deposit holders and ensure the PRA can hold banks to account. The reforms may affect the structure of banks and the amount of capital held. The key aspect of the Act is to establish the concept of ring fenced bodies ("RFB"). A RFB is defined by reference to its core retail deposits which fall within the ring fence and which cannot be allowed to leak outside the ring fence. One of the thresholds for inclusion as a RFB is minimum core customer deposits of £25bn. The PRA has since released a consultation paper (The Implementation of ring-fencing: consultation on legal structure, governance and the continuity of services and facilities). The Group continues to closely monitor progress in this area.

42. Pillar 3 disclosures

Basel III Capital Requirements Directive IV

Pillar 3 disclosure requirements are set out in Part Eight of the Capital Requirements Regulation ("CRR"). The first consolidated disclosures of CYB Investments Limited, which is the Bank's immediate parent, for financial year 2015, can be found at www.cbonline.co.uk.

Since the introduction of Pillar 3 requirements in 2008 under Basel II the CYB Investments Limited Group has met the disclosure requirements on a NAB Ltd consolidated level. This was on the basis that equivalent disclosures are made by a parent undertaking which met CRR Article 13(3) and previously PRA (formally the FSA) requirements.

The CYB Investments Limited Group continues to be included in the consolidated NAB Pillar 3 2015 report in addition to publishing its own Pillar 3 disclosures. The NAB 2015 Pillar 3 can be found at http://www.nab.com.au/about-us/shareholder-centre/regulatory-disclosures.

43. Events after the balance sheet date

Conduct Indemnity

On 28 October 2015 NAB confirmed its intention to divest the Group's immediate parent, CYB Investments Limited, to CYBG PLC ("CYBG") through a demerger and subsequent list CYBG by IPO in February 2016. CYBG will be the newly created holding company for the Group. The proposed demerger is subject to a range of matters including various court and regulatory approvals and NAB shareholder approval.

In order to achieve the proposed CYBG demerger and IPO the PRA requires capital support for CYBG of £1.7bn in relation to potential future legacy conduct costs. The provisions of £465m recognised in the year ended 30 September 2015 will form part of the £1.7bn support package.

Enhanced disclosure task force recommendations

The Group continues to review how it responds to the Enhanced Disclosure Task Force ("EDTF") recommendations that were published in October 2012 and agrees with and supports the primary objectives of the EDTF in improving risk disclosures and providing a greater level of transparency and comparability between banks.

The Group is committed to ensuring compliance with the EDTF's objectives and recommendations and takes a measured and proportionate approach in doing so.

The EDTF's recommendations (categorised into their respective areas) and the Group's responses to these are provided in the following table:

EDTF recommendations	Description	Location within the Group's annual report & consolidated financial statements
1 to 4	General recommendations	• Strategic Report (highlights/business model challenges and top and emerging risks) • Note 39 • Note 40 • Note 41 • Glossary
5 to 8	Risk governance and risk management strategies/business model	• Strategic Report (business model challenges and top and emerging risks) • Note 40
9 to 17	Capital adequacy and risk-weighted assets	• Strategic Report (capital position) • Note 41 • Note 42 Disclosures in this area are consistent with the standardised approach.
18 to 21	Liquidity and funding	• Strategic Report (funding and liquidity) • Note 39 • Note 40
22 to 25	Market risk	• Note 39 • Note 40 The Group does not operate a trading portfolio and there is no appetite for traded market risk other than the de minimus positions that arise from the timing of hedging transactions.
26 to 30	Credit risk	• Note 14 • Note 15 • Note 16 • Note 39
31 to 32	Other risks	• Strategic Report (business model challenges and top and emerging risks) • Note 27 Other than the above, the Group has not identified other risk types that are deemed material for disclosure purposes.

Further relevant disclosures can also be found in the CYB Investments Limited Group's Pillar 3 disclosures which can be downloaded from https://secure.cbonline.co.uk/debtinvestors/clydesdale-bank-update/

Glossary

Term	Definition
Additional Tier 1 securities	Securities that are considered additional tier 1 ("AT1") capital in the context of CRD IV.
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.
Average assets	Represents the average of assets over the year adjusted for any disposed operations.
Bank	Clydesdale Bank PLC.
Bank Levy	This is applicable to certain UK financial institutions and UK operations of foreign banks from 1 January 2011. The amount due is based on a percentage of the chargeable equity and liabilities for each applicable entity as at the balance sheet date.
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 are being phased in starting 1 January 2014 with full implementation by 1 January 2019.
Business lending	Lending to non-retail customers, including overdrafts, asset and lease financing, term lending, bill acceptances, foreign currency loans, international and trade finance, securitisation and specialised finance.
Collateral	The assets of a borrower that are used as security against a loan facility.
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.
Commercial paper	An unsecured promissory note issued to finance short term credit requirements. These instruments have a specified maturity date and stipulate the face amount to be paid to the investor on that date.

Glossary (continued)

Conduct risk	The risk that the Group's behaviours (culture, governance, systems and controls) have led to inappropriate customer outcomes.
Contractual maturities	The date on which the final payment of any financial instrument is due to be paid or received, at which point all the remaining outstanding principal and interest have been repaid in full.
Common Equity Tier 1 capital ("CET1")	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.
Covered bonds	A corporate bond with primary recourse to the institution and secondary recourse to a pool of assets that act as security for the bonds on issuer default. Covered bonds remain on the issuer's balance sheet and are a source of term funding for the Group.
CRD IV	The European Union's ("EU") proposal to implement Basel III, the international agreement on bank capital standards agreed at G20 level. It replaces the EU's earlier capital requirements directives with a revised package consisting of a new Capital Requirements Directive and a new Capital Requirements Regulation. The CRD IV package raises capital and liquidity requirements for European banks and harmonises the European framework for bank supervision.
CRE	Commercial real estate.
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 financial instruments held at fair value to reflect the creditworthiness of the counterparty. Also known as a credit valuation adjustment ("CVA").
Customer deposits	Interest bearing, non-interest bearing and term deposits (including retail and corporate deposits).
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.
Defined Liquidity Group	The defined liquidity group includes all material operating entities within the Group, excluding consolidated securitisation entities. It reflects the regulatory view with respect to oversight of the Group's liquidity position and resources.
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.
Earnings at risk ("EaR")	A measure of the quantity by which net interest income might change in the event of an adverse change in interest rates.
Effective interest rate method ("EIR")	The method used to measure the carrying value of certain financial instruments which amortises the relevant fees over the expected life of the instrument.
Exposure	A claim, contingent claim or position which carries a risk of financial loss.

Fair value	The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal (or most advantageous) market at the measurement date under current market conditions.
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.
FCA	Financial Conduct Authority.
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. Forbearance 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. The granting of a forbearance measure to a borrower is as a consequence of concerns about the borrower's ability to meet their contractual payments when due and specifically relates to such instances where the changes to the existing arrangement have been made on terms that the Group would not ordinarily consider to be on a commercial basis.
Forborne performing loans	Loans to which forbearance measures have been granted and which are less than or up to ninety days past due and do not otherwise meet the criteria of forborne non-performing loans.
Forborne non-performing loans	Forborne non-performing loans to which forbearance measures have been granted and which are more than ninety days past-due, or where the debtor is assessed as unlikely to pay its credit obligations in full without realisation of collateral, regardless of the existence of any past-due amount or of the number of days past due.
FSCS	Financial Services Compensation Scheme. The FSCS is the UK's compensation fund of last resort for customers of authorised financial services firms. The Group may pay compensation if a firm is unable, or likely to be unable, to pay claims against it. This is usually because it has stopped trading or has been declared in default.
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.
Hedge ineffectiveness	Represents the extent to which the income statement is impacted by changes in fair value of hedging instruments not being fully offset by changes in fair value of hedged items.
Housing lending	Mortgages secured by residential properties as collateral.
IFRS	International Financial Reporting Standards as issued by the International Accounting Standards Board.
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.

Glossary (continued)

Impairment 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.
Individual Liquidity Adequacy Assessment ("ILAA")	The ILAA documents the Bank's assessment and management of balance sheet risks relating to funding and liquidity.
Interest rate risk	The risk to the Group's financial performance and position caused by changes in interest rates.
Internal Capital Adequacy Assessment Process ("ICAAP")	The Bank'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	A method of calculating credit risk capital requirements using internal, rather than supervisory, estimates of risk parameters.
Investment grade	This is the highest possible range of credit ratings, from "AAA" to "BBB", as measured by external credit rating agencies.
IRHP	References to "IRHP" incorporate: (i) standalone hedging products identified in the Financial Services Authority ("FSA") 2012 notice; (ii) the voluntary inclusion of certain of the Group's more complex tailored business loan ("TBL") products; and (iii) the Group's secondary review of all fixed-rate tailored business loans ("FRTBLs") complaints which were not in scope for the FSA notice.
IRRBB	Interest rate risk in the banking book.
Key management personnel	Directors of the Group, members of the UK leadership team and PRA approved persons with a controlled function 1 – 28 (as defined in SUP 10B.4.3 within the PRA handbook available at: https://fshandbook.info/FS/html/handbook/SUP/10B/4) and FCA approved persons with an FCA controlled function 1 – 29 (as defined in SUP 10A.4.4 within the FCA handbook available at: https://fshandbook.info/FS/html/handbook/SUP/10A/4#DES95)
Level 1 fair value measurements	Financial instruments whose fair value is derived from unadjusted quoted prices for identical instruments in active markets.
Level 2 fair value measurements	Financial instruments whose fair value is derived from quoted prices for similar instruments in active markets and financial instruments valued using models where all significant inputs are observable.
Level 3 fair value measurements	Financial instruments whose fair value is derived from valuation techniques where one or more significant inputs are unobservable.
Leverage ratio	This is a regulatory standard ratio proposed by the Basel III reforms and is the Tier 1 capital divided by the total on and off balance sheet exposures expressed as a percentage. The Basel Committee has proposed to test a minimum requirement of 3% for the leverage ratio during a parallel run period from 1 January 2013 to 1 January 2017, with a view to migrating to a Pillar 1 treatment on 1 January 2018 based on appropriate review and calibration.

Glossary (continued)

LIBOR	London Interbank Offered Rate.
Liquidity coverage ratio ("LCR")	The stock of high quality liquid assets divided by the total net stressed cash outflows over the next 30 calendar days expressed as a percentage.
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.
Loan to value ("LTV")	A mathematical calculation that expresses the amount of a loan as a percentage of the value of security. A high LTV indicates that there is less of a 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.
NAB	National Australia Bank Limited. A company incorporated in the State of Victoria, Australia. The ultimate 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/(loss) attributable to owners of the Group	Represents the Group's statutory profit/(loss) after tax and reflects the amount of net profit/(loss) that is attributable to owners.
Net promoter score	This is an externally collated customer loyalty metric that measures loyalty between a Provider, who in this context is the Bank, and a consumer.
Net stable funding ratio ("NSFR")	The total amount of available stable funding divided by the total amount of required stable funding, expressed as a percentage.
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.
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.

Glossary (continued)

Pension risk	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.
PPI	Payment Protection Insurance.
PPI redress	Includes PPI customer redress and all associated costs excluding fines.
PRA	Prudential Regulation Authority.
Probability of default ("PD")	The probability that an obligor will default (usually within a one-year time horizon).
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 PRA) for individual Group companies.
Residential mortgage-backed securities ("RMBSs")	Securities that represent interests in groups or pools of underlying mortgages. Investors in these securities have the right to cash received from future mortgage payments (interest and principal).
Restructured loans	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: • 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. See also forbearance.
Retail loans	Money lent to individuals rather than institutions. This includes both secured and unsecured loans such as personal loans, 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.
Return on assets ("ROA")	Profit/(loss) of the Group as a percentage of total assets.
Sale and repurchase agreement ("repo")	A short-term funding agreement that allows a borrower to create a collateralised loan by selling a financial asset to a lender. As part of the agreement, the borrower commits to repurchase the security at a date in the future repaying the proceeds of the loan. For the counter-party (buying the security and agreeing to sell in the future) it is a reverse repurchase agreement or a reverse repo.
Securitisation	The practice of pooling similar types of contractual debt and packaging the cash flows from the financial asset into securities that can be sold to institutional investors in debt capital markets. It provides the Group with a source of secured funding than can achieve a reduction in funding costs by offering typically AAA rated securities secured by the underlying financial asset.

Glossary (continued)

Sovereign exposures	Exposures to governments, ministries, departments of governments, embassies, consulates and exposures on account of cash balances and deposits with central banks.
Structured entities ("SE")	An entity created to accomplish a narrow well-defined objective (e.g. securitisation of financial assets). An SE may take the form of a corporation, trust, partnership or unincorporated entity. SEs are often created with legal arrangements that impose strict limits on the activities of the SE. May also be referred to as a SPV.
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.
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 measure of a bank's financial strength defined by CRD IV. It captures Common Equity Tier 1 Capital plus other Tier 1 securities in issue, subject to deductions.
Tier 2 capital	A component of regulatory capital, including qualifying subordinated debt, eligible collective impairment allowances and other Tier 2 securities as defined by CRD IV.
Tier 1 ratio	Tier 1 capital as a percentage of risk-weighted assets.
Tier 2 ratio	Tier 2 capital as a percentage of risk-weighted assets.
Value at risk ("VaR")	A measure of the loss that could occur on risk positions as a result of adverse movements in market risk factors (e.g. rates, prices, volatilities) over a specified time horizon and to a given level of confidence.
Write-down	A reduction in the carrying value of an asset due to impairment or adverse fair value movements.

Other information

Country by Country Reporting ("CBCR")

The Capital Requirements (Country-by-Country Reporting) Regulations 2013 came into effect on 1 January 2014 and place certain reporting obligations on financial institutions that are within the scope of the European Union's Capital Requirements Directive (CRD IV). The purpose of the Regulations is to provide clarity on the source of the Group's income and the locations of its operations.

The vast majority of entities that are consolidated into the Group's financial statements are UK registered entities with the only substantive overseas element to the Group being a banking operation in Guernsey ("Clydesdale Bank International") that undertakes certain deposit activities. This branch was closed to new business on 14 January 2013. The book has been subsequently run down and the branch closed in September 2015.

The activities of Clydesdale Bank PLC are as described on page 9.

The total operating income and the average number of full time equivalent employees during the year to 30 September 2015 were:

Entity	2015			
	Total operating income (£m)	Employees (Number)	Corporation tax repaid (£m)	Public subsidies received (£m)
Clydesdale Bank PLC	1,004	4,616	5	-
Clydesdale Bank International	-	-	-	-

The only other non UK registered entities of the Group are two Trustee companies that are part of the Group's securitisation vehicles (Lanark and Lannraig). Both of these entities (Lanark Trustees Limited and Lannraig Trustees Limited) are registered in Jersey. These entities play a part in the overall securitisation process by having the beneficial interest in certain mortgage assets assigned to them. Both entities have no assets or liabilities recognised in their financial statements with the securitisation activity taking place in other UK registered entities of the structures. These entities do not undertake any external economic activity and have no employees. The results of these entities as well as those of the entire Lanark and Lannraig securitisation structures are consolidated in the financial statements of the Group.

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Media	Press office 0800 066 5998 press.office@nab.co.uk
National Australia Bank	NAB Group results are available from www.nab.com.au