PRELIMINARY RESULTS 2018

CYBG PLC
Registered Number 09595911
(England and Wales)

ARBN 609 948 281
(Australia)

BASIS OF PRESENTATION

CYBG PLC (the 'Company'), together with its subsidiary undertakings (which together comprise the 'Group'), operate under the Clydesdale Bank, Yorkshire Bank and B brands. It offers a range of banking services for both retail and business customers through retail branches, business banking centres, direct and online channels, and brokers. This release covers the results of the Group for the year ended 30 September 2018.

The financial information set out in the announcement does not constitute the Group's statutory accounts for the years ended 30 September 2018 or 30 September 2017. The financial information for the year ended 30 September 2017 is derived from the statutory accounts for that year which has been delivered to the Registrar of Companies. The auditor reported on those accounts: their report was unqualified, did not draw attention to any matters by way of emphasis and did not contain a statement under s498(2) or (3) of the Companies Act 2006. The audit of the statutory accounts for the year ended 30 September 2018 is not yet complete. These accounts will be finalised on the basis of the financial information presented by the directors in this preliminary announcement.

While the financial information included in this preliminary announcement has been prepared in accordance with the recognition and measurement criteria of International Financial Reporting Standards as adopted for use in the EU (IFRSs), this announcement does not itself contain sufficient information to comply with IFRSs. The Group expects to publish full financial statements that comply with IFRSs on its website in November 2018, and subsequently deliver those full financial statements to the Registrar of Companies.

Statutory basis: Statutory information is set out on pages 33 to 88. However, a number of factors have had a significant effect on the comparability of the Group's financial position and results. Accordingly, the results are also presented on an underlying basis.

Underlying basis: The statutory results are adjusted for certain items which are listed below, to allow a comparison of the Group's underlying performance. A reconciliation from the underlying to statutory basis is shown on page 15 and management's rationale for the adjustments is shown on page 91.

- Restructuring and related expense - Restructuring of the business is currently ongoing with costs including redundancy payments, property vacation costs, associated enablement costs and non-recurring costs arising from operational transformation.
- Virgin Money acquisition costs - Costs incurred directly relating to the acquisition of Virgin Money.
- RBS alternative remedies package spend - Costs incurred, in relation to the RBS alternative remedies package, to enable strategic and inorganic growth.
- Separation costs - Costs incurred directly relating to the demerger from National Australia Bank (NAB).
- Legacy conduct charges - These are customer redress and associated costs arising from legacy products and past sales practices.
- Gain on defined benefit (DB) pension scheme reforms - A one-off gain recognised in the prior year on the closure of the defined benefit pension scheme to future accrual for the majority of members.
- Gain on disposal of VocaLink – A one-off gain recognised in the prior year on the disposal of the Group's VocaLink share.

Alternative performance measures: the financial key performance indicators (KPIs) used by management in monitoring the Group's performance and reflected throughout this report are determined on a combination of bases (including statutory, regulatory and alternative performance measures), as detailed at 'Measuring financial performance – glossary'.

Certain figures contained in this document, including financial information, may have been subject to rounding adjustments and foreign exchange conversions. Accordingly, in certain instances, the sum or percentage change of the numbers contained in this document may not conform exactly to the total figure given.

The information contained within this announcement is deemed by the Group to constitute inside information as stipulated under the Market Abuse Regulation No 596/2014. Upon the publication of this announcement via Regulatory Information Service, this inside information is now considered to be in the public domain.

FORWARD LOOKING STATEMENTS

The information in this document may include forward looking statements, which are based on assumptions, expectations, valuations, targets, estimates, forecasts and projections about future events. These can be identified by the use of words such as 'expects', 'aims', 'targets', 'seeks', 'anticipates', 'plans', 'intends', 'prospects', 'outlooks', 'projects', 'forecasts', 'believes', 'estimates', 'potential', 'possible', and similar words or phrases. These forward looking statements, as well as those included in any other material discussed at any presentation, are subject to risks, uncertainties and assumptions about the Group and its securities, investments and the environment in which it operates, including, among other things, the development of its business and strategy, any acquisitions, combinations, disposals or other corporate activity undertaken by the Group (including but not limited to the acquisition of Virgin Money Holdings (UK) plc), trends in its operating industry, changes to customer behaviours and covenant, macroeconomic and/or geopolitical factors, changes to its board and/or employee composition, exposures to terrorist activity, IT system failures, cyber-crime, fraud and pension scheme liabilities, changes to law and/or the policies and practices of the BoE, the FCA and/or other regulatory and governmental bodies, inflation, deflation, interest rates, exchange rates, changes in the liquidity, capital, funding and/or asset position and/or credit ratings of the Group, future capital expenditures and acquisitions, the repercussions of the UK's referendum vote to leave the European Union (EU), the UK's exit from the EU (including any change to the UK's currency), Eurozone instability, and any referendum on Scottish independence.

In light of these risks, uncertainties and assumptions, the events in the forward looking statements may not occur. Forward looking statements involve inherent risks and uncertainties. Other events not taken into account may occur and may significantly affect the analysis of the forward looking statements. No member of the Group or their respective directors, officers, employees, agents, advisers or affiliates gives any assurance that any such projections or estimates will be realised or that actual returns or other results will not be materially lower than those set out in this document and/or discussed at any presentation. All forward looking statements should be viewed as hypothetical. No representation or warranty is made that any forward looking statement will come to pass. No member of the Group or their respective directors, officers, employees, agents, advisers or affiliates undertakes any obligation to update or revise any such forward looking statement following the publication of this document nor accepts any responsibility, liability or duty of care whatsoever for (whether in contract, tort or otherwise) or makes any representation or warranty, express or implied, as to the truth, fullness, fairness, merchantability, accuracy, sufficiency or completeness of, the information in this document.

The information, statements and opinions contained in this document do not constitute or form part of, and should not be construed as, any public offer under any applicable legislation or an offer to sell or solicitation of any offer to buy any securities or financial instruments or any advice or recommendation with respect to such securities or other financial instruments.

Contents

Highlights	4
Business and financial review	6
Risk management	17
Group financial statements	33
Additional Information	89

CYBG PLC Preliminary Results 2018

Consistent execution of the Group's strategy delivered strong underlying financial performance and ahead of market growth in key lending segments; uniquely positioned for growth through the transformational Virgin Money acquisition and RBS alternative remedies package opportunities

Strong underlying financial performance; statutory loss driven by legacy conduct charges

- Underlying profit before tax up 13% year-on-year to £331m; statutory loss after tax of £145m due to legacy PPI costs
- Net interest income up 1% driven by strong volume growth and NIM of 217bps, partly offset by a £16m reduction in non-interest income. Excluding the impact of year on year fair value movements of £9m, of which £7m is non-recurring, non-interest income is down 4% primarily due to the impact of the one-off £6m marketing incentive campaign cost taken in Q1
- Underlying costs down 6% to £635m, ahead of guidance; 4%pts improvement in underlying cost-to-income ratio of 63% with positive 'jaws' of 5% achieved
- Double-digit underlying RoTE of 10.6%
- Recommending payment of an increased ordinary dividend of 3.1p per share, payable to all shareholders

Continued delivery of sustainable customer growth

- Customer deposit growth of 4.2% to £28.9bn; loan growth of 4.1% to £33.3bn
- Above system lending growth; mortgages up 4.5% to £24.5bn and core SME up 5.6% to £7.2bn
- Robust asset quality with net cost of risk of 12bps (FY17: 14bps); Brexit remains key future uncertainty

Significant action taken on legacy conduct issues

- Total PPI provision during 2018 of £352m (net of conduct indemnity) and £44m for other legacy conduct
- While weekly complaint volumes have been falling since the end of July, the Group considers it prudent to take a further £150m increase in provisions for legacy PPI costs to cover the costs associated with a revised estimate of 83,000 future walk-in complaints out to the August 2019 time bar
- The conduct provisions reduced the Group's CET1 ratio by c.182bps; CET1 ratio of 10.5% (pre-IRB)

Significant milestone of IRB accreditation achieved for mortgage and SME portfolios

- Pro forma CET1 ratio of 14.0% at 30-Sep-2018 including c.350bps CET1 impact of IRB accreditation

Unique combination of growth opportunities in place

- Successfully migrated c.2m retail customers to iB platform; 30% growth in mobile app users; and new technology partnerships in retail and SME demonstrate full potential of Open Banking focussed technology strategy
- Significant investment preparing for RBS switching scheme combined with strong competition rationale supporting CYBG's Capability & Innovation Fund application to secure increased investment in SME franchise
- Virgin Money acquisition creates the first true competitor to the status quo in UK banking, with 6 million customers, an iconic brand, national distribution and genuine full-service retail and SME offering
- The Group will update on its strategic and medium-term targets at a Capital Markets Day planned for June 2019

Pro forma capital position and Combined Group guidance for FY2019

- Robust pro forma combined capital position of 15.2% with IFRS3 fair value accounting adjustments still being assessed
- Guidance for FY19 NIM of 160-170bps and underlying costs of <£950m

David Duffy, Chief Executive Officer commented:

"It has been a landmark year for CYBG, continuing to deliver ahead of market growth and meeting our underlying financial targets in a highly competitive market, while also completing the transformational Virgin Money acquisition in October 2018 following overwhelming shareholder support."

"In a competitive market, we have delivered an increase in underlying profits, returns and capital generation – all of which means we are delighted to recommend an increase to last year's inaugural CYBG dividend, payable to all shareholders.

"Clearly Brexit negotiations mean the external political and macro economic environment remains inherently uncertain. We have planned for a period of uncertainty, but it is impossible to ignore the lower levels of business confidence, especially for SMEs, while the final specific outcome of negotiations remains unclear.

"CYBG has a bright future with a unique combination of growth opportunities. We will participate strongly in the RBS alternative remedies schemes, have a stronger competitive edge as the first IRB accredited bank since the financial crisis, can fully leverage our iB platform in the new Open Banking landscape, and, of course, our combination with Virgin Money creates a genuine national competitor to the banking status quo."

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CYBG PLC will be hosting a presentation for analysts and investors covering the preliminary results at the Morgan Stanley Conference Centre, 2nd Floor, 25 Cabot Square, Canary Wharf, London, E14 4QA, starting at 08:30 GMT today (19:30 AEDT). The meeting will be webcast live and available at www.cybg.com/investor-centre/financial-results. Webcast participants will be able to send questions into the meeting. A recording of the webcast and conference call will be made available on the website www.cybg.com/investor-centre/financial-results shortly after the meeting.

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Key performance indicators[1]

The underlying results presented within this report reflect the Group's results prepared on an underlying basis and as presented to the CEO and the Executive Leadership Team and the Board. These exclude certain items that are included in the statutory results, as management believes that these items are not reflective of the underlying business and do not aid meaningful period on period comparison.

	12 months to 30 Sep 2018	12 months to 30 Sep 2017
Profitability:		
Net interest margin (NIM)	2.17%	2.27%
Statutory return on tangible equity (RoTE)	(6.9)%	6.1%
Statutory cost to income ratio (CIR)	112%	69%
Statutory return on assets	(0.34)%	0.45%
Statutory basic (loss)/earnings per share (EPS)	(19.7)p	17.3p
Underlying RoTE	10.6%	7.5%
Underlying CIR	63%	67%
Underlying return on assets	0.70%	0.54%
Underlying basic EPS	30.4p	21.5p

As at:	30 Sep 2018	30 Sep 2017
Asset Quality:		
Impairment charge to average customer loans (cost of risk)	0.12%	0.14%
90+ days past due (DPD) plus impaired assets to customer loans	0.91%	1.06%
Specific provisions to total impaired assets	35.5%	32.6%
Total provision to customer loans	0.61%	0.69%
Indexed loan to value (LTV) of mortgage portfolio[2]	58.8%	57.5%
Regulatory Capital:		
CET1 ratio	10.5%	12.4%
Tier 1 ratio	12.7%	14.7%
Total capital ratio	15.9%	17.9%
CRD IV leverage ratio	5.6%	6.3%
UK leverage ratio	6.5%	7.4%
Tangible net asset value (TNAV) per share	262.3p	295.6p
Funding and Liquidity:		
Loan to deposit ratio (LDR)	115%	115%
Liquidity coverage ratio (LCR)	137%	164%
Net stable funding ratio (NSFR)	119%	118%

(1) For a definition of each of the key performance indicators, refer to 'Measuring financial performance – glossary' on page 89. The key performance indicators include statutory, regulatory and alternative performance measures.
(2) LTV of the mortgage portfolio is defined as mortgage portfolio weighted by balance and indexed using the MIAC Acadametrics indices at a given date.

Chief Executive Officer's review

"2018 has been another transformational year for CYBG, in which we have continued to execute on our strategy and consistently delivered against the targets we have set. Our strong progress since the IPO has put in place the foundations that enabled us to acquire Virgin Money and to deliver on our ambition to create the first true national competitor to the status quo."

I am delighted to report that we have seen another year of significant progress in 2018. Our disciplined approach to executing on our strategic plan and delivering our commitments has translated into both improved financial performance and strong strategic positioning.

The UK economic outlook remains uncertain and while the economy has remained more resilient than expected, economic data through the year has pointed to a slightly weaker environment. In particular, consumer spending has slowed and businesses have been holding back investment. This has reduced demand for lending, although credit conditions remain benign. In the mortgage market, economic uncertainty has reduced customer demand while competition has remained intense, resulting in a challenging pricing environment, with swap rate increases not being fully passed on to customer pricing. There is still significant uncertainty as to the outcome of the UK's negotiations with the EU. However, the Group's outlook and 2019 guidance is based on our planning assumption of a transitional agreement between the UK and EU from March 2019.

Despite some of these uncertainties, our market position as the only full-service UK challenger bank of scale across both Retail and SME enabled us to deliver ahead of market growth in both mortgages and SME, prudently funded by our strong deposit franchise. Our performance in SME means we remain on track to deliver our commitment to provide at least £6bn of lending to SMEs by the end of 2019.

Our 2018 financial results show improved underlying profit and returns, sustainable loan growth and the payment of an increased ordinary dividend of 3.1p per share. Income was down slightly, with continued growth in net interest income more than offset by lower non-interest income. NIM declined 10bps in the year to 2.17% driven by the competitive front book pricing environment in mortgages. Our cost efficiency programme is ahead of plan, with underlying operating costs of £635m, while impairment charges remain low.

While the Group delivered a strong underlying performance, the significant action taken to manage the Group's legacy conduct issues means we have reported a statutory loss after tax of £145m. While the additional PPI provision charge required in 2018 is disappointing, the Group's strong capital position means we have been able to absorb this without any impact on our strategy and future ambitions.

Capital optimisation and, specifically, achieving IRB accreditation, was one of the Group's key strategic targets set out back in 2016. Following another year of hard work across the Group, I am delighted that in October 2018 we received IRB accreditation from the PRA for both our mortgage and SME portfolios. It is a testament to the strength of our risk management approach, delivers a significantly more capital efficient bank and will enable us to compete in a broader range of products in the marketplace.

Our digital transformation also continued at pace, with the significant, multi-year investment made in our technology platforms enabling us to leverage the iB platform to deliver an enhanced digital customer experience. Key achievements include: the migration of our c.2m Retail customers onto our iB platform; beginning our first FinTech partnerships; and being the first challenger bank to offer an Open Banking enabled current account aggregation service.

While our Group NPS score of +10 is not at the level we aspire to, customer experience is very much a top priority for my leadership team. We are therefore encouraged by the strong +34 NPS score for our digital-only brand B.

Looking forward, I believe CYBG is truly differentiated from its UK banking peers through the genuinely unique combination of growth opportunities available to us. These include the ability to grow our SME business through the RBS Alternative Remedies Package schemes, the delivery of an enhanced customer experience by fully leveraging our digital platform in an Open Banking environment and, of course, the recently announced acquisition of Virgin Money. I believe our combination of scale and growth opportunities are unique in the UK marketplace.

The Virgin Money acquisition was clearly a landmark moment for the Group and the combination will create the first true national competitor to the status quo in UK banking in over a decade, offering a genuine alternative for consumers and small businesses. We have already begun a comprehensive strategic planning process for the Group and I would expect us to be in a position to update the market on our strategy and targets at a Capital Markets Day event in June 2019.

I want to thank our Board and colleagues for their support and hard work, and I would also like to extend a very warm welcome to our new colleagues from Virgin Money. Together, we have a once-in-a-generation opportunity to change the competitive dynamic in UK banking and I am sure I speak for everyone when I say that we can't wait to get started!

David Duffy
Chief Executive Officer

Overview of Group results

The Group has consistently delivered against each of its strategic priorities - sustainable customer growth, efficiency and capital optimisation - and is now a year ahead of plan.

The Group delivered an underlying profit before tax of £331m, up £38m (13%). Increased underlying profitability has been the primary driver for the increase in underlying RoTE from 7.5% to 10.6%, and underlying basic EPS from 21.5p to 30.4p.

A statutory loss after tax of £145m has been reported (2017: profit of £182m) primarily due to legacy conduct costs of £396m in the year (2017: £58m).

The section below details the Group's progress through each of its strategic objectives.

Summary balance sheet

as at 30 September	**2018 £m**	2017 £m
Customer loans	**33,281**	31,967
Other financial assets	**9,234**	10,469
Other non-financial assets	**941**	795
Total assets	**43,456**	43,231
Customer deposits	**(28,854)**	(27,679)
Wholesale funding	**(8,095)**	(8,602)
Other liabilities	**(3,321)**	(3,548)
Total liabilities	**(40,270)**	(39,829)
Ordinary shareholders' equity	**(2,736)**	(2,952)
AT1 equity	**(450)**	(450)
Equity	**(3,186)**	(3,402)
Total liabilities and equity	**(43,456)**	(43,231)

Overview of Group results

Summary income statement[1]

for the year ended 30 September	2018 £m	2017 £m
Net interest income	**851**	844
Non-interest income	**156**	172
Total operating income	**1,007**	1,016
Underlying operating and administrative expenses	**(635)**	(675)
Operating profit before impairment losses	**372**	341
Impairment losses on credit exposures[2]	**(41)**	(48)
Underlying profit on ordinary activities before tax	**331**	293
Restructuring and related expense	**(38)**	(67)
Virgin Money acquisition costs	**(37)**	–
RBS alternative remedies package spend	**(16)**	–
Separation costs	**(8)**	(8)
Legacy conduct costs	**(396)**	(58)
Gain on defined benefit pension scheme reforms	**–**	88
Gain on disposal of VocaLink share	**–**	20
Statutory (loss)/profit on ordinary activities before tax	**(164)**	268
Tax credit/(expense)	**19**	(86)
Statutory (loss)/profit attributable to equity holders	**(145)**	182

(1) The summary income statement is presented on a statutory and underlying basis. In addition, the financial key performance indicators (KPIs) used by management in monitoring the Group's performance and reflected throughout this section are determined on a combination of bases (including statutory, regulatory and alternative performance measures), as detailed in the Glossary on page 89. A reconciliation from the underlying to statutory basis is shown on page 15 and management's rationale for the adjustments is shown on page 91.
(2) Impairment losses on credit exposures relate solely to loans and advances to customers (refer to note 3.5 to the financial statements) and exclude 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 note 2.3 to the financial statements).

Outlook for 2019

Political uncertainty related to Brexit continues to cast a shadow over the UK's short term economic prospects. The central case projections published by many economists are based on the assumption of an orderly Brexit and forecast a temporary slowdown in GDP growth while other key economic indicators remain broadly stable. The Group is well prepared for that outcome and has also undertaken contingency planning for alternative scenarios.

Following the acquisition of Virgin Money on 15 October 2018 the Group begins FY2019 strongly capitalised and well funded with a bigger, broader business that is well prepared for the year ahead.

The short term outlook for the Group's key lending markets - UK homeowners and SMEs - is more subdued than in recent years. In addition the UK household savings ratio continues to decline, limiting growth in the supply of deposits. However the Group's proven ability to win market share through superior product offerings and customer service, and to optimise its liability mix across a range of sources of funding means we expect to continue to deliver sustainable growth in customer balances.

We expect to see strong competition for mortgages and deposits in the year ahead that will feed through into margin pressure. However the Group's broad range of lending businesses allied to its diversified funding model will enable us to continue to manage margins effectively. The Net Interest Margin for FY2019 is expected to be between 1.6 and 1.7 per cent, having been rebased following the combination with Virgin Money.

Our strong track record in delivering cost efficiencies will help to underpin the Group's profits and capital generation. We expect the Group's underlying operating expenses to be less than £950m in FY2019, down from an estimated pro forma combined cost base of £985m in FY2018.

The Group expects to update stakeholders on strategy and other matters, including the development of medium term performance targets, at a Capital Markets Day in June 2019.

Financial performance review

1. Sustainable growth in customer lending and deposit balances

	2018 £m	2017 £m
Mortgages	**24,540**	23,480
SME lending[1] – core	**7,202**	6,821
– non-core	**336**	504
Unsecured personal lending	**1,203**	1,162
Gross loans and advances to customers	**33,281**	31,967
Current accounts[2]	**(14,224)**	(13,798)
Variable rate savings accounts[2]	**(8,427)**	(7,880)
Fixed rate term deposits[3]	**(6,202)**	(5,983)
Other wholesale deposits	**(1)**	(18)
Total customer deposits	**(28,854)**	(27,679)

Mortgages

The mortgage book remains the Group's largest asset portfolio and has a significant impact on our overall financial performance. Our continued focus on customers has resulted in growth of 4.5% in the year, higher than system growth[4] of 2.5%. Our market share increased from 1.73% to 1.77%.

The mortgage market in 2018 has been more subdued, with high re-mortgage activity, but lower levels of new lending and the competitive environment has continued to exert pressure on front book pricing. In late 2017, we brought mortgage processing back onshore, as part of our customer journey improvement initiatives. Some servicing and fulfilment delays arose resulting in our broker pipeline build being lower than we had hoped, with mortgage growth slower around the third quarter of the financial year when we felt the impact of lower applications at the start of 2018. These issues are now resolved, with a return to a more normalised level of growth in the final quarter.

We continued to see customers favour fixed rate mortgage products, as they sought to further capitalise on the prevailing low interest rate environment against a backdrop of market sentiment that expects modest short to medium-term interest rate rises. This, combined with our targeted customer retention strategy, has resulted in growth in the fixed rate book to 78% of total mortgage balances (2017: 73%) and accounted for 96% of mortgages drawn in the year (2017: 95%). Longer term fixed rate mortgages are growing more popular with 5 year fixed mortgages now accounting for 27% of the portfolio (2017: 22%).

In line with our expectations, the buy-to-let (BTL) property market has been more subdued following last year's changes in tax relief for landlords, an increase in Stamp Duty and the Prudential Regulation Authority's (PRA) enhanced affordability assessments. This has led to a shift in the mix of our mortgage book with BTL falling from 33% in the prior year to 31% with owner occupied accounting for a higher proportion of drawdowns in the year (79%, up from 70% in the year to 30 September 2017). Reflecting this change in mix, the average LTV of new lending was 70% (30 September 2017: 71%) and the average LTV of the mortgage book increased from 57.5% to 58.8%. Our proportion of residential mortgages 90 days in arrears has remained stable at 0.56% (2017: 0.52%).

SME lending

Our core SME lending portfolio increased by £381m (5.6%) in the year, in line with market guidance and ahead of system growth[5] of 2.1%. Growth has been delivered across term lending, asset finance and invoice finance. We are outperforming the market, despite the subdued demand resulting from Brexit uncertainty, as a result of our strong propositions and sector focus, while maintaining high credit underwriting standards. We are delivering on our pledge to support small and medium sized businesses across the UK as part of our commitment to lend £6bn in the three years to 2019. Lending origination targets have been achieved or exceeded in each of our core regions and this, coupled with lower attrition in the year, has contributed to the overall increase in balances.

The SME portfolio remains well positioned. Underlying asset quality is resilient and stable, reflective of the diversity within the portfolio as a result of controlled risk appetite and an economic environment which continues to support business performance. The impaired asset portfolio has reduced to £83m (2017: £126m) which is at its lowest level for more than 10 years.

In line with our strategy we continued to proactively run down our non-core portfolio, which reduced from £504m to £336m through the managed exit of non-core balances.

(1) Includes financial assets at fair value of £362m (September 2017: £477m).
(2) £150m of current account balances were reclassified as variable rate savings balances in the comparative period.
(3) Includes financial liabilities at fair value of £15m (September 2017: £26m).
(4) System growth is sourced from the BoE 'Mortgages outstanding by type of lender, UK (BOE)' report (MM4).
(5) System growth is sourced from the BoE 'Industrial analysis of monetary financial institutions' lending to UK residents' report (C1,2), and excludes individuals and individual trusts, activities auxiliary to financial intermediation, insurance companies and pension funds, and financial intermediation (excluding insurance and pension funds) results.

Financial performance review

Unsecured personal lending

Unsecured personal lending has grown by 3.5% or £41m in the year to £1,203m. This has been driven largely by a focus on the fixed rate personal loans portfolio which increased by 13% from a low base of £658m to £743m. We have improved our presence on aggregator websites and offered existing customers enhanced accessibility to our products, introducing in-app purchase functionality and allowing customers that are pre-assessed for credit worthiness to secure a loan at the click of a mouse. The fixed rate personal loan market remains highly competitive, resulting in some margin erosion, as market rates have dipped to near historical lows and are yet to respond to the rising rate environment.

Growth in the fixed rate personal loan book was slightly offset by a fall in credit card balances of £15m to £381m (2017: £396m). Variable rate personal loans and overdrafts fell by £32m in the year from £111m to £79m. Variable rate loan balances continue to reduce as, although these products remain on sale, they are not actively promoted or targeted.

Current accounts

Current account funding increased by £426m in the year from £13,798m to £14,224m due principally to continued growth in business current account balances (up £328m) with the Group continuing to see new customer recruitment from the 25-month fee free offer launched in December 2016. An unprecedented number of new personal current accounts were opened following our high profile national personal current account recruitment campaign, which had a market leading customer switching incentive. The B current account was the main beneficiary of the campaign (with balances up £256m) while there was a reduction of £158m in the Current Account Plus and other personal current account products. The new B account openings were in line with our strategy to sustainably grow this portfolio in a way that recruits new customers with whom we have an opportunity to build a long-term relationship.

Variable rate savings accounts

Funding from variable rate savings accounts increased by £547m principally driven by £783m of growth in B savings accounts and £116m in business savings accounts, the latter being driven through targeted relationship management. Partially offsetting this is attrition of £228m in cash ISA balances following continued product simplification and repricing of the portfolio. There has been a change in book mix, with a higher proportion of balances being held in longer term notice products, providing an additional liquidity benefit.

Fixed rate term deposits

Our fixed rate term deposit book increased by £219m to £6,202m as a result of deposit raising initiatives taken primarily in the first quarter of the year, including the successful launch of our second online digital bond along with two further cash ISA fixed rate bonds designed to retain maturing term deposits. As a result of close margin management and deposit initiatives, funding costs have fallen as the number of longer term higher priced products were allowed to mature without replacement.

Funding and liquidity

The Group continues to maintain its strong funding and liquidity position and seeks to achieve an appropriate balance between profitability, liquidity risk and capital optimisation. Reflecting our retail deposit-led funding strategy, our loan to deposit ratio was stable over the year at 115% (2017: 115%).

In addition to retail deposits, we ensure appropriate diversification in our funding base through a number of wholesale funding programmes. In the first half of the year we made further drawings from the BoE Term Funding Scheme (TFS), taking overall drawings at 30 September 2018 to £2.25 billion. We have accessed TFS judiciously – we have not relied on it to fund our growth and our drawings are at a level that can be refinanced comfortably over time. We have also maintained our access to public markets – we successfully completed further issuances of mortgage-backed securities through the Group's Lanark programme across USD and GBP tranches, raising approximately £500m and £550m in January and July respectively. The Group's liquidity surplus continues to comfortably exceed our regulatory minimum and internal risk appetite, with a Liquidity Coverage Ratio (LCR) of 137% as at 30 September 2018 (2017: 164%). Net Stable Funding Ratio (NSFR) was 119% at 30 September 2018 (2017: 118%).

The issue of £500m of senior debt in September provided further funding to the Group and reflects our progression towards meeting the BoE's Minimum Requirement for Own Funds and Eligible Liabilities (MREL) by 2022.

Financial performance review

Net interest income

Average balance sheet	2018			2017		
	Average balance[1] £m	**Interest income/ (expense) £m**	**Average yield/(rate) %**	Average balance[1] £m	Interest income/ (expense) £m	Average yield/(rate) %
Interest-earning assets						
Mortgages	**24,051**	**657**	**2.73**	22,439	652	2.91
SME lending[2]	**7,311**	**288**	**3.94**	7,110	264	3.71
Unsecured personal lending	**1,210**	**101**	**8.35**	1,172	105	8.99
Liquid assets	**6,081**	**34**	**0.57**	6,007	21	0.34
Due from other banks	**764**	**4**	**0.47**	969	2	0.17
Swap income/other	**–**	**29**	**n/a**	–	31	n/a
Total average interest-earning assets	**39,417**	**1,113**	**2.82**	37,697	1,075	2.85
Total average non-interest-earning assets	**2,891**			2,489		
Total average assets	**42,308**			40,186		
Interest-bearing liabilities						
Current accounts	**11,127**	**(11)**	**(0.10)**	11,032	(6)	(0.05)
Savings accounts	**8,136**	**(36)**	**(0.44)**	7,832	(32)	(0.41)
Term deposits	**6,306**	**(102)**	**(1.61)**	5,190	(89)	(1.71)
Wholesale funding	**7,294**	**(113)**	**(1.56)**	6,940	(104)	(1.51)
Total average interest-bearing liabilities	**32,863**	**(262)**	**(0.80)**	30,994	(231)	(0.75)
Total average non-interest-bearing liabilities	**6,070**			5,926		
Total average liabilities	**38,933**			36,920		
Total average equity attributable to ordinary equity holders	**3,375**			3,266		
Total average liabilities and average equity attributable to ordinary equity holders	**42,308**			40,186		
Net interest income		**851**			844	

(1) Average balances are calculated using the daily balances across the year.
(2) Includes loans designated at fair value through profit or loss.

We guided to a reduction in NIM this year as we expected to see the impact of the shift in our mortgage mix towards a higher proportion of lower yielding owner-occupier lending, together with the continuation of competitive mortgage pricing over the last two years, all feeding through into lower average rates across the mortgage book. Group NIM of 2.17% was in line with guidance of c220bps, down from 2.27% since FY2017. Furthermore we continue to see mortgage customers favouring fixed rate deals and this customer preference, alongside proactive early retention programmes in the marketplace, continues to exert pressure on average mortgage margins through competitive fixed rate pricing. Nonetheless, the Group continues to drive net interest income growth through its sustainable balance sheet growth strategy.

Pricing in the unsecured personal lending market remains very competitive and the total average gross yield across the book was 8.4% (2017: 9.0%).

Offsetting the margin pressure in our Retail asset portfolios we saw improved average customer rates in our SME book, benefitting from pricing discipline and a higher interest rate environment. In addition we actively managed our funding volumes and pricing to support NIM.

Non-interest income

Non-interest income reduced by £16m (9%) in the year from £172m to £156m. Net fee and commission income reduced by £5m in the year principally due to a £6m cost for the personal current account incentives campaign which resulted in increased current account volumes, supporting our customer growth strategy. In addition, we saw net fair value losses of £3m in FY2018 compared to net fair value income of £6m in the prior year. The swing of £9m included £2m of hedge ineffectiveness and £7m of other fair value items that are not expected to recur.

Financial performance review

Impairment losses on credit exposures

Impairment losses decreased from £48m to £41m. Net cost of risk was 2bps lower reflecting strong portfolio quality and benign economic conditions. The reduction includes a lower charge taken on our SME exposures primarily as specific provisions were lower than previous years offsetting an increase in the impairment charge for Retail exposures. By contrast we have experienced increased impairment losses for our Retail unsecured portfolios resulting from the combined effect of personal loan portfolio growth, higher default rates on lending originated in earlier years and a lower level of recoveries.

	2018				2017			
	Retail – secured bps	**Retail – unsecured bps**	**SME bps**	**Total bps**	Retail – secured bps	Retail – unsecured bps	SME bps	Total bps
Gross cost of risk	**1**	**281**	**36**	**19**	2	266	70	28
Specific provision releases and recoveries				**(6)**				(12)
Fair value loans				**(1)**				(2)
Net cost of risk				**12**				14

2. Delivering on our efficiency programme

Operating and administrative expenses	**2018 £m**	2017 £m
Personnel expenses	**216**	248
Depreciation and amortisation expenses	**89**	87
Other operating and administrative expenses	**330**	340
Total underlying operating and administrative expenses	**635**	675
Restructuring and related expense	**38**	67
Virgin Money acquisition costs	**37**	–
RBS alternative remedies package spend	**16**	–
Separation costs	**8**	8
Legacy conduct charges	**396**	58
Gain on defined benefit pension scheme reforms	**–**	(88)
Total statutory operating and administrative expenses	**1,130**	720

In 2016, we committed to delivering a net reduction of £100m in underlying operating expenses. In 2018, we completed our Sustain efficiency programme and achieved run rate benefits that exceeded our targets. On an underlying basis, total operating and administrative expenses have fallen by £40m to £635m.

Personnel expenses fell from £248m to £216m, driven by headcount reductions following last year's voluntary severance programme, as well as the closure of the defined benefit pension scheme to future accrual on 1 August 2017. This reduction has been delivered while building an improved reward package across CYBG which has been a key area of focus in 2018. Improvements have included consolidated pay increases, enhanced defined contribution pension provision and the introduction of a flexible benefits account worth up to 5% (capped at £2,500) of salary from 1 January 2018 for all colleagues below Executive Director. In addition, in recognition of the delivery of an unprecedented level of change in FY2017, all eligible colleagues received £500 of free shares in December 2017 at a cost of £3m.

Costs related to the restructuring and streamlining of our business have fallen by £29m to £38m, largely due to a lower volume of restructuring initiatives in the year. Costs have been of a similar nature to the prior year but on a smaller scale as the majority of the Sustain initiatives were undertaken in prior financial years.

Transaction related costs of £37m were recognised in regard to the acquisition of Virgin Money and £16m of costs were incurred relating to preparation for the RBS alternative remedies package.

Financial performance review

Statutory operating and administrative expenses have increased by £410m driven largely by legacy conduct charges. In line with the rest of the industry, the Group has experienced a sustained period of elevated PPI complaints during the year, ahead of the August 2019 industry deadline. In addition to the £350m charge recognised in the first half of FY2018, 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. The Board noted that weekly incoming complaint volumes have been reducing in the second half of FY2018. Notwithstanding this improvement the Board concluded that an additional charge of £150m is required. During the year the Group drew down the full amount of the remaining indemnity cover (£148m) as the increased provision was partially covered under the terms of the conduct indemnity deed entered into with National Australia Bank. The balance of £352m has therefore been recognised as a charge to the income statement. We continue to expect a slowdown in complaint volumes into FY2019 due to the impact of the Financial Guidance and Claims Act that became effective in July which implemented a fee cap and limits to cold-calling for Claims Management Companies. The Group has also recognised additional costs of £44m for other less significant conduct related matters. The Group continues to assess the impact of resolving legacy conduct issues on an ongoing basis.

3. Capital optimisation

	2018 £m	2017 £m
Common equity tier 1 capital	**2,113**	2,437
Additional Tier 1 capital	**450**	450
Tier 2 capital	**626**	627
Total capital	**3,189**	3,514
Risk weighted assets	**20,102**	19,678

	2018 %/bps	2017 %/bps
At 1 October	**12.4%**	12.6%
Generated	**185**	168
Asset growth	**(23)**	(42)
Investment spend	**(85)**	(93)
AT1 distributions	**(14)**	(20)
Underlying capital generation	**63**	13
Non underlying items – conduct	**(182)**	(27)
Non underlying items – Virgin Money transaction costs	**(18)**	-
Non underlying items – restructuring costs	**(16)**	(31)
Other	**(34)**	25
Net capital absorbed	**(187)**	(20)
At 30 September	**10.5%**	12.4%

The Group's fully loaded total capital ratio was 15.9% and the CET1 ratio stood at 10.5% at September 2018. The reduction in the capital ratios related primarily to legacy conduct charges.

Underlying capital generation was 63bps, largely driven by strong underlying profits offset by growth in mortgages and SME lending with risk weighted assets (RWAs) increasing by £424m. Investment spend absorbed 85bps as the Group has invested heavily in our digital proposition to improve the customer experience and drive operational efficiencies.

Formal IRB accreditation for the mortgages and SME portfolios was received in October 2018. The adoption of IRB models is expected to result in a material reduction in the Group’s credit RWAs and a consequential significant increase in the Group’s CET1 ratio of 350bps. The pro forma CET1 ratio on the IRB basis at 30 September 2018 was 14.0%. The pro forma CRD IV Leverage ratio on the IRB basis at 30 September 2018 was 5.5%.

On 15 October 2018, the Group completed the acquisition of Virgin Money. Following the combination, the CET1 ratio is expected to be c.15.2% prior to the impact of the IFRS 3 accounting adjustments.

Financial performance review

Reconciliation of statutory to underlying results

The underlying results presented within this Financial performance review reflect the Group's results prepared on an underlying basis and as presented to the CEO and his Leadership Team and the Board. These exclude certain items that are included in the statutory results, as management believes that these items are not reflective of the underlying business and do not aid meaningful year-on-year comparison. The table below reconciles the statutory results to the underlying basis, and full details on the adjusted items are included in the Glossary on page 91.

2018 income statement

	Statutory results £m	Legacy conduct costs £m	Business restructuring £m	RBS alternative remedies package spend £m	Virgin Money transaction costs £m	Separation costs £m	Underlying basis £m
Net interest income	**851**	–	–	–	–	–	**851**
Non-interest income	**156**	–	–	–	–	–	**156**
Total operating income	**1,007**	–	–	–	–	–	**1,007**
Total operating and administrative expenses before impairment losses	**(1,130)**	**396**	**38**	**16**	**37**	**8**	**(635)**
Operating (loss)/profit before impairment losses	**(123)**	**396**	**38**	**16**	**37**	**8**	**372**
Impairment losses on credit exposures(1)	**(41)**	–	–	–	–	–	**(41)**
(Loss)/profit on ordinary activities before tax	**(164)**	**396**	**38**	**16**	**37**	**8**	**331**
Tax credit/(expense)	**19**	**(40)**	**(6)**	**(3)**	**(1)**	**(2)**	**(33)**
(Loss)/profit attributable to equity holders	**(145)**	**356**	**32**	**13**	**36**	**6**	**298**
Financial performance measures							
CIR	**112%**	**(38)%**	**(4)%**	**(2)%**	**(4)%**	**(1)%**	**63%**
RoTE	**(6.9)%**	**14.0%**	**1.3%**	**0.5%**	**1.4%**	**0.3%**	**10.6%**
Basic EPS	**(19.7)p**	**40.3p**	**3.6p**	**1.4p**	**4.1p**	**0.7p**	**30.4p**
Return on assets	**(0.34)%**	**0.83%**	**0.07%**	**0.03%**	**0.09%**	**0.02%**	**0.70%**

(1) Impairment losses on credit exposures relate solely to loans and advances to customers (refer to note 3.6 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 note 2.3 to the financial statements).

Underlying profit after tax attributable to ordinary equity holders is equal to the underlying profit attributable to equity holders less dividends and distributions (net of tax relief) of £29m (2017: £29m) and amounted to £269m (2017: £191m).

Financial performance review

2017 income statement

	Statutory results £m	Legacy conduct costs £m	Business restructuring £m	Separation costs £m	Pension scheme reforms £m	AFS investment disposal £m	Underlying basis £m
Net interest income	844	–	–	–	–	–	844
Non-interest income	192	–	–	–	–	(20)	172
Total operating income	1,036	–	–	–	–	(20)	1,016
Total operating and administrative expenses before impairment losses	(720)	58	67	8	(88)	–	(675)
Operating profit before impairment losses	316	58	67	8	(88)	(20)	341
Impairment losses on credit exposures[(1)]	(48)	–	–	–	–	–	(48)
Profit on ordinary activities before tax	268	58	67	8	(88)	(20)	293
Tax expense	(86)	(5)	(9)	(2)	31	(2)	(73)
Profit attributable to equity holders	182	53	58	6	(57)	(22)	220
Financial performance measures							
CIR	69%	(5)%	(6)%	(1)%	8%	2%	67%
RoTE	6.1%	2.1%	2.1%	0.2%	(2.1)%	(0.9)%	7.5%
Basic EPS	17.3p	5.9p	6.6p	0.7p	(6.5)p	(2.5)p	21.5p
Return on assets	0.45%	0.14%	0.16%	0.01%	(0.16)%	(0.06)%	0.54%

(1) Impairment losses on credit exposures relate solely to loans and advances to customers (refer to note 3.6 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 note 2.3 to the financial statements).

Risk overview

The approach to and management of risk is defined in the Group's Risk Management Framework. Integral to the framework is the identification of principal risks, the process by which the Group sets its risk appetite and the nature and extent of risk it is willing to assume in order to achieve its strategic objectives. The framework identifies eight principal risks: credit risk; balance sheet and prudential regulation risk; regulatory and compliance risk; conduct risk; operational risk (including resilience and information security); financial crime risk; strategic, business and financial performance risk; and people risk. Further detail on these risks and how they are managed is available in the 2018 annual report and accounts.

Mapped to the principal risk categories, the Group maintains a top risks register, capturing the specific risks with potential to impact the Group's short and medium term outlook. The top risks are appropriately categorised with owners, required actions and mitigation plans in place. The top risks currently being monitored include, but are not limited to, geopolitical uncertainty including Brexit risk; competition; consumer credit; cyber-security, IT and financial crime; regulatory change; the risks arising from the acquisition of Virgin Money; the continued risk of customer detriment; service interruption and third party supplier risk. Top risks are reviewed regularly by both Executive and Board Risk Committee.

Credit risk

Credit risk is the risk that a borrower or counterparty fails to pay the interest or capital due on a loan or other financial instrument.

Credit risk manifests itself in the financial instruments and/or products that the Group offers, and those in which the Group invests (including, among others, loans, guarantees, credit-related commitments, letters of credit, acceptances, inter-bank transactions, swaps and bonds). Credit risk can be found both on- and off-balance sheet.

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[1]	**2018 £m**	2017 £m
Property – mortgage	**24,540**	23,480
Agriculture, forestry, fishing and mining	**1,676**	1,743
Instalment loans to individuals and other personal lending (including credit cards)	**1,239**	1,165
Manufacturing	**853**	724
Wholesale and Retail	**779**	778
Property – construction	**246**	212
Financial, investment and insurance	**116**	90
Government and public authorities	**41**	32
Other commercial and industrial	**3,791**	3,743
	33,281	31,967

Contingent liabilities and credit-related commitments	**2018 £m**	2017 £m
Property – mortgage	**1,937**	2,305
Agriculture, forestry, fishing and mining	**294**	375
Instalment loans to individuals and other personal lending (including credit cards)	**1,800**	1,945
Manufacturing	**587**	588
Wholesale and Retail	**477**	606
Property – construction	**–**	154
Financial, investment and insurance	**84**	290
Government and public authorities	**276**	426
Other commercial and industrial	**1,680**	1,830
	7,135	8,519

(1) Includes balances due from customers on acceptances and excludes accrued interest.

Credit risk

An assessment of the credit quality of loans and advances to customers is shown below:

Distribution of loans and advances to customers by credit quality

As at 30 September 2018	Retail overdrafts £m	Credit cards £m	Other retail lending £m	Mortgages £m	Lease finance £m	SME lending[1] £m	Total £m
Gross loans and advances:							
Neither past due nor impaired	**48**	**365**	**749**	**24,131**	**636**	**6,301**	**32,230**
Past due but not impaired	**7**	**16**	**18**	**370**	**23**	**130**	**564**
Impaired	**–**	**–**	**–**	**39**	**1**	**83**	**123**
	55	**381**	**767**	**24,540**	**660**	**6,514**	**32,917**

As at 30 September 2017	Retail overdrafts £m	Credit cards £m	Other retail lending £m	Mortgages £m	Lease finance £m	SME lending[1] £m	Total £m
Gross loans and advances:							
Neither past due nor impaired	51	384	635	23,104	572	6,054	30,800
Past due but not impaired	7	12	16	327	22	129	513
Impaired	–	–	–	49	–	126	175
	58	396	651	23,480	594	6,309	31,488

(1) SME lending includes business overdrafts.

Credit risk categorisation	Description
Neither past due nor impaired	Loans that are not in arrears and where there is no objective evidence of impairment.
Past due but not impaired	Loans that are in arrears but have not been individually assessed as impaired.
Impaired	Loans which have been individually assessed for impairment as there is objective evidence of impairment, including changes in customer circumstances.

Credit risk

Loans and advances which were past due but not impaired

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

2018	**Retail overdrafts £m**	**Credit cards £m**	**Other retail lending £m**	**Mortgages £m**	**Lease finance £m**	**SME lending[1] £m**	**Total £m**
1 to 29 DPD	**6**	**8**	**7**	**174**	**23**	**77**	**295**
30 to 59 DPD	**–**	**2**	**4**	**40**	**–**	**15**	**61**
60 to 89 DPD	**–**	**2**	**2**	**18**	**–**	**8**	**30**
Past due 90 days and over	**1**	**4**	**5**	**138**	**–**	**30**	**178**
	7	**16**	**18**	**370**	**23**	**130**	**564**
2017	Retail overdrafts £m	Credit cards £m	Other retail lending £m	Mortgages £m	Lease finance £m	SME lending[1] £m	Total £m
1 to 29 DPD	5	6	6	142	22	88	269
30 to 59 DPD	1	2	3	32	–	10	48
60 to 89 DPD	–	1	2	30	–	2	35
Past due 90 days and over	1	3	5	123	–	29	161
	7	12	16	327	22	129	513

Movement in impairment provisions throughout the year

2018	**Retail overdrafts £m**	**Credit cards £m**	**Other retail lending £m**	**Mortgages £m**	**Lease finance £m**	**SME lending[1] £m**	**Total £m**
Opening balance	**4**	**7**	**12**	**33**	**2**	**152**	**210**
Charge for the year	**3**	**8**	**14**	**1**	**–**	**15**	**41**
Amounts written off	**(4)**	**(10)**	**(16)**	**(2)**	**–**	**(36)**	**(68)**
Recoveries of amounts written off in previous years	**2**	**3**	**4**	**–**	**–**	**4**	**13**
Other[2]	**–**	**–**	**–**	**–**	**–**	**(1)**	**(1)**
Closing balance	**5**	**8**	**14**	**32**	**2**	**134**	**195**
Specific	**–**	**–**	**–**	**12**	**–**	**31**	**43**
Collective	**5**	**8**	**14**	**20**	**2**	**103**	**152**
	5	**8**	**14**	**32**	**2**	**134**	**195**
2017	Retail overdrafts £m	Credit cards £m	Other retail lending £m	Mortgages £m	Lease finance £m	SME lending[1] £m	Total £m
Opening balance	3	6	10	39	2	155	215
Charge for the year	2	6	9	(2)	–	33	48
Amounts written off	(4)	(9)	(13)	(4)	–	(45)	(75)
Recoveries of amounts written off in previous years	3	4	6	–	–	5	18
Other[2]	–	–	-	–	–	4	4
Closing balance	4	7	12	33	2	152	210
Specific	–	–	–	13	–	43	56
Collective	4	7	12	20	2	109	154
	4	7	12	33	2	152	210

(1) SME lending includes business overdrafts.
(2) Other includes the recognition of certain impaired loans which were previously recorded at fair value through profit or loss, the unwind of net present value elements of specific provisions and other minor movements.

Retail lending

The LTV 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 LTV analysis of the Group's Retail mortgage stock.

LTV[1]	2018 %	2017 %
Less than 50%	**31**	33
50% to 75%	**51**	49
76% to 80%	**6**	7
81% to 85%	**5**	4
86% to 90%	**4**	4
91% to 95%	**2**	1
96% to 100%	**–**	–
Greater than 100%	**–**	–
Unknown	**1**	2
	100	100

(1) LTV of the mortgage portfolio is defined as mortgage portfolio weighted by balance and indexed using the MIAC Acadametrics indices at a given date. Unknown represents loans where data is not currently available due to front book data matching still to be completed and a de minimis amount due to weaknesses in historic data capture processes.

Retail forbearance
The tables below summarise the level of forbearance in respect of the Group's mortgage portfolio at 30 September:

As at 30 September 2018	Total Retail loans and advances subject to forbearance measures			Impairment allowance on Retail loans and advances subject to forbearance measures	
	Number of loans	Gross carrying amount £m	% of total portfolio	Impairment allowance £m	Coverage %
Formal arrangements	**1,497**	**168**	**0.68**	**3.3**	**2.00**
Temporary arrangements	**1,275**	**161**	**0.66**	**2.3**	**1.45**
Interest-only conversion	**231**	**32**	**0.13**	**0.1**	**0.18**
Term extension	**150**	**12**	**0.05**	**0.1**	**0.48**
Other	**41**	**4**	**0.02**	**–**	**0.36**
Legal	**148**	**15**	**0.06**	**0.5**	**3.34**
	3,342	**392**	**1.60**	**6.3**	**1.61**

As at 30 September 2017	Total Retail loans and advances subject to forbearance measures			Impairment allowance on Retail loans and advances subject to forbearance measures	
	Number of loans	Gross carrying amount £m	% of total portfolio	Impairment allowance £m	Coverage %
Formal arrangements	1,614	164	0.69	3.9	2.43
Temporary arrangements	1,418	174	0.74	3.0	1.72
Interest-only conversion	202	30	0.13	0.2	0.56
Term extension	149	12	0.05	0.1	0.51
Other	29	2	0.01	–	0.61
Legal	167	16	0.07	0.9	5.66
	3,579	398	1.69	8.1	2.04

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 proactively 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 2018, the Group had 117 (2017: 97) customers with interest-only mortgages not subject to forbearance and which were post six-month maturity with a total value of £19m (2017: £14m).

A further forbearance reserve of £4m (2017: £4m) 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 £10.3m (2017: £12.1m) and to increase overall coverage to 2.63% (2017: 3.05%). 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 2018, there were 38 repossessions of which 16 were voluntary (2017: 50 including 13 voluntary).

Retail forbearance – unsecured consumer credit
The Group currently exercises limited forbearance strategies in relation to other types of consumer credit, including current accounts, unsecured loans and credit cards. The Group has assessed the total loan balances subject to forbearance on other types of consumer credit to be £12m at 30 September 2018 (2017: £11m), representing 1.02% of the unsecured Retail portfolio (2017: 1.02%).

Impairment provisions on forborne balances totalled £4.2m at 30 September 2018 (2017: £3.1m), providing overall coverage of 34.36% (2017: 27.18%).

SME lending

Credit quality of loans and advances

For SME lending, the Group has an internally developed credit rating system, as defined under the Group's credit risk management policy, which 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 PD for each customer and can be broadly mapped to external agencies' rating scales. Impaired assets consist of SME lending and secured Retail lending where current circumstances indicate that losses of loan principal and/or interest may be incurred.

Description	eCRS[1]	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

(1) eCRS – electronic Customer Rating System.

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 ratings policy.

The table below represents the credit quality of SME loans and advances that are neither past due nor impaired:

As at 30 September	**2018 £m**	2017 £m
Senior investment grade	**839**	946
Investment grade	**1,731**	1,807
Sub-investment grade	**4,367**	3,873
	6,937	6,626

SME forbearance

The tables below summarise the total number of arrangements in place and the loan balances and impairment provisions associated with those arrangements.

As at 30 September 2018	**Total SME loans and advances subject to forbearance measures**			**Impairment allowance on SME loans and advances subject to forbearance measures**	
	Number of loans	**Gross carrying amount £m**	**% of total portfolio**	**Impairment allowance £m**	**Coverage %**
Term extension	**179**	**162**	**2.15**	**10.5**	**6.48**
Deferral of contracted capital repayments	**103**	**129**	**1.73**	**15.6**	**12.02**
Reduction in contracted interest rate	**2**	**1**	**0.01**	**–**	**4.05**
Alternative forms of payment	**4**	**25**	**0.33**	**7.5**	**30.46**
Debt forgiveness	**4**	**11**	**0.14**	**0.6**	**5.64**
Refinancing	**17**	**10**	**0.13**	**1.0**	**9.87**
Covenant breach/reset/waiver	**61**	**207**	**2.75**	**9.2**	**4.43**
	370	**545**	**7.24**	**44.4**	**8.14**

As at 30 September 2017	Total SME loans and advances subject to forbearance measures			Impairment allowance on SME loans and advances subject to forbearance measures	
	Number of loans	Gross carrying amount £m	% of total portfolio	Impairment allowance £m	Coverage %
Term extension	206	190	2.58	12.8	6.71
Deferral of contracted capital repayments	109	141	1.91	20.4	14.47
Reduction in contracted interest rate	3	1	0.02	–	3.37
Alternative forms of payment	5	28	0.37	8.1	29.40
Debt forgiveness	3	11	0.15	1.4	12.70
Refinancing	19	33	0.44	4.4	13.41
Covenant breach/reset/waiver	50	155	2.11	8.1	5.24
	395	559	7.58	55.2	9.88

Included in other financial assets at fair value is a portfolio of loans that is included in the above table. The value of fair value loans subject to forbearance at 30 September 2018 is £15m (2017: £45m), representing 0.19% of the total SME portfolio (2017: 0.61%). Impairment allowances on these amounts totalled £2m (2017: £4m), a coverage of 11.66% (2017: 8.89%).

Balance sheet and prudential regulation risks

Balance sheet risks in the financial services industry are highly regulated with ongoing changes in the regulatory environment expected to influence the risks and their management. The key risks include capital, liquidity and funding risks, market risk which in the case of the Group is non-traded market risk (incorporating interest rate and foreign exchange risks), pension risk and non-traded equity risk.

Capital

Capital is held by the Group to protect its depositors, to cover inherent risks in a normal and stressed operating environment and to support the Group's strategy of sustainable growth. Capital risk is the risk that the Group has insufficient quantity or quality of capital to support its operations.

Regulatory capital(1)

CET1 capital	**2018 £m**	2017 £m
Capital instruments	**89**	88
Retained earnings and other reserves	**2,637**	2,854
Regulatory adjustments and deductions		
Defined benefit pension fund assets(2)	**(138)**	(135)
Prudent valuation adjustment(3)	**(3)**	(4)
Intangible assets(4)	**(412)**	(339)
Deferred tax asset relying on future profitability(5)	**(99)**	(28)
Cash flow hedge reserve	**39**	1
	2,113	2,437
Tier 1 capital		
Additional Tier 1 (AT1) capital instruments	**450**	450
Total Tier 1 capital	**2,563**	2,887
Tier 2 capital		
Subordinated debt	**474**	473
Credit risk adjustments	**152**	154
Total Tier 2 capital	**626**	627
Total capital	**3,189**	3,514

(1) This table shows the capital position on a CRD IV 'fully loaded' basis.
(2) The defined benefit pension fund asset (net of deferred tax liabilities) does not qualify as capital for regulatory purposes.
(3) A prudent valuation adjustment is applied in respect of fair-valued instruments as required under regulatory capital rules.
(4) Intangible assets shall be deducted from capital for regulatory purposes.
(5) Under CRD IV, deferred tax assets that rely on future profitability are deducted from CET1 capital.

Reconciliation of statutory total equity to regulatory capital	**2018 £m**	2017 £m
Statutory total equity	**3,186**	3,402
Deductions from capital	**(553)**	(478)
Deferred tax asset relying on future profitability	**(99)**	(28)
Cash flow hedge reserve	**39**	1
Foreseeable AT1 dividends and charges	**(10)**	(10)
Regulatory Tier 1 capital	**2,563**	2,887

Balance sheet and prudential regulation risks

Regulatory capital flow of funds[1]	2018 £m	2017 £m
CET1 capital		
CET1 capital at 1 October	**2,437**	2,397
Share capital: issued under employee share scheme	**1**	–
Retained earnings and other reserves (including structured entities)	**(217)**	181
Prudent valuation adjustment	**1**	3
Intangible assets	**(73)**	(83)
Deferred tax asset relying on future profitability	**(71)**	7
Defined benefit pension fund assets	**(3)**	(135)
Cash flow hedge reserve	**38**	67
CET1 capital at 30 September	**2,113**	2,437
Tier 1 capital		
Tier 1 capital at 1 October	**450**	450
Tier 1 capital at 30 September	**450**	450
Total Tier 1 capital	**2,563**	2,887
Tier 2 capital		
Tier 2 capital at 1 October	**627**	625
Credit risk adjustments	**(2)**	3
Other movements	**1**	(1)
Tier 2 capital at 30 September	**626**	627
Total capital	**3,189**	3,514

Minimum Pillar 1 capital requirements	2018 £m	2017 £m
Credit risk	**1,449**	1,420
Operational risk	**132**	130
Counterparty risk	**10**	11
Credit valuation adjustment	**17**	13
Tier 1 regulatory capital requirements	**1,608**	1,574

(1) This table shows the capital position on a CRD IV 'fully loaded' basis.

Balance sheet and prudential regulation risks

RWA movements

RWA flow statement	2018 £m	2017 £m
RWAs at 1 October	**19,678**	19,029
Book size growth	**420**	529
Book quality deterioration/ (improvement)[1]	**4**	(28)
Methodology and policy	**–**	148
RWAs at 30 September	**20,102**	19,678

(1) The marginal deterioration in book quality in 2018 is primarily due to the continued diversification in the Liquid Asset Buffer.

Pillar 1 RWAs and capital requirements by business line

	At 30 September 2018			At 30 September 2017		
Capital requirements for calculating RWAs	**Capital required £m**	**RWA £m**	**Exposure £m**	Capital required £m	RWA £m	Exposure (restated) £m
Central governments or central banks	**–**	**1**	**11,361**	–	–	12,947
Regional governments or local authorities	**1**	**12**	**143**	2	19	156
Public sector entities	**–**	**2**	**155**	–	5	155
Multilateral development banks	**–**	**–**	**155**	–	–	205
Financial institutions	**11**	**136**	**630**	13	163	1,453
Corporates	**316**	**3,956**	**4,311**	273	3,418	3,791
Retail	**90**	**1,124**	**1,499**	72	905	1,207
Secured by mortgages on immovable property	**938**	**11,708**	**28,423**	961	12,001	28,203
Exposures in default	**45**	**562**	**465**	47	590	483
Collective investments undertakings	**–**	**1**	**1**	–	1	1
Equity exposures	**–**	**5**	**4**	–	5	3
Items associated with particularly high risk	**4**	**49**	**33**	3	40	26
Covered bonds	**5**	**61**	**615**	4	48	477
Other items	**39**	**487**	**715**	45	557	585
Total credit risk	**1,449**	**18,104**	**48,510**	1,420	17,752	49,692
Operational risk	**132**	**1,655**		130	1,621	
Counterparty risk	**10**	**125**		11	138	
Credit valuation adjustment	**17**	**218**		13	167	
	1,608	**20,102**		1,574	19,678	

The Exposure amounts disclosed above are post credit conversion factors and pre credit mitigation.

Balance sheet and prudential regulation risks

Capital position and CET1	2018 £m	2017 £m
RWA[(1)]		
Retail mortgages	**9,002**	8,646
Business lending	**7,407**	7,359
Other retail lending	**981**	932
Other lending	**109**	148
Other[(2)]	**605**	667
Credit risk	**18,104**	17,752
Credit valuation adjustment	**218**	167
Operational risk	**1,655**	1,621
Counterparty risk	**125**	138
Total RWAs	**20,102**	19,678
Capital ratios		
CET1 ratio[(3)]	**10.5%**	12.4%
Tier 1 ratio	**12.7%**	14.7%
Total capital ratio	**15.9%**	17.9%

(1) RWAs are calculated under the standardised approach.
(2) The items included in the Other exposure class that attract a capital charge include items in the course of collection, cash in hand, fixed assets and deferred tax assets that are not deducted.
(3) CET1 capital is comprised of shares issued and related share premium, retained earnings and other reserves less specified regulatory adjustments.

The Group measures the amount of capital it requires and holds by applying the Capital Requirements Directive and Regulation (CRD IV) as implemented in the UK by the Prudential Regulation Authority (PRA) and supplemented through additional regulation under the PRA Rulebook. The table below summarises the amount of capital in relation to RWAs the Group is currently required to hold, excluding any PRA Buffer. These ratios apply at the consolidated Group level.

	As at 30 Sep 2018	
Minimum requirements	**CET1**	**Total Capital**
Pillar 1[(1)]	4.5%	8.0%
Pillar 2A[(2)]	2.5%	4.5%
Individual capital guidance	**7.0%**	**12.5%**
Capital conservation buffer[(3)]	1.9%	1.9%
UK countercyclical capital buffer[(4)]	0.5%	0.5%
Total (excluding PRA buffer)[(5)]	**9.4%**	**14.9%**

(1) The minimum amount of total capital under Pillar 1 of the regulatory framework is determined as 8% of RWAs, of which at least 4.5% of RWAs is required to be covered by CET1 capital.
(2) Growth in RWAs at CYBG PLC has meant that at 30 September 2018 the Group's Pillar 2A total capital requirement, as set by the PRA's Individual Capital Guidance (ICG), has reduced from 4.6% to 4.5%. At least 56.25% of this needs to be met with CET1, equating to approximately 2.5% of RWAs.
(3) The capital conservation buffer (CCB) is being phased in over the period from 1 January 2016 to 1 January 2019. The CCB has been set at 2.5% of RWAs, with 1.875% applicable for 2018.
(4) The UK countercyclical capital buffer (CCyB) may be set between 0% and 2.5%. On 27 June 2018 the UK CCyB increased from 0% to 0.5% and the Financial Policy Committee (FPC) reaffirmed that it expects to increase the UK CCyB from 0.5% to 1% from 28 November 2018. The FPC will conduct a comprehensive assessment of the resilience of the UK banking system in the 2018 stress test and review the adequacy of the 1.0% CCyB rate.
(5) The Group may be subject to a PRA buffer as set by the PRA but is not permitted to disclose the level of any buffer. A PRA buffer can consist of two components:
   – A risk management and governance buffer that is set as a scalar of the Pillar 1 and Pillar 2A requirements.
   – A buffer relating to the results of the BoE stress tests.

Underlying capital generation post AT1 distribution was 63bps (before the net impact of charges associated with the acquisition of Virgin Money, restructuring, separation from our former parent and legacy conduct issues). While the Group's CET1 ratio of 10.5% is below our guidance range of 12-13%, we continue to maintain a significant buffer to our transitional CRD IV minimum requirement of 9.4%, being a buffer of £221 million.

The Basel Committee published their final Basel III framework in December 2017. A key objective of the revisions is to reduce excessive variability of current RWAs and improve the comparability of banks' capital ratios. Implementation dates range from 2022 to 2027 and the Committee has introduced transitional arrangements to ensure an orderly and timely implementation. The Group's initial analysis suggests that the new requirements will not have a material impact on the total amount of capital it is required to hold.

Balance sheet and prudential regulation risks

Pro forma IRB RWAs and Capital ratios

As announced on 11 October 2018, the Group has received IRB accreditation for both its Mortgage and SME/Corporate portfolios.

The Group's estimated IRB RWAs and capital ratios, as at 30 September 2018, are as follows:

Capital position and CET1	2018 £m
RWA	
Retail mortgages	**4,460**
Business lending	**6,598**
Other retail lending	**981**
Other lending	**109**
Other	**609**
Credit risk	**12,757**
Credit valuation adjustment	**218**
Operational risk	**1,655**
Counterparty risk	**125**
Total RWAs	**14,755**
Capital ratios	
CET1 ratio	**14.0%**
Tier 1 ratio	**17.1%**
Total capital ratio	**21.3%**

The Group's credit RWAs on an IRB basis would have been c.£4.5 billion lower in the Mortgage portfolio and c.£0.8 billion lower in the SME/Corporate portfolio. These reductions would have resulted in a pro forma increase in CYBG's Common Equity Tier 1 ratio of approximately 350 basis points to c. 14.0% as at 30 September 2018.

Balance sheet and prudential regulation risks

Leverage

Leverage ratio	2018 £m	2017 £m
Total Tier 1 capital for the leverage ratio		
Total CET1 capital	**2,113**	2,437
AT1 capital	**450**	450
Total Tier 1	**2,563**	2,887
Exposures for the leverage ratio		
Total assets as per published financial statements	**43,456**	43,231
Adjustment for off-balance sheet items	**1,763**	2,019
Adjustment for derivative financial instruments	**(134)**	(228)
Adjustment for securities financing transactions (SFTs)	**1,468**	1,461
Other adjustments	**(613)**	(505)
Leverage ratio exposure	**45,940**	45,978
CRD IV Leverage ratio	**5.6%**	6.3%
UK leverage ratio(1)	**6.5%**	7.4%

(1) The Group's leverage ratio on a UK basis, excluding qualifying central bank claims from the exposure measure in accordance with the policy statement issued by the PRA in October 2017. The Group is currently excluded from the full reporting requirements of the UK leverage ratio framework.

The leverage ratio is monitored against a Board set RAS with the responsibility for managing the ratio delegated to ALCO, which monitors it on a monthly basis.

Impact of acquisition of Virgin Money

Following the successful completion of the acquisition of Virgin Money, the estimated Combined Group's new Total Capital Requirement, including the estimated impact of IRB accreditation at CYBG PLC as described above, was set by the PRA as follows (excluding any PRA buffer):

Minimum requirements (1)	CET1	Total Capital
Pillar 1	4.5%	8.0%
Pillar 2A	3.6%	6.4%
Total capital requirement	**8.1%**	**14.4%**
Capital conservation buffer	1.9%	1.9%
UK countercyclical capital buffer	0.5%	0.5%
Total (excluding PRA buffer)	**10.5%**	**16.8%**

(1) Estimated Combined Group capital ratios have been calculated by adding the Risk Weighted Assets of CYBG PLC and Virgin Money at 30 September 2018 and applying the PRA's requirements which applied from 15 October 2018.

The increase in the percentage Pillar 2A requirement incorporates the reduction in RWAs as a result of IRB accreditation at CYBG PLC as described above. Furthermore, this component also reflects perceived risks relating to the integration of the two businesses. The Group expects that this will no longer be required once integration is complete. For comparison, the Pillar 2A Total Capital requirements for CB Solo Consolidated and Virgin Money are not impacted by this risk and were 5.7% and 5.4% respectively (on a post IRB basis).

Balance sheet and prudential regulation risks

The estimated Combined Group's capital ratios, including the estimated impact of IRB accreditation at CYBG PLC, as described above, at 30 September were well in excess of the CRD IV requirements as follows:

Capital Ratio	Estimated Combined Group
CET1	15.2%
Total Capital	21.6%
Leverage Ratio	4.7%

The Bank of England has not yet advised the Combined Group's Final Minimum Requirement for Own Funds and Eligible Liabilities (MREL). The Group continues to expect that from 1 January 2020 until 31 December 2021 the Group will be required to hold 18% of risk-weighted assets in the form of MREL. From 1 January 2022, the Group will be subject to an end state MREL of two times Pillar 1 and Pillar 2A capital.

Funding and liquidity risk

Funding risk relates to the impact on the Group's strategy of being unable to raise funds from customers and the wholesale markets of sufficient quantity and of appropriate mix and tenor. An inability to raise sufficient funds may lead to a reduction in lending growth or a requirement to raise the price paid for deposits, both outcomes having an adverse effect on shareholder value. Where funding risk manifests itself in an adverse effect on mix and tenor, for example, a high proportion of short-term wholesale deposits, there is an increased liquidity risk to the Group.

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.

Balance sheet and prudential regulation risks

External credit ratings

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

	Outlook as at	As at	
	30 Sep 2018[(1)]	30 Sep 2018	30 Sep 2017
CYBG PLC			
Fitch	Stable	BBB+	BBB+
Standard & Poor's	Stable	BBB-	BBB-
Clydesdale Bank PLC			
Fitch	Stable	BBB+	BBB+
Standard & Poor's	Stable	BBB+	BBB+
Moody's[(2)]	On Review	Baa1	Baa2

(1) For detailed background on the latest credit opinions, by S&P and Fitch, please refer to the respective rating agency websites.
(2) Long-term deposit rating.

On 7 December 2017, Moody's upgraded the long-term deposit rating of Clydesdale Bank PLC by one notch to Baa1. This reflected Moody's view on the improvement in the Bank's management and risk and compliance frameworks, together with the delivery of the strategic plan and return to profitability. As part of the same rating action, Moody's revised the outlook on Clydesdale Bank PLC's long-term deposit rating to "positive" in anticipation of ongoing senior unsecured issuance from CYBG PLC to meet MREL.

In November 2017, S&P revised their view of UK economic risk for the UK banking sector, which led to the outlooks for Clydesdale Bank PLC and CYBG PLC being revised from negative to stable. On 23 March 2018, S&P affirmed the ratings of Clydesdale Bank PLC and CYBG PLC with a stable outlook.

In June 2018, following the announcement of the Group's offer for Virgin Money, all three rating agencies released updates relating to the Group Baseline Credit Assessment. S&P and Fitch affirmed the Group's rating and outlook whilst Moody's placed Clydesdale Bank PLC's Adjusted Baseline Credit Assessment of Baa2, on review for upgrade, and its long-term Deposit Rating of Baa1, on review for downgrade. At the same time, Moody's placed Virgin Money's Baa2 long-term local-currency deposit ratings and Baa2 long-term issuer ratings on review for upgrade, as well as its Baa2 Baseline Credit Assessment and adjusted Baseline Credit Assessment.

Moody's noted that "The review for upgrade on both banks' Baseline Credit Assessments is driven by (i) the substantial potential for cost savings; (ii) the two banks' complementary business mixes, providing new revenue opportunities; and (iii) Moody's expectations that the combined entity will retain a strong capital position and stable funding profile."

As at 20 November 2018, there have been no changes to the enlarged Group's long term credit ratings or outlooks since the report date.

Liquid assets

The quantity and quality of the Group's liquid assets are calibrated to the Board's view of liquidity risk appetite and remain at a prudent level above regulatory requirements. The Group was compliant with all internal and regulatory liquidity metrics at 30 September 2018.

The liquid asset portfolio provides a buffer against sudden and potentially sharp outflows of funds and liquid assets must therefore be of a high quality so they can be realised for cash and cannot be encumbered for any other purpose (e.g. to provide collateral for payments systems). Details on encumbered assets are provided in the following section.

The liquid asset portfolio is primarily comprised of cash at the BoE, UK Government Securities (Gilts) and listed securities (e.g. bonds issued by supra-nationals and AAA rated covered bonds).

Liquid asset portfolio	**2018 £m**	2017 £m
Cash and balances with central banks	**3,942**	4,367
UK government treasury bills and gilts	**513**	1,129
Other debt securities	**943**	829
Total	**5,398**	6,325

The volume of Gilts held by the Bank reduced over 2018 as shorter dated securities were sold or matured. Before investing in any security an assessment is completed for both the credit quality and the treatment for liquidity purposes. ALCO oversees the composition of the liquid asset portfolio.

Balance sheet and prudential regulation risks

Encumbered assets by asset category

September 2018	Assets encumbered with non-central bank counterparties				Positioned at the central bank (including encumbered) £m	Other assets: Assets not positioned at the central bank				
	Covered bonds £m	Securi-tisations £m	Other £m	Total £m		Readily available for encumbrance £m	Other assets capable of being encumbered £m	Cannot be encumbered £m	Total £m	**Total £m**
Cash and balances with central banks	–	–	–	–	2,809	3,764	–	–	6,573	**6,573**
Due from other banks	161	299	306	766	–	–	70	–	70	**836**
Investments – available for sale	–	–	36	36	46	1,468	5	7	1,526	**1,562**
Other financial assets	–	–	–	–	–	–	362	–	362	**362**
Derivatives	–	–	–	–	–	–	–	262	262	**262**
Loans and advances to customers	1,393	5,243	–	6,636	6,940	5,016	11,322	2,830	26,108	**32,744**
Intangible assets	–	–	–	–	–	–	–	412	412	**412**
Deferred tax assets	–	–	–	–	–	–	–	206	206	**206**
Other assets	–	–	–	–	–	–	95	404	499	**499**
Total assets	1,554	5,542	342	7,438	9,795	10,248	11,854	4,121	36,018	**43,456**

September 2017	Assets encumbered with non-central bank counterparties				Positioned at the central bank (including encumbered) £m	Other assets: Assets not positioned at the central bank				
	Covered bonds £m	Securi-tisations £m	Other £m	Total £m		Readily available for encumbrance £m	Other assets capable of being encumbered £m	Cannot be encumbered £m	Total £m	Total £m
Cash and balances with central banks	–	–	–	–	2,850	4,087	–	–	6,937	6,937
Due from other banks	46	358	338	742	–	–	432	–	432	1,174
Investments – available for sale	–	–	–	–	95	1,971	–	10	2,076	2,076
Other financial assets	–	–	–	–	–	–	477	–	477	477
Derivatives	–	–	–	–	–	–	–	282	282	282
Loans and advances to customers	1,347	5,841	–	7,188	6,294	5,940	8,906	2,965	24,105	31,293
Intangible assets	–	–	–	–	–	–	–	339	339	339
Deferred tax assets	–	–	–	–	–	–	–	154	154	154
Other assets	–	–	–	–	–	–	100	399	499	499
Total assets	1,393	6,199	338	7,930	9,239	11,998	9,915	4,149	35,301	43,231

Consolidated income statement

for the year ended 30 September	Note	2018 £m	2017 £m
Interest income and similar income		**1,113**	1,075
Interest expense and similar charges		**(262)**	(231)
Net interest income	2.2	**851**	844
Gains less losses on financial instruments at fair value		**(3)**	6
Other operating income		**159**	186
Non interest income	2.3	**156**	192
Total operating income		**1,007**	1,036
Total operating and administrative expenses before impairment losses	2.4	**(1,130)**	(720)
Operating (loss)/profit before impairment losses		**(123)**	316
Impairment losses on credit exposures	3.6	**(41)**	(48)
(Loss)/profit on ordinary activities before tax		**(164)**	268
Tax credit/(expense)	2.5	**19**	(86)
(Loss)/profit for the year		**(145)**	182
(Loss)/profit attributable to ordinary shareholders		**(181)**	146
Profit attributable to other equity holders		**36**	36
(Loss)/profit for the year attributable to equity holders		**(145)**	182
Basic (loss)/earnings per share (pence)	2.6	**(19.7)**	17.3
Diluted (loss)/earnings per share (pence)	2.6	**(19.7)**	17.2

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

The notes on pages 38 to 88 form an integral part of these financial statements.

Consolidated statement of comprehensive income

for the year ended 30 September	Note	2018 £m	2017 £m
(Loss)/profit for the year		**(145)**	182
Items that may be reclassified to the income statement			
Change in cash flow hedge reserve			
Losses during the year		**(58)**	(84)
Transfers from/(to) the income statement		**9**	(4)
Taxation thereon		**11**	21
		(38)	(67)
Change in available for sale reserve			
Losses during the year		**–**	(7)
Transfers to the income statement		**–**	(20)
Taxation thereon		**–**	7
		–	(20)
Total items that may be reclassified to the income statement		**(38)**	(87)
Items that will not be reclassified to the income statement			
Change in asset revaluation reserve			
Taxation thereon		**1**	–
Remeasurement of defined benefit pension plans	3.16	**(9)**	154
Taxation thereon		**3**	(35)
		(6)	119
Total items that will not be reclassified to the income statement		**(5)**	119
Other comprehensive (losses)/income, net of tax		**(43)**	32
Total comprehensive (losses)/income for the year, net of tax		**(188)**	214
Total comprehensive (losses)/income attributable to ordinary shareholders		**(224)**	178
Total comprehensive income attributable to other equity holders		**36**	36
Total comprehensive (losses)/income attributable to equity holders		**(188)**	214

The notes on pages 38 to 88 form an integral part of these financial statements.

Consolidated balance sheet

as at 30 September	Note	2018 £m	2017 £m
Assets			
Cash and balances with central banks	3.1	**6,573**	6,937
Due from other banks		**836**	1,174
Financial assets available for sale	3.2	**1,562**	2,076
Other financial assets at fair value	3.3	**362**	477
Derivative financial instruments	3.4	**262**	282
Loans and advances to customers	3.5	**32,744**	31,293
Due from customers on acceptances		**4**	4
Property, plant and equipment	3.8	**88**	86
Investment properties	3.9	**7**	14
Intangible assets	3.10	**412**	339
Deferred tax assets	3.11	**206**	154
Defined benefit pension assets	3.16	**212**	207
Other assets		**188**	188
Total assets		**43,456**	43,231
Liabilities			
Due to other banks	3.12	**3,122**	3,817
Other financial liabilities at fair value	3.3	**15**	26
Derivative financial instruments	3.4	**361**	376
Due to customers	3.13	**28,904**	27,718
Liabilities on acceptances		**4**	4
Provisions for liabilities and charges	3.14	**331**	554
Debt securities in issue	3.15	**4,973**	4,785
Retirement benefit obligations	3.16	**3**	3
Deferred tax liabilities	3.11	**77**	75
Other liabilities	3.17	**2,480**	2,471
Total liabilities		**40,270**	39,829
Equity			
Share capital	4.1	**89**	88
Other equity instruments	4.1	**450**	450
Capital reorganisation reserve	4.1	**(839)**	(839)
Merger reserve	4.1	**633**	633
Other reserves	4.1	**(20)**	15
Retained earnings		**2,873**	3,055
Total equity		**3,186**	3,402
Total liabilities and equity		**43,456**	43,231

The notes on pages 38 to 88 form an integral part of these financial statements.

CYBG PLC, Registered number: 09595911

Consolidated statement of changes in equity

	Note	Share capital £m	Capital reorganisation reserve £m	Merger reserve £m	Other equity instruments £m	Other reserves: Equity based compensation reserve £m	Other reserves: Asset revaluation reserve £m	Other reserves: Available for sale reserve £m	Other reserves: Cash flow hedge reserve £m	Retained earnings £m	Total equity £m
As at 1 October 2016		88	(839)	633	450	6	1	27	66	2,779	3,211
Profit for the year		–	–	–	–	–	–	–	–	182	182
Other comprehensive (losses)/income, net of tax		–	–	–	–	–	–	(20)	(67)	119	32
Total comprehensive (losses)/income for the year		–	–	–	–	–	–	(20)	(67)	301	214
AT1 distribution paid (net of tax)		–	–	–	–	–	–	–	–	(29)	(29)
Transfer from equity based compensation reserve		–	–	–	–	(4)	–	–	–	4	–
Equity based compensation expensed		–	–	–	–	6	–	–	–	–	6
As at 30 September 2017	4.1	88	(839)	633	450	8	1	7	(1)	3,055	3,402
Loss for the year		–	–	–	–	–	–	–	–	(145)	(145)
Other comprehensive (losses)/income, net of tax		–	–	–	–	–	1	–	(38)	(6)	(43)
Total comprehensive (losses)/income for the year		–	–	–	–	–	1	–	(38)	(151)	(188)
Dividends paid to ordinary shareholders		–	–	–	–	–	–	–	–	(9)	(9)
AT1 distribution paid (net of tax)		–	–	–	–	–	–	–	–	(29)	(29)
Transfer from equity based compensation reserve		–	–	–	–	(7)	–	–	–	7	–
Ordinary shares issued		1	–	–	–	–	–	–	–	–	1
Equity based compensation expensed		–	–	–	–	9	–	–	–	–	9
As at 30 September 2018	4.1	**89**	**(839)**	**633**	**450**	**10**	**2**	**7**	**(39)**	**2,873**	**3,186**

The notes on pages 38 to 88 form an integral part of these financial statements.

Consolidated statement of cash flows

for the year ended 30 September	Note	2018 £m	2017 £m
Operating activities			
(Loss)/profit on ordinary activities before tax		**(164)**	268
Adjustments for:			
Non-cash or non-operating items included in profit before tax	5.2	**(715)**	(728)
Changes in operating assets	5.2	**(1,059)**	(1,857)
Changes in operating liabilities	5.2	**(122)**	919
Interest received		**1,108**	1,123
Interest paid		**(173)**	(258)
Tax received – Group relief		**–**	1
Net cash used in operating activities		**(1,125)**	(532)
Cash flows from investing activities			
Interest received		**12**	11
Proceeds from maturity of available for sale investments		**245**	20
Proceeds from sale of available for sale investments		**822**	60
Purchase of available for sale investments		**(593)**	(492)
Proceeds from sale of tangible fixed assets[1]		**9**	19
Purchase of tangible fixed assets[1]		**(22)**	(21)
Purchase and development of intangible assets		**(144)**	(148)
Net cash provided by/(used in) investing activities		**329**	(551)
Cash flows from financing activities			
Interest received		**1**	3
Interest paid		**(94)**	(90)
Redemption and principal repayment on RMBS and covered bonds	3.7	**(1,372)**	(740)
Issuance of RMBS and covered bonds	3.7	**1,049**	750
Issuance of medium-term notes/subordinated debt	3.15	**497**	298
Amounts drawn down under the TFS		**1,250**	1,900
Amounts repaid under the TFS		**(900)**	–
Ordinary dividends paid		**(9)**	–
AT1 distributions		**(36)**	(36)
Net cash provided by financing activities		**386**	2,085
Net (decrease)/increase in cash and cash equivalents		**(410)**	1,002
Cash and cash equivalents at the beginning of the year		**6,952**	5,950
Cash and cash equivalents at the end of the year[2]	5.2	**6,542**	6,952

(1) Tangible fixed assets include property, plant and equipment, investment properties and property inventory.
(2) Cash and cash equivalents is cash and balances with central banks less mandatory deposits plus cash equivalents within other assets, less due to other banks, and other liabilities.

Reconciliation of movements to liabilities from cash flows arising from financing activities

	Term Funding Scheme £m	Debt securities in issue £m	Total £m
At 1 October 2017	1,901	4,785	6,686
Cash flows:			
Issuances	–	1,546	1,546
Redemptions	–	(1,372)	(1,372)
Drawdowns	1,250	–	1,250
Repayment	(900)	–	(900)
Non-cash flows:			
Movement in accrued interest	3	2	5
Unrealised foreign exchange movements	–	30	30
Unamortised costs	–	(18)	(18)
At 30 September 2018	**2,254**	**4,973**	**7,227**

The notes on pages 38 to 88 form an integral part of these financial statements.

Notes to the consolidated financial statements

Section 1: Basis of preparation

Overview

This section sets out the Group's accounting policies that relate to the consolidated financial statements as a whole. Where an accounting policy is specific to one note, the policy is described in the note to which it relates. This section also shows new accounting standards, amendments and interpretations, relevant to the Group, and whether they are effective in 2018 or later years. We explain how these changes are expected to impact the financial position and performance of the Group.

1.1 General information

The Company is a public company limited by shares, incorporated in the United Kingdom under the Companies Act and registered in England and Wales.

The consolidated financial statements comprise those of the Company and its controlled entities, together the 'Group'.

1.2 Basis of accounting

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. 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.

1.3 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 contained within the Group's Annual Report and Accounts. In addition, the Risk report included within the Group's Annual Report and Accounts includes the Group's risk management objectives and the Group's objectives, policies and processes for managing its capital.

In assessing the Group's going concern position as at 30 September 2018, the Directors have considered a number of factors, including the current balance sheet position, the principal and emerging risks which could impact the performance of the Group, the Group's strategic and financial plan and the impact of the acquisition of Virgin Money. 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 continue to improve as the Group's strategy is executed.

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 risks successfully in line with its business model and strategic aims. Accordingly, they continue to adopt the going concern basis in preparing the consolidated financial statements.

1.4 Basis of consolidation

Controlled entities are all entities (including structured entities) to which the Company 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.

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 combinations other than those under common control. 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. 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. 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.

Section 1: Basis of preparation continued

1.5 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

The Group records an asset, liability, expense or revenue arising from a transaction using the closing exchange rate between the functional and foreign currency on the transaction date. At each subsequent 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, with those measured at fair value 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.

1.6 Financial assets and liabilities

Recognition and derecognition

A financial asset or a financial liability is recognised on the balance sheet when the Group becomes party to the contractual provisions of the instrument. Purchases and sales of financial assets classified within fair value through profit or loss are recognised on trade date.

The Group derecognises a financial asset when the contractual cash flows from the asset expire 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. Financial liabilities are derecognised when the Group has discharged its obligation to the contract, or the contract is cancelled or expires.

Offsetting

This can only occur, and the net amount be presented on the balance sheet, when the Group currently has a legally enforceable right to set off the recognised amounts and intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

1.7 Critical accounting estimates and judgements

The preparation of financial statements requires the use of certain critical accounting estimates and judgements 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 Group considers the most significant use of accounting estimates and judgements relate to the following areas:

- financial assets and liabilities at fair value through profit or loss (note 3.3);
- impairment provisions on credit exposures (note 3.6);
- deferred tax (note 3.11);
- PPI redress provision and other conduct related matters (note 3.14); and
- retirement benefit obligations (note 3.16).

Notes to the consolidated financial statements

Section 1: Basis of preparation continued

1.8 New accounting standards and interpretations

The Group has adopted the following International Accounting Standards Board (IASB) pronouncements in the current financial year. Except where otherwise stated, these did not have a material impact on the Group's consolidated financial statements:

– amendments to IAS 12: 'Recognition of Deferred Tax Assets for Unrealised Losses' issued in January 2016 and effective for financial years beginning on or after 1 January 2017. The amendments clarify the requirements on the recognition of deferred tax assets for unrealised losses;
– amendments to IAS 7: 'Disclosure initiative' issued in January 2016 and effective for financial years beginning on or after 1 January 2017. The amendments to IAS 7: 'Statement of Cash Flows' require disclosures that enable users of the financial statements to evaluate changes in liabilities arising from an entity's financing activities; and
– 'Annual Improvements to IFRS Standards 2014-2016 Cycle', issued December 2016 and effective for financial years beginning on or after 1 January 2017. The amendment relates to IFRS 12: 'Disclosure of Interests in Other Entities' and clarifies the scope of the standard.

New accounting standards and interpretations not yet adopted

IFRS 9 'Financial Instruments' (issued July 2014) and IFRS 15 'Revenue from Contracts with Customers' (issued September 2015) are both effective for financial years beginning on or after 1 January 2018. IFRS 16 'Leases' was issued in January 2016 and is effective for financial years beginning on or after 1 January 2019. Separate updates on the Group's implementation of these new standards can be found at the end of this section.

There are a number of other standards, interpretations and amendments that have not been applied by the Group in preparing these financial statements as they are either not available for adoption in the EU or are not mandatory for the Group as at 30 September 2018. The pronouncements, while relevant to the Group, are not anticipated to have a material impact and include:

– amendments to IFRS 2: 'Classification and Measurement of Share-based Payment Transactions' issued in June 2016 and effective for financial years beginning on or after 1 January 2018. The amendments provide guidance on the effects of vesting and non-vesting conditions on the measurement of cash-settled share-based payments; classification of share-based payments with a net settlement feature for withholding tax obligations; and accounting for modifications to a share-based payment that change the classification from cash-settled to equity-settled;
– 'Annual Improvements to IFRS Standards 2014-2016 Cycle', issued December 2016 and effective for financial years beginning on or after 1 January 2018. The amendment relates to IAS 28: 'Investments in Associates and Joint Ventures' and the measurement of an associate or joint venture at fair value;
– IFRIC interpretation 22: 'Foreign Currency Transactions and Advance Consideration', issued December 2016 and effective for financial years beginning on or after 1 January 2018. The new interpretation provides requirements on which exchange rate to use in reporting foreign currency transactions (such as revenue transactions) when payment is made or received in advance;
– amendments to IFRS 9: 'Prepayment Features with Negative Compensation' issued in October 2017 and effective for financial years beginning on or after 1 January 2019. The amendments allow companies to measure particular prepayable financial assets with so-called negative compensation at amortised cost or fair value through other comprehensive income if a specified condition is met, instead of these being measured at fair value through profit or loss. The Group expects to early adopt this amendment with effect from 1 October 2018 in line with the adoption of IFRS 9;
– IFRIC interpretation 23: 'Uncertainty over Income Tax Treatments', issued June 2017 and effective for financial years beginning on or after 1 January 2019. The new interpretation applies to any situation in which there is uncertainty as to whether an income tax treatment is acceptable under tax law and is not limited to actual ongoing disputes;
– 'Annual Improvements to IFRS Standards 2015-2017 Cycle'(1), issued December 2017 and effective for financial years beginning on or after 1 January 2019. The IASB has made amendments to the following standards: IFRS 3 'Business Combinations'; IFRS 11 'Joint arrangements'; IAS 12 'Income Taxes'; and IAS 32 'Borrowing Costs';
– amendment to IAS 19: 'Plan amendment, curtailment or settlement'(1) issued in February 2018 and effective prospectively for financial years beginning on or after 1 January 2019. The amendments clarify that after a plan event companies should use these updated assumptions to measure current service cost and net interest for the remainder of the reporting period; and
– amendments to references to the 'Conceptual Framework in IFRS Standards'(1), issued in March 2018 and effective for financial years beginning on or after 1 January 2020. The amendments were issued following the IASB's publication of a revised version of its Conceptual Framework for Financial Reporting and updates the references in IFRS standards to previous versions of the Conceptual Framework.

(1) Not yet endorsed by the EU.

Notes to the consolidated financial statements

Section 1: Basis of preparation continued

1.8 New accounting standards and interpretations continued

Updates on the implementation of IFRS 9: 'Financial Instruments', IFRS 15: 'Revenue from Contracts with Customers' and IFRS 16: 'Leases'

IFRS 9

IFRS 9 'Financial Instruments' was issued by the IASB in July 2014 and endorsed for use in the EU in November 2016. It is effective for accounting periods beginning on or after 1 January 2018 and replaces IAS 39 'Financial Instruments: Recognition and Measurement' for the Group with effect from 1 October 2018.

In addition, the IASB also issued 'Prepayment Features with Negative Compensation (Amendment to IFRS 9)' in October 2017. This is a narrow scope amendment that enables the use of the amortised cost classification for some financial assets with a prepayable option that could result in the option's holder receiving compensation (referred to as 'negative compensation') for early termination. It is effective for accounting periods beginning on or after 1 January 2019 (with early adoption permitted) and was endorsed for use in the EU in March 2018. The Group will early adopt the amendment to IFRS 9 with effect from 1 October 2018, with no significant impact expected.

Classification and measurement

The existing IAS 39 financial asset classification categories are replaced under IFRS 9 as follows:

Financial assets categories	IAS 39	IFRS 9
Loans and receivables at amortised cost	•	•
Held to maturity (HTM)	•	
Available for sale (AFS)	•	
Fair value through profit or loss (FVTPL)	•	•
Fair value through other comprehensive income (FVOCI)		•

IFRS 9 introduces a two-stage process for the classification of financial assets:

1. The business model assessment

Financial assets with a 'hold to collect' contractual cash flows business model should be classified at amortised cost. Where the business model is 'hold to collect and sell', the financial asset should be classified at fair value through other comprehensive income (FVOCI). To be considered under the FVOCI category, the selling of financial instruments must be integral to the underlying business model.

Final classification is dependent on the financial asset passing the cash flow characteristics assessment. If the financial asset is held in a business model that is neither 'hold to collect' nor 'hold to collect and sell, it must be held at fair value through profit or loss (FVTPL). The option to classify a financial asset at FVTPL under certain circumstances that exists under IAS 39 is also retained in IFRS 9.

2. The cash flow characteristic assessment

The second stage in classification is to assess whether the contractual terms of the financial asset give rise to cash flows which are consistent with that of 'solely payments of principal and interest' (SPPI). IFRS 9 considers financial assets that meet the SPPI criteria as being consistent with a 'basic lending arrangement'.

Any financial asset which fails the SPPI test must be held at FVTPL.

Section 1: Basis of preparation continued

1.8 New accounting standards and interpretations continued

The Group has assessed the financial assets that come under the scope of IFRS 9 and determined that they will transition to IFRS 9 on 1 October 2018 as follows:

	IAS 39			IFRS 9		
Financial assets	Loans and receivables	FVTPL	AFS	Amortised cost	FVTPL	FVOCI
Cash and balances with central banks	•			•		
Due from other banks	•			•		
Listed securities			•			•
Unlisted securities			•		•	
Other financial assets			•		•	
Other financial assets at fair value		•			•	
Derivative financial instruments		•			•	
Loans and advance to customers	•			•		
Due from customers on acceptances	•			•		

The only significant change in classification will be for the Group's Treasury financial assets, which will move from the IAS 39 AFS category to the new FVOCI category under IFRS 9[1].

Impairment

The most significant impact of IFRS 9 is the change in credit loss methodology, which moves from the 'incurred loss' basis under IAS 39 to an 'expected loss' basis under IFRS 9.

The single impairment loss methodology (for all financial assets held at either amortised cost or FVOCI) requires the calculation of either a 12-month expected credit loss (ECL) allowance where the financial asset has not experienced a significant increase in credit risk since origination or a lifetime ECL calculation where this significant increase has been observed. Loan commitments and financial guarantees not measured at fair value through profit or loss are also in scope for impairment. IFRS 9 does not define what is meant by a significant increase in credit risk since origination, with the Group exercising judgement in determining how this should be interpreted. The Group has developed a suite of both quantitative and qualitative factors that will determine whether there has been a significant increase in credit risk since origination. Portfolio specific factors are used within the Group's Retail and SME portfolios, with the treatment of customers in receipt of the Group's forbearance programmes being a common trigger in both portfolios that would indicate there has been a significant increase in credit risk since origination. The Group will also utilise the 30 days past due backstop in moving to a lifetime ECL calculation, but expects other triggers to have moved a customer to a lifetime ECL calculation before this point.

The concepts of 12-month and lifetime ECL calculations are not a feature of IAS 39, which requires objective evidence of impairment on a financial asset or group of financial assets due to the identification of a loss event after initial recognition but before the balance sheet date for an impairment loss to be calculated. The move to an expected loss basis will therefore have an initial impact and is generally expected to require an increase in the level of impairment provision held.

IFRS 9 also requires that the ECL calculation reflects an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes; the time value of money; and reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

In meeting this requirement, the Group has incorporated a number of relevant economic parameters within the credit loss models such as base, inflation and unemployment rates. These are included for the full forecast period and will vary between the three economic scenarios the Group will utilise for IFRS 9 purposes (base case, upside and downside). The economic parameters used and the relative weightings of the scenarios are validated internally by an economic scenarios panel which comprises representation from a number of internal stakeholder functions[2].

Hedging

While IFRS 9 introduces revised hedge accounting requirements, the IASB is still considering the approach to accounting for dynamic risk management. Consequently, IFRS 9 includes an accounting policy option to continue hedge accounting under the requirements of IAS 39 until such time as the IASB's overall hedge accounting strategy is complete. The Group will exercise the accounting policy option to continue hedge accounting under IAS 39 but will look to provide the new hedge accounting disclosures, where applicable, in the 2019 annual financial statements.

(1) As with the AFS category, fair value movements in the FVOCI category will pass through a reserve account which can be recycled through profit or loss.
(2) This is supplemented by a third-party supplier of economic data.

Notes to the consolidated financial statements

Section 1: Basis of preparation continued

1.8 New accounting standards and interpretations continued

IFRS 9 implementation strategy and transitional impact

During 2018, the Group has continued the development and refinement of IFRS 9 compliant credit loss models. These models adhere to the Group's internal model standards and policies and have been subject to review, challenge and approval from the Group's internal model governance pathway. The IFRS 9 Project team has provided updates to the Board's Audit Committee on a regular basis throughout the year on the outputs from the parallel run process and the improvements in the reporting of the outputs over the same period.

The Group will continue to review and evaluate the credit loss model methodology and overall ECL calculation mechanics and related controls in advance of further IFRS 9 disclosure requirements in 2019. While the Group has calculated the impairment impact of IFRS 9 based on the current view of forward-looking economic conditions and parameters, these are inherently difficult to predict with any great certainty and require an element of management judgement. This is particularly relevant in relation to the eventual outcome of the UK Government's Brexit negotiations, which will not be finalised until March 2019. Consequently, the Group's estimation of expected credit losses under IFRS 9 and the impact this has on results and other related disclosures remain subject to change until finalisation of the Group's results for the year ended 30 September 2019.

The change to the basis of impairment loss provisioning is currently expected to result in a transitional impact of £21m (net of tax) due to the increased level of credit impairments required under IFRS 9 compared with IAS 39. As IFRS 9 does not require the restatement of comparative information, the transitional impact will result in a net decrease in the Group's total equity at 1 October 2018.

The transitional impact of IFRS 9 on the Group's reported CET1 ratio at 1 October 2018 will be a reduction of 14bps on a fully loaded basis. As a result of the transitional capital rules option, which the Group has already confirmed it will exercise(1), the effect on the transitional CET1 ratio is negligible.

Transitional disclosures, required by IFRS 7, will be included within the Group's interim financial statements for the six months to 31 March 2019.

IFRS 15

IFRS 15 was issued in May 2014 and is endorsed for use in the EU. It is effective for financial years beginning on or after 1 January 2018 and will be adopted by the Group with effect from 1 October 2018. The core principle of IFRS 15 is that revenue reflects the transfer of goods or services to customers in an amount that reflects the consideration to which an entity expects to be entitled. The standard provides a principles based five-step model for recognition.

The majority of the Group's revenue is in the form of interest income from financial instruments, which is not in scope for IFRS 15. Interest income from lease contracts is also not in scope. Fees and commissions together with certain elements of non-interest income do fall within the scope of the standard. In nearly all cases the Group's current accounting policy is consistent with the requirements of IFRS 15, accordingly there is no material impact in relation to the timing of when the Group recognises revenues.

IFRS 16

IFRS 16 was issued in January 2016 and is endorsed for use in the EU. It is effective for financial years beginning on or after 1 January 2019 and will be adopted by the Group with effect from 1 October 2019. For lessees, operating leases will be brought onto the Group's balance sheet with an asset recognised for the contractual 'right of use' and a financial liability recognised for the contractual payments. This change will mainly impact the properties that the Group currently accounts for as operating leases. There are no substantial changes to the accounting for leases by lessors, nor for finance leases. An implementation plan is in place and the Group continues to assess the impact of the standard.

(1) This has the effect on phasing the Day 1 impact of the transition to IFRS 9 over five years for capital purposes, with 95% of the impact added back in the first year.

Notes to the consolidated financial statements

Section 2: Results for the year

2.1 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 Group's Chief Operating Decision Maker, the Executive Leadership Team.

The Group's business is organised into two principal operating segments: SME banking and Retail banking. In addition, Central Functions consist of the Group's back office support functions.

SME banking

The Group's established regional SME franchise offers a full range of banking products and services to meet business customers' banking needs across its small business, commercial, corporate and structured finance segments.

The Group's SME franchise comprises small businesses (which the Group defines as businesses with lending of up to £0.5m but less than £2.0m in turnover) and medium businesses (which the Group defines as businesses with lending of more than £0.5m and greater than £2.0m in turnover).

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

– 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; and
– business current accounts: the Group provides business customers day to day banking, current account facilities (including debit cards, cheque books, regular statements, direct debits and standing orders), and online banking.

Retail banking

The Group has a comprehensive regional and national retail banking product proposition comprising:

– PCA: the Group offers a full range of PCAs, including, for example, B, a digital proposition, together with a packaged bank account and a basic bank account;
– savings accounts: the Group offers a variety of savings accounts that pay a variable rate of interest. It also offers cash ISAs that provide depositors tax free returns;
– term 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 and BTL loans;
– personal loans: the Group provides unsecured personal loans through its branch network and through its digital and telephone distribution channels;
– credit cards: the Group currently offers four credit card products: Private Mastercard, Business Mastercard, Gold Mastercard and B Mastercard;
– overdrafts: the Group provides overdraft lending across a variety of PCA products, subject to the account holder's status; and
– introductions to insurance and investment products through its branch network.

Section 2: Results for the year continued

2.1 Segment information continued

Geographical areas

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

Operating segments 2018	**SME banking £m**	**Retail banking £m**	**Central functions £m**	**Other[1] £m**	**Total £m**
Net interest income	**261**	**641**	**(51)**	**–**	**851**
Non-interest income	**76**	**99**	**(19)**	**–**	**156**
Total operating income	**337**	**740**	**(70)**	**–**	**1,007**
Operating and administrative expenses	**(63)**	**(94)**	**(478)**	**(495)**	**(1,130)**
Impairment losses on credit exposures[2]	**(15)**	**(26)**	**–**	**–**	**(41)**
Segment operating profit/(loss) before tax	**259**	**620**	**(548)**	**(495)**	**(164)**
Average interest earning assets	**7,391**	**25,198**	**6,828**	**–**	**39,417**

Operating segments 2017	SME banking £m	Retail banking £m	Central functions £m	Other[1] £m	Total £m
Net interest income	251	644	(51)	–	844
Non-interest income	83	100	(11)	20	192
Total operating income	334	744	(62)	20	1,036
Operating and administrative expenses	(61)	(97)	(517)	(45)	(720)
Impairment losses on credit exposures[2]	(33)	(15)	–	–	(48)
Segment operating profit/(loss) before tax	240	632	(579)	(25)	268
Average interest earning assets	7,209[3]	23,522[3]	6,966	–	37,697

(1) 'Other' reflects underlying adjustments to the statutory view of performance and is therefore not recharged to the Group's two principal operating segments, such as conduct related provisions and restructuring costs. For a breakdown of the items included in this category, refer to 'Measuring financial performance – glossary'.
(2) The impairment losses on credit exposures of £26m (2017: £15m) for Retail banking includes losses on certain retail products attributable to SME (private banking) customers.
(3) Comparative disclosures have been amended to conform with the current period's presentation.

Liabilities are managed on a centralised basis and therefore are not disclosed by segment.

Section 2: Results for the year continued

2.2 Net interest income

Accounting policy

Interest income is reflected in the income statement using the effective interest method which discounts the estimated future cash payments or receipts over the expected life of the financial instrument, to the net carrying amount of the financial asset or liability.

When calculating the effective interest rate, 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 includes all amounts paid or received that are an integral part of the effective interest rate such as transaction costs and all other premiums or discounts. Where it is not possible to reliably estimate 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 within the effective interest rate calculation. Non-utilisation of a commitment fee is recognised as revenue upon expiry of the agreed commitment period. Loan related administration and service fees are recognised as revenue over the period of service.

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

Where a trading derivative is economically hedging an interest-bearing 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 (in a manner consistent with hedging derivatives) and not as part of the fair value movement of the trading derivative.

	2018 £m	2017 £m
Interest income and similar income		
Loans and advances to other banks	**26**	11
Financial assets available for sale	**12**	11
Loans and advances to customers	**1,057**	1,030
Financial assets at fair value through profit or loss	**15**	18
Other interest income	**3**	5
Total interest income and similar income	**1,113**	1,075
Less: interest expense and similar charges		
Due to other banks	**18**	15
Due to customers	**148**	126
Debt securities in issue	**94**	90
Other interest expense	**2**	–
Total interest expense and similar charges	**262**	231
Net interest income	**851**	844

Notes to the consolidated financial statements

Section 2: Results for the year continued

2.3 Non-interest income

Accounting policy

Gains less losses on financial instruments at fair value

This includes fair value gains and losses from three distinct activities:

- derivatives classified as held for trading – the full change in fair value of trading derivatives is recognised inclusive of interest income and expense arising on those derivatives except when economically hedging other assets and liabilities at fair value as outlined in note 2.2;
- other financial assets and liabilities designated at fair value through profit or loss – these relate to the Group's fixed interest rate loan portfolio and related term deposits (note 3.3), which were designated at inception as fair value through profit or loss. 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. The valuation technique used is reflective of current market practice; and
- hedged assets, liabilities and derivatives designated in hedge relationships – fair value movements are recognised on both the hedged item and hedging derivative in a fair value hedge relationship (the net of which represents hedge ineffectiveness), and hedge ineffectiveness on cash flow hedge relationships (note 3.4).

Fees and commissions

Where not integral to the effective interest rate, these are recognised on an accruals basis as the services are provided or on completion of the underlying transaction.

	2018 £m	2017 £m
Gains less losses on financial instruments at fair value		
Interest rate derivatives	**16**	45
Other assets and liabilities at fair value[1]	**(13)**	(35)
Ineffectiveness arising from fair value hedges (note 3.4)	**–**	(4)
Ineffectiveness arising from cash flow hedges (note 3.4)	**(6)**	–
	(3)	6
Other operating income		
Fees and commissions	**141**	146
Margin on foreign exchange derivative brokerage	**18**	18
Gains on disposal of available for sale financial assets	**–**	20
Net fair value movement on investment properties	**–**	(1)
Other income	**–**	3
	159	186
Total non-interest income	**156**	192

(1) A credit risk gain on other assets and liabilities at fair value of £3m, offset by a fair value loss of £16m, has been recognised in the current year (2017: £6m gain and £41m loss, respectively).

On 28 April 2017, Mastercard completed its acquisition of 94.2% of VocaLink, resulting in a gain of £20m, which was included within 'Gains on disposal of available for sale financial assets' in the year ended 30 September 2017.

Section 2: Results for the year continued

2.4 Operating and administrative expenses

Accounting policy

Personnel expenses primarily consist of wages and salaries, accrued bonus and social security costs arising from services rendered by employees during the financial year.

The Group recognises bonus costs where it has a present obligation that can be reliably measured. Bonus costs are recognised over the relevant service period required to entitle the employee to the reward.

The Group's accounting policies on pension expenses and equity based compensation are included in notes 3.16 and 4.2 respectively.

	2018 £m	2017 £m
Personnel expenses	**223**	166
Restructuring and related expense (note 3.14)	**38**	67
Virgin Money acquisition costs	**37**	–
RBS alternative remedies package spend	**16**	–
Depreciation and amortisation expense (notes 3.8, 3.10)	**89**	87
Other operating and administration expenses	**727**	400
Total operating and administrative expenses	**1,130**	720

Personnel expenses comprise the following items:

	2018 £m	2017 £m
Salaries, wages and non-cash benefits and social security costs	**139**	171
Defined contribution pension expense	**33**	19
Defined benefit pension expense/(income) (note 3.16)	**2**	(54)
Equity based compensation (note 4.2)	**9**	6
Other personnel expenses	**40**	24
Personnel expenses	**223**	166

In the year to September 2017, the Group recognised gains in relation to its defined benefit pension scheme. A past service credit of £88m was included in personnel expenses as a result of the closure of the Scheme to future accrual for the majority of members. In addition, a curtailment gain of £13m was recognised in respect of redundancies which did not attract an enhancement entitlement and was offset against the related restructuring costs.

The average number of FTE employees of the Group during the year was made up as follows:

	2018 Number	2017 Number
Managers	**2,161**	2,234
Clerical staff	**3,608**	3,806
	5,769	6,040

The average monthly number of employees was 6,461 (2017: 6,818).

All staff are contracted employees of the Group and its subsidiary undertakings. The average figures above do not include contractors.

Other items of significance to the Group which are included within other operating and administrative expenses are:

	2018 £m	2017 £m
Operating lease charges	**26**	29
PPI redress expense (note 3.14)	**352**	48
Other conduct expenses (note 3.14)	**44**	10
Separation costs	**8**	8
Auditor's remuneration	**3**	2

Section 2: Results for the year continued

2.4 Operating and administrative expenses continued

Auditor's remuneration included within other operating and administrative expenses:

	2018 £'000	2017 £'000
Fees payable to the Company's auditor for the audit of the Company's financial statements	**21**	20
Fees payable to the Company's auditor for the audit of the Company's subsidiaries	**1,593**	1,251
Total audit fees	**1,614**	1,271
Audit related assurance services	**120**	124
Other assurance services	**700**	308
Total non-audit fees	**820**	432
Fees payable to the Company's auditor in respect of associated pension schemes	**84**	63
Total fees payable to the Company's auditor	**2,518**	1,766

Non-audit services of £820k (2017: £432k) performed by the auditor during the year included the review of the Interim Financial Report; agreed upon procedures under the Conduct Indemnity arrangement with NAB; preparation of a comfort letter for the global medium-term note programme issuance; and a TFS assurance review. The increase in the year is principally due to reporting accountant procedures in relation to the Virgin Money transaction.

In addition to the above, out of pocket expenses of £49k (2017: £48k) were borne by the Group, principally related to reimbursement of travel expenses incurred by staff when performing the above services.

2.5 Taxation

Accounting policy

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 directly in equity, in which case the tax is also recognised in equity.

Current tax is the expected tax payable or receivable 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 assets and liabilities are recognised on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the 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.

	2018 £m	2017 £m
Current tax		
UK corporation tax		
Current year	**8**	17
Adjustment in respect of prior years	**8**	–
	16	17
Deferred tax (note 3.11)		
Current year	**(1)**	64
Adjustment in respect of prior years	**(34)**	5
	(35)	69
Tax (credit)/expense for the year	**(19)**	86

Section 2: Results for the year continued

2.5 Taxation continued

The tax assessed for the year differs from that arising from applying the standard rate of corporation tax in the UK of 19%. A reconciliation from the expense implied by the standard rate to the actual tax expense is as follows:

	2018 £m	2017 £m
(Loss)/profit on ordinary activities before tax	**(164)**	268
Tax (credit)/expense based on the standard rate of corporation tax in the UK of 19% (2017: 19.5%)	**(31)**	52
Effects of:		
Disallowable expenses	**42**	9
Conduct indemnity adjustment	**(5)**	7
Deferred tax assets recognised	**(8)**	(21)
Impact of rate changes	**9**	34
Adjustments in respect of prior years	**(26)**	5
Tax (credit)/expense for the year	**(19)**	86

The total amount of tax, current and deferred, recognised directly in equity during the year was a credit of £23m (2017: £1m). Disallowable expenses represent, in the main, the Group's share of incremental conduct charges that are not deductible in computing taxable profits, and non-deductible transaction costs predominantly in relation to the acquisition of Virgin Money.

The prior year adjustment comprises movements in the deferred tax asset recognised for losses following the enactment of the Corporate Loss Restriction in Finance Act (No.2) 2017 in November 2017. These rules allowed, for the first time, certain losses to be relieved against the profits of group entities other than the one in which they arose, and also changed the order of precedence for relief of existing losses. The consequence of this change was that historic losses which were previously derecognised are now brought onto the balance sheet in accordance with the Group's established methodology. The remainder of the prior year adjustment relates to the revaluation of the conduct indemnity adjustment, and incorporates a fully offsetting movement between current and deferred tax.

The rate change charge arises on the revaluation of assets as a consequence of the UK mainstream rate of tax trending towards the enacted rate of 17%, and where deferred tax assets have been utilised at rates lower than initially forecast.

2.6 Earnings per share (EPS)

Accounting policy

Basic earnings per share

Basic earnings per share is calculated by taking the profit attributable to ordinary shareholders of the parent company and dividing this by the weighted-average number of ordinary shares outstanding during the period.

Diluted earnings per share

This requires the weighted average number of ordinary shares in issue to be adjusted to assume conversion of all dilutive potential ordinary shares. These arise from awards made under equity based compensation schemes. Share awards with performance conditions attaching to them are not considered to be dilutive unless these conditions have been met at the reporting date.

The Group presents basic and diluted (loss)/earnings per share data in relation to the ordinary shares of CYBG PLC.

	2018 £m	2017 £m
(Loss)/profit attributable to ordinary shareholders	**(181)**	146
Tax relief on AT1 distribution attributable to ordinary equity holders	**7**	7
(Loss)/profit attributable to ordinary equity holders for the purposes of basic and diluted EPS	**(174)**	153

	2018 Number of shares (million)	2017 Number of shares (million)
Weighted-average number of ordinary shares in issue		
– Basic	**885**	883
– Diluted	**885**	884
Basic (loss)/earnings per share (pence)	**(19.7)**	17.3
Diluted (loss)/earnings per share (pence)	**(19.7)**	17.2

The calculation of the diluted earnings per share for the current year end excludes conditional awards of over 1m ordinary shares made under equity based compensation schemes. These are considered anti-dilutive due to the Group making a loss in the year.

Section 3: Assets and liabilities

3.1 Cash and balances with central banks

	2018 £m	2017 £m
Cash assets	**1,656**	1,507
Balances with central banks (including EU payment systems)	**4,917**	5,430
	6,573	6,937
Less mandatory deposits with central banks[1]	**(75)**	(44)
Included in cash and cash equivalents (note 5.2)	**6,498**	6,893

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

3.2 Financial assets available for sale

Accounting policy

Available for sale financial assets are recognised on trade date and comprise listed and unlisted non-derivative financial assets not classified into any other financial asset category. They are initially recognised at fair value including direct and incremental transaction costs, and subsequently measured at fair value. Gains and losses arising from changes in fair value are included as a separate component of equity until sale or impairment, at which point the cumulative gain or loss is transferred to the income statement.

All available for sale financial assets are continually monitored for evidence of any impairment, which would typically be deemed to have arisen where there is evidence of a significant or prolonged reduction in the fair value of the security below its cost. Where such evidence of impairment exists, the cumulative net loss previously recognised directly in equity is transferred to the income statement.

In situations where evidence suggests a subsequent increase in value, reversals of impairment of previously impaired equity instruments are recognised directly in equity while reversals of impairment of debt instruments are recognised in the income statement.

Interest income, determined using the effective interest method, is recognised in the income statement. Impairment losses and translation differences on monetary items are recognised in the income statement within the year in which they arise.

	2018 £m	2017 £m
Listed securities	**1,551**	2,066
Unlisted securities	**5**	4
Other financial assets	**6**	6
	1,562	2,076

Refer to note 3.18 for further information on the valuation methodology applied to available for sale assets and their classification within the fair value hierarchy.

Credit quality of investments

	2018 £m	2017 £m
Available for sale		
Senior investment grade	**1,551**	2,066
Other	**11**	10
	1,562	2,076

Senior investment grade securities

These include £595m (2017: £1,221m) of UK Government Gilts. The remainder relates to highly liquid, AAA-rated corporate bonds.

Section 3: Assets and liabilities continued

3.3 Financial assets and liabilities at fair value through profit or loss

Accounting policy
Financial assets and liabilities are designated at fair value through profit or loss, with gains and losses recognised in the income statement as they arise (note 2.3), when this reduces an accounting mismatch or where the performance is evaluated on a fair value basis. In such cases, transaction costs are recognised immediately in the income statement upon initial recognition of the financial asset and liability.

The derivatives related to the assets and liabilities at fair value through profit or loss do not meet the requirements for hedge accounting and are accounted for as held for trading derivative financial instruments (note 3.4).

Critical accounting estimates and judgements
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 such data is not available, judgement is required to establish fair values. The judgements include considerations of liquidity and credit risk.

The most significant judgement is in relation to the Group's fair value loan portfolio. The most significant unobservable input impacting the carrying value of the loans other than interest rates is the future expectation of credit losses. If the lifetime expected losses were 20% greater than predicted, the carrying value of the loans would decrease by £2m and vice versa.

	2018 £m	2017 £m
Financial assets at fair value through profit or loss		
Loans and advances	**362**	477
Financial liabilities at fair value through profit or loss		
Due to customers – term deposits	**15**	26

Loans and advances
Included in financial assets at fair value through profit or loss is a historical portfolio of loans (sales ceased in 2012). 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 £362m (2017: £477m) including accrued interest receivable of £2m (2017: £2m). The cumulative loss in the fair value of the loans attributable to changes in credit risk amounts to £8m (2017: £11m) and the change for the current year is a decrease of £3m (2017: decrease of £13m), of which £3m (2017: £6m) has been recognised in the income statement.

Due to customers – term deposits
Included in other financial liabilities at fair value through profit or loss are fixed rate deposits, the interest rate risk on which is hedged using interest rate derivative contracts. The deposits are recorded at fair value to avoid an accounting mismatch.

The change in fair value attributable to changes in the Group's credit risk is £Nil (2017: £Nil). The Group is contractually obligated to pay £0.3m (2017: £1m) less than the carrying amount at maturity to the deposit holder.

Section 3: Assets and liabilities continued

3.4 Derivative financial instruments

Accounting policy
All derivative instruments manage exposures to interest rates and foreign currency and are recognised on the balance sheet at fair value on trade date. 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 notional amount of a derivative contract is not recorded on the balance sheet but is disclosed as part of this note.

The method of recognising the fair value gain or loss on a derivative depends on whether it is designated as a hedging instrument and the nature of the item being hedged. Certain derivatives are designated as either hedges of highly probable future cash flows attributable to a recognised asset or liability, or a highly probable forecast transaction (a cash flow hedge); or hedges of the fair value of recognised assets or liabilities or firm commitments (a fair value hedge).

Cash flow hedge
The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in equity. Specifically, the separate component of equity (note 4.1) 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 in which the hedged item affects profit or loss.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss 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.

Fair value hedge
The carrying value of the hedged item on initial designation is adjusted for the fair value attributable to the hedged risk. Subsequently, 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 basis over the remaining life of the asset or liability.

Hedge effectiveness
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 documentation covers how effectiveness will be measured throughout the life of the hedge relationship and its assessment, both at hedge inception and on an ongoing 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%.

Derivatives held for trading
The Group uses derivatives for risk management purposes and does not have a trading book. However, derivatives that do not meet the hedging criteria within IAS 39, or for which hedge accounting is not applied, are classified as held for trading. Changes in value of held for trading derivatives are immediately recognised in the income statement (note 2.3).

Section 3: Assets and liabilities continued

3.4 Derivative financial instruments continued

The tables below analyse derivatives between those designated as hedging instruments and those classified as held for trading:

	2018 £m	2017 £m
Fair value of derivative financial assets		
Designated as hedging instruments	**203**	202
Designated as held for trading	**59**	80
	262	282
Fair value of derivative financial liabilities		
Designated as hedging instruments	**259**	229
Designated as held for trading	**102**	147
	361	376

Cash collateral on derivatives placed with banks totalled £306m (2017: £338m). Cash collateral received on derivatives totalled £37m (2017: £31m). These amounts are included within due from and due to other banks respectively.

The derivative financial instruments held by the Group are further analysed below. The notional contract amount is the amount from which the cash flows are derived, and does not represent the principal amounts at risk relating to these contracts.

Total derivative contracts

	Notional contract amount 2018 £m	Fair value of assets 2018 £m	Fair value of liabilities 2018 £m	Notional contract amount 2017 £m	Fair value of assets 2017 £m	Fair value of liabilities 2017 £m
Derivatives designated as hedging instruments						
Cash flow hedges						
Interest rate swaps	**24,570**	**88**	**111**	17,952	56	104
Cross currency swaps	**690**	**70**	**–**	527	89	–
Forward foreign exchange	**–**	**–**	**–**	6	–	–
	25,260	**158**	**111**	18,485	145	104
Fair value hedges						
Interest rate swaps	**2,180**	**45**	**148**	1,452	57	125
Derivatives designated as held for trading						
Foreign exchange rate related contracts						
Spot and forward foreign exchange	**1,788**	**26**	**23**	2,689	45	47
Cross currency swaps	**455**	**10**	**10**	150	9	9
Options	**11**	**–**	**–**	103	2	2
	2,254	**36**	**33**	2,942	56	58
Interest rate related contracts						
Swaps	**811**	**15**	**59**	983	18	82
Swaptions	**33**	**–**	**–**	33	–	–
Options	**501**	**1**	**3**	477	2	3
	1,345	**16**	**62**	1,493	20	85
Commodity related contracts	**53**	**7**	**7**	93	4	4
Total derivative contracts	**31,092**	**262**	**361**	24,465	282	376

Section 3: Assets and liabilities continued

3.4 Derivative financial instruments continued

Derivatives traded to manage the Group's interest rate exposure on a net portfolio basis are accounted for as cash flow hedges. Derivatives traded to manage interest rate risk on certain fixed rate assets, such as UK Government Gilts, are accounted for as fair value hedges.

The Group hedging positions also include those designated as foreign currency and interest rate hedges of debt issued from the Group's securitisation and covered bond programmes respectively. As such, certain derivative financial assets and liabilities have been booked in structured entities and consolidated within these financial statements.

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

Nominal values per time period	**2018 £m**	2017 £m
Within 0 to 3 months	**2,582**	92
Between 3 and 12 months	**7,325**	2,986
1 to 5 years	**14,882**	14,817
Greater than 5 years	**471**	590
	25,260	18,485

The Group has hedged 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 2018 £m	**Forecast payable cash flows 2018 £m**	Forecast receivable cash flows 2017 £m	Forecast payable cash flows 2017 £m
Within 1 year	**109**	**283**	52	399
Between 1 and 2 years	**130**	**366**	70	86
Between 2 and 3 years	**108**	**160**	70	86
Between 3 and 4 years	**63**	**5**	44	122
Between 4 and 5 years	**37**	**3**	19	6
Greater than 5 years	**60**	**10**	26	18
	507	**827**	281	717

	2018 £m	2017 £m
Gain/(loss) arising from fair value hedges (note 2.3)		
Hedging instrument	**14**	1
Hedged item attributable to the hedged risk	**(14)**	(5)
	–	(4)

	2018 £m	2017 £m
Loss from cash flow hedges due to hedge ineffectiveness (note 2.3)	**(6)**	–

Section 3: Assets and liabilities continued

3.5 Loans and advances to customers

Accounting policy

Loans and advances to customers arise when the Group provides money directly to a customer and include mortgages, term lending, overdrafts, credit card lending, lease finance and invoice financing.

Loans and advances to customers are initially recognised at fair value including direct and incremental transaction costs. They are subsequently measured at amortised cost, using the effective interest method, adjusted for impairment losses. 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.

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 leased asset is not held on the Group balance sheet; instead, a finance lease is recognised representing the minimum lease payments receivable under the terms of the lease, discounted at the rate of interest implicit in the lease. Interest income is recognised in interest receivable, allocated to accounting periods to reflect a constant periodic rate of return.

	2018 £m	2017 £m
Mortgages	**24,540**	23,480
Term lending – SME	**5,009**	4,762
Term lending – Retail	**767**	709
Overdrafts	**1,525**	1,524
Lease finance	**660**	594
Credit cards	**381**	396
Trade finance	**35**	23
Gross loans and advances to customers	**32,917**	31,488
Accrued interest receivable	**79**	75
Unearned income	**(32)**	(28)
Deferred and unamortised fee income	**(25)**	(32)
Impairment provisions on credit exposures (note 3.6)	**(195)**	(210)
	32,744	31,293

The Group has transferred a proportion of mortgages to the securitisation and covered bond programmes (note 3.7).

The Group has a portfolio of fair valued business loans of £362m (2017: £477m) which are held separately as Other financial assets at fair value on the balance sheet (note 3.3). Combined with the above this is equivalent to total loans and advances of £33,106m (2017: £31,770m).

Lease finance

The Group leases 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 during the year for the purpose of letting under finance leases and hire purchase contracts amounted to £20m (2017: £13m) and £399m (2017: £408m) respectively. The total receivables from finance leases and hire purchase contracts were £32m (2017: £17m) and £596m (2017: £550m) respectively.

Finance lease and hire purchase receivables

	2018 £m	2017 £m
Gross investment in finance lease and hire purchase receivables		
Due within 1 year	**269**	241
Due within 1 to 5 years	**376**	346
Due after more than 5 years	**15**	7
	660	594
Unearned income	**(32)**	(27)
Net investment in finance lease and hire purchase receivables	**628**	567

Section 3: Assets and liabilities continued

3.6 Impairment provisions on credit exposures

Accounting policy
Assets carried at amortised cost
At each reporting date the Group assesses if there is objective evidence of impairment of a financial asset or group of financial assets due to one or more loss events that occurred after initial recognition but prior to the balance sheet date. Examples of loss events are
(i) where there has been an actual breach of contract by the borrower such as a default or delinquency in payment of interest or principal; or
(ii) the granting of a concession to the borrower that the Group would not otherwise consider.

The Group first assesses whether objective evidence of impairment exists either individually for assets that are separately significant, or collectively for assets that are not separately significant. If it is determined that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, the asset is included in a group of financial assets with similar credit risk characteristics and collectively assessed for impairment ('collective provisions').

Collective provisions
Collective provisions are generally established for homogeneous portfolios such as the Retail portfolios and the small business portfolio within the SME franchise.

Within the Group's Retail environment, past loss experience is a key factor in determining an appropriate collective provision level and takes into account a number of different elements including:

- the number of days past due;
- the realisable value of any security held; and
- the timing of any such security sale.

These and other factors will influence the probability that the customer defaults on the loan (the PD). In the event of a default occurrence, the Retail collective provision calculator provides the amount the Group expects to be irrecoverable from that customer (the LGD). The level and impact of LGD varies significantly between the Group's secured and unsecured lending portfolios.

Collective provisioning for the Group's SME portfolio is also based on the use of PD and LGD. The assets are included in a group of financial assets with similar risk characteristics and collectively assessed for impairment. The modelled collective assessment considers factors such as:

- credit quality;
- levels of arrears;
- credit utilisation;
- loan to collateral ratios; and
- other factors including the Group's internal customer rating system (eCRS).

These characteristics are relevant to the estimation of future cash flows for groups of such assets as they are indicative of the borrower's ability to pay all amounts due according to the contractual terms of the assets being evaluated.

Reliance is placed on the eCRS rating when assessing PD as these are directly mapped within the model. Manual interventions to the eCRS rating, such as the placement on a watch list, will directly lead to an increase in PD and consequently the level of collective provision required. LGD assumptions are driven by the level of security assigned to the customer within the collective provisioning model. These are regularly monitored to ensure comparability with recent actual loss experience.

In addition, for both the Group's Retail and SME portfolios, experienced judgement is used to estimate the amount of an impairment loss. This reflects a limited number of refinements that have been assessed as necessary to reflect specific and evolving circumstances that, by their nature, cannot be adequately captured in the models. The use of judgements and supportable estimates is considered by management to be an essential part of the credit impairment process. The methodology and assumptions used for estimating future cash flows are reviewed regularly to identify and reduce any significant differences between loss estimates and actual loss experience.

Section 3: Assets and liabilities continued

Specific provision
If there is objective evidence that an impairment loss has been incurred on a loan, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows (including the estimated realisable value of any security) discounted at the asset's original effective interest rate (a 'specific provision').

Specific provision allowances are primarily established against the Group's commercial business within the SME franchise. Assets are reviewed on a regular basis and those showing potential or actual vulnerability are placed onto a watch list where enhanced monitoring is undertaken.

Impairment
When first recognised, the impairment allowance, which is a combination of both the collective and specific provision, is recognised in the income statement.

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. 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. The amount of the reversal is recognised in the income statement.

When a loan is deemed uncollectable, and all necessary internal procedures have been completed, it is written off against the related impairment loss. Subsequent recoveries of amounts previously written off reduce the expense in the income statement.

The Group's impairment policy for available for sale financial assets is included in note 3.2.

Critical accounting estimates and judgements
In determining the required level of collective impairment provisions, the Group uses the output from various statistical models, with management judgement required to assess the modelled outputs and, where necessary, make appropriate adjustments.

The key assumptions within the Group's collective provisioning models which give rise to significant estimation uncertainty are the PD and the LGD. Both measures are predicated on expectations of customer behaviour and performance, which requires management to form a judgement based on a wide range of historic and current evidence. The actual amount of the future cash flows and their timing may differ significantly from the assumptions made for the purposes of determining the impairment allowances and consequently these allowances can be subject to variation as time progresses and the circumstances of the customer become clearer.

From an SME perspective, changes made to eCRS will have a direct impact as these are mapped to PDs. Assumption changes on retail customer behaviour will also have an impact on the PDs used.

Within the Retail portfolio, the Group's collective provision is reflective of the fact that the majority of lending is concentrated on customer mortgages, where the available security is generally sufficient to cover the exposure. This differs from the SME portfolio where the availability and strength of the security will have less of an impact on overall recoveries, leading to a potentially higher collective provision charge relative to the overall exposure.

Sensitivities within the collective provision
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 below assume all other assumptions remain unchanged.

If the PDs were to move by +/- 5% from those presently used within the Group's provisioning models, the impairment provision would increase/decrease accordingly by £5m.

An important element to the PD is the loss emergence period (LEP) which represents the Group's assessment of the period from when a loss event occurs to eventual default. The impact of the LEP differs between the Group's Retail and SME portfolios.

A two-month increase in the LEP would result in a further £2m impairment provision within the SME portfolio, and a further £1m being added to the Retail impairment provision.

To the extent that recovery rates improve from those presently used within each of the Group's provisioning models by 5%, the impairment provision on loans and advances would decrease by £14m. Alternatively, if recovery rates deteriorate by 5%, the impairment provision on loans and advances would increase by £24m.

Provision in the SME portfolio is sensitive not only to default rates and severity of losses, but also to the assessment of risk and security. If 10% of the SME portfolio were to fall by one notch, the impairment provision would increase by £2m.

In addition to modelled outputs, the impairment provision is further impacted by management judgements. These include judgements that reflect elements which are not sufficiently sensitive to the current economic conditions, model risk reserves that are held to cover against a range of potential model limitations, and judgements made in respect of potential recoveries for specific provisions which also involve customer and economic specific conditions. These management judgements do not allow for any meaningful sensitivity comparison.

Section 3: Assets and liabilities continued

3.6 Impairment provisions on credit exposures continued

	2018 £m	2017 £m
Opening balance	**210**	215
Charge for the year	**41**	48
Amounts written off	**(68)**	(75)
Recoveries of amounts written off in previous years	**13**	18
Other[(1)]	**(1)**	4
Closing balance	**195**	210
Specific	**43**	56
Collective	**152**	154
	195	210

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

3.7 Securitisation and covered bond programmes

Accounting policy
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 Group has no shareholding in these entities, where it is exposed, or has rights, to variable returns from its involvement with the entities and it has the ability to affect those returns through its power over the entity, they are regarded as controlled entities as described in note 1.5 and are consolidated in the Group's financial statements.

Securitisation
The Group has securitised a portion 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 securities (RMBS) 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 loan portfolio. The Group continues servicing these mortgage loans in return for an administration fee.

The mortgage loans do not qualify for derecognition because the Group remains exposed to the majority of the risks and rewards of the mortgage loan portfolio, principally the associated credit risk. The securitisation structured entities are consolidated and the securitised mortgage loans retained on the Group's balance sheet. A liability is recognised for the proceeds of the funding transaction. The externally held securitised notes in issue are included within debt securities in issue (note 3.15). There are a number of notes held internally by the Group, not recognised on the balance sheet, which are used as collateral for repurchases and similar transactions or for credit enhancement purposes.

Covered bond
A subset of the Group's retail mortgage loan portfolio has been ring fenced and assigned to a bankruptcy remote limited liability partnership, Clydesdale Covered Bond 2 LLP, associated with the covered bond programme, to provide a guarantee for the obligations payable on the covered bonds issued by the Group. Similar to the securitisation programmes, the Group is entitled to any residual income after all payment obligations due under the terms of the covered bonds and senior programme expenses have been met.

The Group continues servicing these mortgage loans in return for an administration fee.

The mortgage loans do not qualify for derecognition because the Group retains all of the risks and rewards of the mortgage loan portfolio. The covered bond partnership is consolidated with the mortgage loans retained on the consolidated balance sheet and the covered bonds issued included within debt securities in issue. The covered bond holders have dual recourse: firstly, to Clydesdale Bank PLC on an unsecured basis; and secondly, to the LLP under the Covered Bond Guarantee secured against the mortgage loans.

Significant restrictions
Where the Group uses its financial assets to raise finance through securitisations and the sale of securities subject to repurchase agreements, this leads to the assets becoming encumbered. Once encumbered, the assets are not available for transfer around the Group.

Section 3: Assets and liabilities continued

3.7 Securitisation and covered bond programmes continued

The assets and liabilities in relation to securitisation and covered bonds in issue at 30 September are as follows:

2018	Securitisation £m	Covered Bonds £m	Total £m
Liabilities			
At 1 October 2017	**3,242**	**748**	**3,990**
Issuance of debt	**1,049**	**–**	**1,049**
Repayments	**(1,372)**	**–**	**(1,372)**
Other movements	**30**	**(16)**	**14**
At 30 September 2018	**2,949**	**732**	**3,681**
Assets			
Securitised mortgage loans	**6,412**	**1,389**	**7,801**

2017	Securitisation £m	Covered Bonds £m	Total £m
Liabilities			
At 1 October 2016	3,208	797	4,005
Issuance of debt	750	–	750
Repayments	(740)	–	(740)
Other movements	24	(49)	(25)
At 30 September 2017	3,242	748	3,990
Assets			
Securitised mortgage loans	6,182	1,344	7,526

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

The following table sets out the net position of the fair value of financial assets relating to the securitisation programmes where the counterparty to the associated liabilities has recourse only to the financial assets:

	2018 £m	2017 £m
Fair value of transferred assets	**6,248**	6,074
Fair value of associated liabilities	**(2,948)**	(3,262)
	3,300	2,812

There were no events during the year that resulted in any Group transferred financial assets being derecognised.

The Group has contractual and non-contractual arrangements which may require it to provide financial support as follows:

Securitisation programmes

The Group provides credit support to the structured entities via reserve funds, which are partly funded through subordinated debt arrangements and by holding junior notes. Exposures totalled £23m in subordinated debt (2017: £47m) and £971m in junior notes held (2017: £856m). The Group has a beneficial interest in the securitised mortgage portfolio held by the structured entities of £1,074m (2017: £711m).

Furthermore, the Group has an obligation to repurchase mortgage exposures if certain mortgage loans no longer meet the programme criteria.

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

Covered bond programme

The nominal level of over-collateralisation was £860m (2017: £681m) 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.

Furthermore, the Group has an obligation to repurchase mortgage exposures if certain mortgage loans no longer meet the programme criteria.

Section 3: Assets and liabilities continued

3.8 Property, plant and equipment

Accounting policy

The Group's freehold and long-term leasehold land and buildings are carried at their fair value as determined by the Directors, taking account of advice received from independent valuers. 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. Directors' valuations are performed annually in July, with the independent valuations carried out on a three-year cycle on an open market basis. The valuations are classified in Level 3 of the fair value hierarchy as defined in note 3.18.

All other items of property, plant and equipment are carried at cost, less accumulated depreciation and impairment losses. Cost includes expenditure that is directly attributable to acquisition of the asset. Impairment is assessed whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

With the exception of freehold and long-term leasehold 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. The annual rates of depreciation or amortisation are:

Buildings	50 years
Leases (leasehold improvements)	the lower of the expected lease term or the asset's remaining useful life
Fixtures and equipment	3–10 years

Residual values and useful lives of assets are reviewed at each reporting date. Depreciation is recognised within depreciation expense in the income statement.

	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 2016	6	3	154	100	263
Additions	–	–	14	7	21
Disposals	(1)	–	(25)	(5)	(31)
At 30 September 2017	5	3	143	102	253
Additions	–	–	9	13	22
Disposals	(2)	–	(3)	(1)	(6)
At 30 September 2018	**3**	**3**	**149**	**114**	**269**
Accumulated depreciation					
At 1 October 2016	1	–	90	73	164
Charge for the year	–	–	14	8	22
Disposals	–	–	(16)	(3)	(19)
At 30 September 2017	1	–	88	78	167
Charge for the year (note 2.4)	–	–	10	8	18
Disposals	–	–	(3)	(1)	(4)
At 30 September 2018	**1**	**–**	**95**	**85**	**181**
Net book value					
At 30 September 2018	**2**	**3**	**54**	**29**	**88**
At 30 September 2017	4	3	55	24	86

Section 3: Assets and liabilities continued

3.8 Property, plant and equipment continued

Valuations

A comparison of the carrying value between the revaluation basis and the historical cost basis, for freehold and long-term leasehold land and buildings, is shown below:

	2018 £m	2017 £m
Carrying value as included under the revaluation basis	**5**	7
Carrying value if the historical cost basis had been used	**5**	6

3.9 Investment properties

Accounting policy

Investment properties are measured at fair value and are revalued annually by the Directors. The valuations are based upon advice received from independent valuers and performed on an open market basis. Adjustments are made to observable market data for comparable properties for specific characteristics such as the nature, location or condition of the asset. Fair value movements are recognised in the income statement in the period in which they arise.

Investment properties are classified in Level 3 of the fair value hierarchy as defined in note 3.18.

	2018 £m	2017 £m
At 1 October	**14**	22
Disposals	**(7)**	(7)
Revaluation	**–**	(1)
At 30 September	**7**	14

During the year 90% (2017: 86%) of the investment properties generated total rental income of £1m (2017: £1m) and incurred operating and administrative expenses of £1m (2017: £1m). The operating and administrative expenses of the investment properties that did not generate rental income were £Nil (2017: £Nil).

Notes to the consolidated financial statements

Section 3: Assets and liabilities continued

3.10 Intangible assets

Accounting policy

Capitalised software costs are stated at cost, less amortisation and any provision for impairment.

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 10 years. Impairment losses are recognised in the income statement as incurred.

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, which typically arises when the benefits associated with the software were substantially reduced from what had originally been anticipated or the asset has been superseded by a subsequent investment. In such situations, 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.

Intangible assets which are fully amortised are reviewed annually to consider whether the assets remain in use.

Capitalised software costs

	2018 £m	2017 £m
Cost		
At 1 October	**589**	463
Additions	**144**	148
Write-off	**–**	(22)
At 30 September	**733**	589
Accumulated amortisation		
At 1 October	**250**	207
Charge for the year (note 2.4)	**71**	65
Write-off	**–**	(22)
At 30 September	**321**	250
Net book value at 30 September	**412**	339

£1m (2017: £3m) of the £144m (2017: £148m) software additions do not form part of internally generated software projects.

Section 3: Assets and liabilities continued

3.11 Deferred tax

Accounting policy

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. A deferred tax asset is recognised for unused tax losses and unused tax credits only if it is probable that future taxable amounts will arise against which those temporary differences and losses may be utilised.

Critical accounting estimates and judgements

The Group has deferred tax assets of £206m (2017: £154m); the increase from the previous balance sheet date is mainly due to increased loss recognition due to the implementation of the Corporate Loss Restriction, losses incurred in the year and additionally previously written off historic losses re-recognised in accordance with IAS 12. The Group has assessed the recoverability of these deferred tax assets at 30 September 2018 and considers it probable that sufficient future taxable profits will be available against which the underlying deductible temporary differences can be utilised over the corporate planning horizon.

At 30 September 2018, the Group had an unrecognised deferred tax asset of £157m (2017: £180m) representing trading losses with a gross value of £926m (2017: £1,058m). Although there is no prescribed period after which losses expire, a deferred tax asset has not been recognised in respect of these losses as the Directors have insufficient certainty over their recoverability in the foreseeable future.

Movement in net deferred tax asset

	2018 £m	2017 £m
At 1 October	**79**	156
Recognised in the income statement (note 2.5)	**35**	(69)
Recognised directly in equity	**15**	(8)
At 30 September	**129**	79

The Group has recognised deferred tax in relation to the following items:

	2018 £m	2017 £m
Deferred tax assets		
Tax losses carried forward	**99**	28
Capital allowances	**88**	120
Cash flow hedge reserve	**12**	1
Transitional adjustment – available for sale reserve	**1**	3
Employee equity based compensation	**3**	2
Other	**3**	–
	206	154
Deferred tax liabilities		
Defined benefit pension scheme surplus	**(74)**	(72)
Gains on unlisted available for sale investments	**(3)**	(3)
	(77)	(75)
Net deferred tax asset	**129**	79

Since 1 April 2017, the statutory rate of UK corporation tax has been 19% and will fall to 17% from 1 April 2020. In accordance with the appropriate accounting standard, these enacted rates are used to measure the value at which assets are expected to be realised and liabilities settled.

A prior year adjustment to claim capital allowances provisionally disclaimed at 30 September 2017 has resulted in an increase to the residual loss deferred tax asset of £14m and a decrease in the corresponding capital allowance deferred tax asset of £19m. The difference between the two amounts, which arises because the two types of deferred tax assets are recognised at different rates, is taken to the income statement as part of the prior year credit set out in note 2.5.

The acquisition of Virgin Money on 15 October 2018 is not expected to have a material impact on the deferred tax asset recognition.

Section 3: Assets and liabilities continued

3.12 Due to other banks

Accounting policy
Repurchase agreements
Securities sold subject to sale and repurchase agreements ('repos') are retained in their respective balance sheet categories. The associated liabilities are included in amounts due to other banks based upon the counterparties to the transactions.

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

	2018 £m	2017 £m
Securities sold under agreements to repurchase [(1)]	**802**	1,864
Transaction balances with other banks	**29**	21
Deposits from other banks	**37**	31
Secured loans	**2,254**	1,901
	3,122	3,817

(1) The underlying securities sold under agreements to repurchase have a carrying value of £1,172m (2017: £2,660m).

Secured loans comprise amounts drawn under the TFS (including accrued interest).

3.13 Due to customers

	2018 £m	2017 £m
Interest bearing demand deposits	**19,895**	19,130
Term deposits	**6,192**	5,957
Non-interest bearing demand deposits	**2,756**	2,548
Other wholesale deposits	**1**	18
	28,844	27,653
Accrued interest payable	**60**	65
	28,904	27,718

Section 3: Assets and liabilities continued

3.14 Provision for liabilities and charges

Accounting policy

Provisions for liabilities and charges 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 for liabilities and charges are not discounted to the present value of their expected net future cash flows except where the time value of money is considered material.

Critical accounting estimates and judgements

PPI redress provision and other conduct related matters

Management has 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 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.

Significant judgement is required in determining the key assumptions used to estimate the quantum of the provision, including the level of 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). 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 2018, consequently, the provision calculated may be subject to change in future years if outcomes differ to those currently assumed. Sensitivity analysis indicating the impact of reasonably possible changes in key assumptions on the PPI provision is presented within this note.

There are similar uncertainties and judgements for other conduct risk related matters, however the level of liability is materially lower.

	2018 £m	2017 £m
PPI redress provision		
Opening balance	**422**	725
Charge to the income statement (note 2.4)	**352**	48
Charge reimbursed/reimbursable under Conduct Indemnity	**148**	446
Utilised	**(647)**	(797)
Closing balance	**275**	422
Customer redress and other provisions		
Opening balance	**109**	101
Charge to the income statement (note 2.4)	**44**	10
Charge reimbursed/reimbursable under Conduct Indemnity	**–**	88
Utilised	**(112)**	(90)
Closing balance	**41**	109
Restructuring provision[1]		
Opening balance	**23**	26
Charge to the income statement	**15**	58
Utilised	**(23)**	(61)
Closing balance	**15**	23
Total provisions for liabilities and charges	**331**	554

(1) Restructuring provision includes surplus lease space provision.

Section 3: Assets and liabilities continued

3.14 Provision for liabilities and charges continued

PPI redress

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. During the year, the Group reassessed the level of provision that was considered appropriate to meet current and future expectations in relation to the mis-selling of PPI policies and concluded that a further charge of £500m was required incorporating the Group's estimate of the impact of heightened media coverage, the FCA advertising campaign and increased activity by claims management companies ahead of the August 2019 industry deadline. It also incorporated a reassessment of the costs of processing cases and the impact of experience adjustments. The impact on the Group's income statement (£352m) has been reduced by the remaining balance of the Capped Indemnity. The total provision raised to date in respect of PPI is £2,640m (2017: £2,140m), with £275m of this remaining (2017: £293m)[(1)] for customer initiated complaints including costs of administration.

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 and resulted in an increase in operational and administrative costs. As reported previously, this involved the Group reopening complaints and reviewing the original decision reached in light of the new PPI complaint handling processes. This process has been concluded during the year at an additional cost of £88m.

To 30 September 2018, the Group has received 483,000[(2)] complaints (2017: 361,000) and has allowed for 83,000 further walk in complaints (2017: 73,000). This reflects an expectation that incoming complaints will reduce from current levels in aggregate reflecting the recently observed decline following the implementation of the fee cap.

The increase in provision has taken into account the above factors as well as a revision in the Group's expectation of new customer initiated complaints in light of current experience. The overall 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 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, the application of a time bar, Plevin, and FCA advertising); (ii) the number of those claims that ultimately will be upheld; (iii) the amount that will be paid in respect of those claims; and (iv) the costs of administration.

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.

The table below sets out the key assumptions and the effect on the provision at 30 September 2018 of future, potential, changes in key assumptions:

Assumptions

	Change in assumption	Sensitivity[(3)]
Number of expected future customer initiated complaints (83,000 new complaints)	+/-10%	£24m
Uphold rate	+/-1%	£3m
Average redress costs[(4)]	+/-1%	£1m

(1) Comparatives refer to the remaining provision for customer initiated complaints only, the balance being for the completion of the remediation exercise.
(2) Of these cases, c.12,000 were work in progress as at 30 September 2018 (2017: c.11,000).
(3) 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.
(4) Sensitivity to a change in average redress across customer initiated complaints.

Customer redress and other provisions

Other provisions include amounts in respect of a number of non-PPI conduct related matters, legal proceedings, and claims arising in the ordinary course of the Group's business. Over the course of the year, the Group has raised further provisions of £44m for these matters, none of which was covered by the Capped Indemnity. The ultimate cost to the Group of other customer redress matters is driven by a number of factors relating to offers of redress, compensation, offers of alternative products, consequential loss claims and administrative costs. The matters are at varying stages of their life cycle and in certain circumstances, usually early in the life of a potential issue, elements of the potential exposure are contingent. These factors could result in the total cost of review and redress varying materially from the Group's estimate. The final amount required to settle the Group's potential liabilities in these matters is therefore uncertain and further provision could be required.

Section 3: Assets and liabilities continued

3.14 Provision for liabilities and charges continued

Conduct Indemnity Deed

The Group's economic exposure to the impact of historic conduct related liabilities was mitigated by a Capped Indemnity of £1.7bn from NAB. The full amount of the remaining Capped Indemnity was drawn down in the current year. The Company and NAB had an agreement under which NAB provided the Company with a Capped Indemnity to meet the costs of dealing with conduct matters related to products sold in the period prior to the date of the Group's Demerger (the Conduct Indemnity Deed). The legacy conduct matters covered by the Capped Indemnity are referred to as Relevant Conduct Matters. The Capped Indemnity provided the Group with economic protection against certain costs and liabilities (including financial penalties imposed by a regulator) resulting from conduct issues relating to:

a) PPI, standalone interest rate hedging products, voluntary scope tailored business loans and fixed rate tailored business loans; and

b) other conduct matters, subject to certain limitations and minimum financial thresholds.

Amounts payable under the Capped Indemnity included, subject to certain limitations, payments to customers to satisfy, settle or discharge a Relevant Conduct Matter and the direct costs and expenses of satisfying, settling, discharging or administering such Relevant Conduct Matter.

It was agreed that NAB would meet 90.3% of Qualifying Conduct Costs claimed by the Company, up to the amount of the Capped Indemnity.

Claims under the Capped Indemnity have been recognised in the consolidated income statement simultaneously with the charge for Relevant Conduct Matters. The conduct expense and associated reimbursement income have been presented net within Other operating and administrative expenses. The provision expense and reimbursement income are disclosed above.

Now that the Qualifying Conduct Costs have exceeded the Capped Indemnity, any costs in excess of the amounts currently provided will be borne by the Group.

To the extent that tax relief is expected in relation to provisions for which reimbursement income is applicable, amounts may become repayable to NAB. In the consolidated financial statements, deferred tax assets are only recognised in respect of the loss share proportion (9.7%) of unused tax losses on Relevant Conduct Matters, on the basis that the Group does not obtain the economic benefit of the future tax relief which is repayable to NAB.

The utilisation of the Capped Indemnity is set out below:

	Conduct protection £m
Conduct protection provided by NAB	1,700
Capital injected into CYB Investments Limited (CYBI) prior to Demerger[(1)]	(120)
Drawn in the period to 30 September 2017[(2)]	(1,432)
Undrawn Conduct Indemnity as at 30 September 2017	148
Drawn in the year to 30 September 2018	(148)
Undrawn balance as at 30 September 2018	–

(1) £120m of the £670m of capital injected in CYBI on 24 September 2015 related to the Conduct Indemnity Deed.
(2) £465m of the £1,432m represented the pre-covered provision amount.

Restructuring provision

Restructuring of the business is currently ongoing and a provision is held to cover redundancy payments, property vacation costs and associated enablement costs. During the year £38m (2017: £67m) was charged to the income statement, of which £23m (2017: £9m) was charged directly to the income statement and £15m (2017: £58m) was provided for in accordance with the requirements of IAS 37. £23m (2017: £61m) of the total provision was utilised in the year.

Included within the restructuring provision is an amount for committed rental expense on surplus lease space consistent with the expected 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.

Section 3: Assets and liabilities continued

3.15 Debt securities in issue

Accounting policy

Debt securities comprise short and long-term debt issued by the Group including commercial paper, medium-term notes, term loans, covered bonds and RMBS notes.

Debt securities are initially recognised at fair value, being the issue proceeds, net of transaction costs incurred. These instruments are subsequently measured at amortised cost using the effective interest method resulting in premiums, discounts and associated issue costs being recognised in the income statement over the life of the instrument.

The breakdown of debt securities in issue is shown below:

2018	Medium-term notes £m	Subordinated debt £m	Securitisation £m	Covered bonds £m	Total £m
Amortised cost	**794**	**476**	**2,949**	**698**	**4,917**
Fair value hedge adjustments	**(1)**	**–**	**–**	**34**	**33**
Total debt securities	**793**	**476**	**2,949**	**732**	**4,950**
Accrued interest payable	**3**	**3**	**7**	**10**	**23**
	796	**479**	**2,956**	**742**	**4,973**

2017	Medium-term notes £m	Subordinated debt £m	Securitisation £m	Covered bonds £m	Total £m
Amortised cost	297	476	3,242	698	4,713
Fair value hedge adjustments	–	–	–	50	50
Total debt securities	297	476	3,242	748	4,763
Accrued interest payable	3	3	6	10	22
	300	479	3,248	758	4,785

The Group issued the following debt securities during the year:

Issue date	Debt security	Initial proceeds	Programme
1 February 2018	Lanark 2018-1 1A	$300m	Securitisation
1 February 2018	Lanark 2018-1 2A	£285m	Securitisation
5 July 2018	Lanark 2018-2 1A	$400m	Securitisation
5 July 2018	Lanark 2018-2 2A	£250m	Securitisation
25 September 2018	Medium-term notes 2018	£500m	Medium-term notes

The following redemptions occurred during the year with the final redemption value in line with the scheduled programme terms:

Redemption date	Debt security	Initial proceeds	Programme
20 November 2017	Lannraig 2011-1 1A	£335m	Securitisation
22 November 2017	Lanark 2012-2 2A	£525m	Securitisation
22 August 2018	Lanark 2014-2 1A	€550m	Securitisation
22 August 2018	Lanark 2015-1 1A	£300m	Securitisation

Further reduction in the carrying value is as a result of scheduled principal repayments on outstanding securitisation notes.

Section 3: Assets and liabilities continued

3.15 Debt securities in issue continued

Details of the terms and conditions of the notes issued under the medium-term notes and subordinated debt programmes as at 30 September 2018 were as follows:

Medium-term notes	Carrying value[(1)] £m
CYBG 3.125% fixed to floating rate callable senior notes due 2025	**298**
CYBG 4% fixed rate reset callable senior notes due 2026	**495**
Total medium-term notes	**793**

Subordinated debt	Carrying value[(1)] £m
CYBG 5% fixed rate reset callable subordinated notes due 2026	**476**

Details of the terms and conditions of the notes issued under the securitisation and covered bond programmes as at 30 September 2018 were as follows:

Issue date	Currency	Carrying value[(1)] £m	Coupon rate	Call date
Class A Lanark RMBS notes				
19 March 2014	GBP	**218**	3M GBP LIBOR + 0.50%	22 November 2018
11 December 2014	GBP	**274**	3M GBP LIBOR + 0.60%	22 February 2020
6 August 2015	EUR	**249**	3M EURIBOR + 0.45%	22 May 2021
4 August 2016	GBP	**419**	3M GBP LIBOR + 1.00%	22 February 2019
5 July 2017	GBP	**349**	3M GBP LIBOR + 0.42%	22 November 2020
5 July 2017	GBP	**399**	3M GBP LIBOR + 0.55%	22 August 2022
1 February 2018	USD	**202**	3M USD LIBOR + 0.42%	22 August 2020
1 February 2018	GBP	**284**	3M GBP LIBOR + 0.42%	22 February 2023
5 July 2018	USD	**306**	3M USD LIBOR + 0.42%	22 February 2021
5 July 2018	GBP	**249**	3M GBP LIBOR + 0.52%	22 August 2023
		2,949		
Covered bonds				
8 June 2012	GBP	**732**	4.625%	8 June 2026
Total securitised notes and covered bonds (note 3.7)		**3,681**		

(1) Excludes accrued interest.

Section 3: Assets and liabilities continued

3.16 Retirement benefit obligations

Accounting policy

The Group makes contributions to both defined benefit and defined contribution pension schemes which entitle employees to benefits on retirement or disability.

Defined contribution pension scheme

The Group recognises the obligation for contributions to the scheme 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

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. Surpluses are only recognised to the extent that they are recoverable through reduced contributions in the future or through refunds from the scheme. In assessing whether a surplus is recoverable, the Group considers its current right to obtain a refund or a reduction in future contributions and does not anticipate any future acts by other parties that could change the amount of the surplus that may be ultimately recovered.

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. Where actuarial remeasurements arise, the Group recognises such amounts directly in equity 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 operates both defined benefit and defined contribution arrangements. The Group's principal trading subsidiary, Clydesdale Bank PLC, 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 a 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, with the Trustee 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 on a basis consistent with the methodology applied to the defined benefit pension scheme. This is a closed scheme and the provision will be utilised over the life of the remaining scheme members.

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

	2018 £m	2017 £m
Active members' defined benefit obligation	**(24)**	(807)
Deferred members' defined benefit obligation[1]	**(2,131)**	(1,549)
Pensioner and dependant members' defined benefit obligation	**(1,591)**	(1,618)
Total defined benefit obligation	**(3,746)**	(3,974)
Fair value of Scheme assets	**3,958**	4,181
Net defined benefit pension asset	**212**	207
Post-retirement medical benefits obligations	**(3)**	(3)

(1) Deferred members' defined benefit obligation includes employees who became deferred members on 1 August 2017 as part of the Scheme closure exercise.

Section 3: Assets and liabilities continued

3.16 Retirement benefit obligations continued

The Group has implemented a number of reforms to the Scheme to manage the liability. It closed the Scheme to new members in 2004 and since April 2006 has determined benefits accruing on a career average revalued earnings basis. On 1 August 2017, the Scheme was closed to future benefit accrual for the majority of current employees, with affected employees' future pension benefits being provided through the existing defined contribution scheme, 'Total Pension'. The Total Pension income statement charge for the year is shown in note 2.4.

The last scheme funding valuation was at 30 September 2016 with a calculated deficit of £290m. In the latest recovery plan dated 31 January 2018, the Group agreed to eliminate the deficit through the following scheduled contributions: a single contribution of £25m on 15 October 2018; thereafter, equal monthly contributions totalling £50m per annum until 31 March 2022; and £55m in the year to 31 March 2023.

On 26 October 2018 the High Court ruled on a landmark pensions case relating to the defined benefits pension schemes operated by Lloyds Banking Group. Refer to note 5.5 for further information on post balance sheet events.

Reconciliation of the net defined benefit pension asset/(liability)

	2018 £m	2017 £m
Opening net defined benefit pension scheme asset/(liability)	**207**	(75)
Service (cost)/credit	**(3)**	54
Interest on net defined benefit asset/(liability)	**5**	(1)
Remeasurement effects recognised in SOCI	**(9)**	154
Employer contributions	**18**	69
Administrative expenses	**(6)**	(7)
Curtailments and settlements	**–**	13
Closing fair value of net defined benefit pension scheme asset	**212**	207

Reconciliation of the defined benefit pension scheme assets

	2018 £m	2017 £m
Opening fair value of defined benefit pension scheme assets	**4,181**	4,462
Interest income on Scheme assets at discount rate	**109**	104
Return on Scheme assets greater/(less) than discount rate	**27**	(195)
Employer contributions (note 5.3)	**18**	69
Benefits paid	**(93)**	(102)
Transfer payments	**(278)**	(150)
Administrative costs paid	**(6)**	(7)
Closing fair value of defined benefit pension scheme assets	**3,958**	4,181

Reconciliation of the defined benefit pension scheme obligations

	2018 £m	2017 £m
Opening defined benefit pension scheme obligations	**(3,974)**	(4,537)
Current service cost	**(1)**	(26)
Past service (cost)/credit	**(2)**	80
Interest expense on the defined benefit obligation	**(104)**	(105)
Actuarial (loss)/gain – experience adjustments	**(35)**	76
Actuarial gain – demographic assumptions	**19**	88
Actuarial (loss)/gain – financial assumptions	**(20)**	185
Benefits paid from Scheme assets	**93**	102
Transfer payments	**278**	150
Curtailments and settlements	**–**	13
Closing defined benefit pension scheme obligations	**(3,746)**	(3,974)

Section 3: Assets and liabilities continued

3.16 Retirement benefit obligations continued

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

	2018 £m	2017 £m
Quoted		
Equities	**650**	804
Government bonds	**2,017**	1,495
Global sovereign bonds	**24**	33
Corporate bonds	**706**	829
Alternative credit	**260**	97
Infrastructure	**255**	272
Secure income alternatives	**336**	209
Derivatives(1)	**172**	169
Other	**4**	4
Repurchase agreements	**(836)**	–
Cash	**238**	124
Unquoted		
Property	**132**	145
Fair value of defined benefit pension scheme assets	**3,958**	4,181

(1) Derivative financial instruments are used to modify the profile of the assets of the Scheme to better match the Scheme's liabilities. Derivative holdings may lead to increased or decreased exposures to the physical asset categories disclosed above.

The Scheme is not invested in any of the Group's own financial instruments.

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 Group 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 asset returns will be a key factor in the overall investment return. The investment portfolio is subject also to a range of risks typical of the assets held, in particular equity risk, 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. As at 30 September 2018, both the interest rate and inflation rate hedge ratios were around 60% of liabilities when measured on a self-sufficiency basis. The estimated hedge ratios will be updated pending changes to the Trustee's strategic asset allocation but it is expected these have both increased. 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

	2018 £m	2017 £m
Current service cost	**1**	26
Past service cost	**2**	8
Past service credit on closure of Scheme	**–**	(88)
Curtailment and settlement gains	**–**	(13)
Net interest on net defined benefit (asset)/liability	**(5)**	1
Defined benefit pension income for the year	**(2)**	(66)
Administrative costs incurred	**6**	7
Cost/(credit) recognised in the income statement (note 2.4)	**4**	(59)

The Group incurred a past service cost of £2m (2017: £8m) in relation to enhanced early retirement entitlements on redundancy; in both years these were fully offset in the income statement by a corresponding release from the restructuring provision. In the prior year, the income statement benefitted from a curtailment gain of £13m due to a higher than normal level of redundancies with no enhancement entitlement; this gain was offset against the related restructuring costs.

Notes to the consolidated financial statements

Section 3: Assets and liabilities continued

3.16 Retirement benefit obligations continued

Amounts recognised in the statement of comprehensive income

	2018 £m	2017 £m
Opening cumulative actuarial losses	**(695)**	(849)
Actuarial (loss)/gain due to liability experience adjustments	**(35)**	76
Actuarial (loss)/gain due to liability assumption changes	**(20)**	185
Actuarial gain due to demographic assumption changes	**19**	88
Return on Scheme assets greater/(less) than discount rate	**27**	(195)
Cumulative actuarial losses recognised in the statement of comprehensive income	**(704)**	(695)

Actuarial assumptions

	2018 % p.a.	2017 % p.a.
Financial assumptions		
Discount rate	**2.75**	2.74
Inflation (RPI)	**3.30**	3.24
Inflation (CPI)	**2.30**	2.24
Career average revalued earnings (CARE) revaluations:		
Pre 31 March 2012 benefits (RPI)	**3.30**	3.24
Post 31 March 2012 benefits (CPI capped at 5% per annum)	**2.30**	2.24
Pension increases (capped at 2.5% per annum)	**2.13**	2.12
Pension increases (capped at 5% per annum)	**3.15**	3.10
Rate of increase for pensions in deferment	**2.30**	2.24

Demographic assumptions Post-retirement mortality:	2018 years	2017 years
Current pensioners at 60 – male	**28.2**	28.2
Current pensioners at 60 – female	**29.8**	29.7
Future pensioners at 60 – male	**29.3**	29.3
Future pensioners at 60 – female	**31.0**	30.9

Section 3: Assets and liabilities continued

3.16 Retirement benefit obligations continued

Critical accounting estimates and judgements

The value of the Group's defined benefit pension scheme requires management to make several assumptions. The key areas of estimation uncertainty are:

- *The discount rate applied*. The discount rate is required to be set with reference to market yields at the end of the reporting period on high quality corporate bonds in the currency and with a term consistent with the Scheme's obligations. The average duration of the Scheme's obligations is approximately 19 years. The market for bonds with a similar duration is illiquid and, as a result, significant management judgement is required to determine an appropriate yield curve on which to base the discount rate.
- *Inflation assumptions*. Inflation is set with reference to market expectations of the RPI measure of inflation for a term consistent with the Scheme's obligations, based on data published by the BoE. Other measures of inflation (such as CPI, or inflation measures subject to an annual cap) are derived from this assumption.
- *Mortality assumptions*. The cost of the benefits payable by the Scheme will also depend upon the life expectancy of the members. The assumptions for mortality rates are based on standard mortality tables which allow for future improvements in life expectancies.

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%	(169)	(6)
	-0.25%	182	5
Inflation	+0.25%	115	3
	-0.25%	(113)	(3)
Life expectancy	+1 year	126	4
	-1 year	(120)	(3)

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 2018 is 19 years (2017: 20 years). The expected contributions for the year ending 30 September 2019 are £77m (2018: £33m) and expected benefit payments for the year ending 30 September 2019 are £98m (2018: £100m).

The Group and Trustee have entered into a contingent security arrangement (the 'Security Arrangement') (note 5.3).

3.17 Other liabilities

	2018 £m	2017 £m
Notes in circulation	**2,254**	2,197
Accruals and deferred income	**125**	163
Other	**101**	111
	2,480	2,471

Section 3: Assets and liabilities continued

3.18 Fair value of financial instruments

Accounting policy

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 valuation date.

When available, the Group measures the fair value of an instrument using quoted prices in an active market for that instrument. 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 paid 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.

In certain limited circumstances the Group applies the fair value measurement option to financial assets including 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 an accounting mismatch. 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 and recognised in the income statement.

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); and

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

For the purpose of reporting movements between levels of the fair value hierarchy, transfers are recognised at the beginning of the reporting period in which they occur.

Section 3: Assets and liabilities continued

3.18 Fair value of financial instruments continued

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

The tables overleaf 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.

There are various limitations inherent in this fair value disclosure particularly where prices are derived from unobservable inputs due to some financial instruments not being traded in an active market. The methodologies and assumptions used in the fair value estimates are therefore described in the notes to the tables. The difference between carrying value and fair value is relevant in a trading environment, but is not relevant to assets such as loans and advances.

	30 September 2018					30 September 2017				
			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 advance to customers	**32,744**	**32,307**	**–**	**1,110**	**31,197**	31,293	31,088	–	1,009	30,079
Financial liabilities										
Due to other banks	**3,122**	**3,057**	**–**	**3,057**	**–**	3,817	3,817	–	3,817	–
Due to customers	**28,904**	**28,968**	**–**	**28,968**	**–**	27,718	27,833	–	27,833	–
Debt securities in issue	**4,973**	**5,052**	**1,279**	**3,773**	**–**	4,785	4,910	795	4,115	–

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

(a) Loans and advances to customers – The fair values of loans and advances are determined by firstly segregating them into portfolios of similar characteristics. Contractual cash flows are then adjusted for expected credit losses and expectations of customer behaviour based on observed historic data. The cash flows 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.

(b) Due to other banks – The fair value is determined from a discounted cash flow model using current market rates for instruments of similar terms and maturity.

(c) 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.

(d) Debt securities in issue – The fair value is taken directly from quoted market prices where available or determined from a discounted cash flow model using current market rates for instruments of similar terms and maturity.

(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 subsequent to initial recognition at fair value, using the fair value hierarchy described above.

	Fair value measurement as at 30 September 2018				Fair value measurement as at 30 September 2017			
	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	**–**	**262**	**–**	**262**	–	282	–	282
AFS investments – listed	**1,551**	**–**	**–**	**1,551**	2,066	–	–	2,066
AFS investments – unlisted	**–**	**–**	**5**	**5**	–	–	4	4
AFS – other	**–**	**–**	**6**	**6**	–	–	6	6
Other financial assets at fair value	**–**	**362**	**–**	**362**	–	–	477	477
Total financial assets at fair value	**1,551**	**624**	**11**	**2,186**	2,066	282	487	2,835
Financial liabilities								
Derivative financial liabilities	**–**	**361**	**–**	**361**	–	376	–	376
Other financial liabilities at fair value	**–**	**15**	**–**	**15**	–	–	26	26
Total financial liabilities at fair value	**–**	**376**	**–**	**376**	–	376	26	402

Section 3: Assets and liabilities continued

3.18 Fair value of financial instruments continued

There were no transfers between Level 1 and 2.

The Group's valuations 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 values of derivatives, including foreign exchange contracts, interest rate swaps, interest rate and currency option contracts, and currency swaps, are obtained from discounted cash flow models or option pricing models as appropriate.

(b) Available for sale investments

- *Listed (Level 1)* – The fair values of listed investments are based on quoted closing market prices.
- *Unlisted (Level 3)* – Includes £4m of Visa Inc. preferred stock received as partial consideration for the sale of the Group's share in Visa Europe (note 2.3). The preferred stock is convertible into Visa Inc. common stock or its equivalent at a future date, subject to potential reduction for certain litigation losses that may be incurred by Visa Europe. The fair value of the preference shares has been calculated by taking the period end New York Stock Exchange share price for Visa Inc. and discounting for illiquidity and clawback related to contingent litigation. For other unlisted equity and debt investments, the Group's share of the net asset value or the transaction price respectively are considered the best representation of the exit price and are the Group's best estimates of fair value.
- *Available for sale – other (Level 3)* – The other available for sale financial asset represents deferred consideration receivable and consists of the rights to future commission. 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.

(c) Financial assets and liabilities at fair value through profit or loss – 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.

Level 3 movement analysis:

	2018			2017		
	Financial assets available for sale (£m)	**Other financial assets at fair value (£m)**	**Other financial liabilities at fair value (£m)**	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	**10**	**477**	**(26)**	36	750	(48)
Transfer to Level 2[1]	**–**	**(477)**	**26**	–	–	–
Fair value (losses)/gains recognised[2]						
In profit or loss – (unrealised)	**1**	**–**	**–**	–	(39)	2
In profit or loss – (realised)	**(1)**	**–**	**–**	1	2	–
In available for sale – (unrealised)	**1**	**–**	**–**	1	–	–
Purchases	**–**	**–**	**–**	–	–	–
Sales[3]	**–**	**–**	**–**	(26)	–	–
Settlements	**–**	**–**	**–**	(2)	(236)	20
Balance at the end of the year	**11**	**–**	**–**	10	477	(26)

(1) The financial assets at fair value comprise a portfolio of loans which are no longer on sale. The continued run-off of these loans has resulted in the unobservable credit risk inputs no longer being significant to their fair value. As such the loans (and associated liabilities) have been reclassified to Level 2 in the fair value hierarchy. In accordance with the Group's accounting policy, the transfer is deemed to have occurred at the beginning of the reporting period. There were no transfers into or out of Level 3 in the year ended 30 September 2017.
(2) Net gains or losses were recorded in non-interest income or within the available for sale reserve as appropriate.
(3) The sale principally relates to the disposal of the VocaLink investment during the prior year (note 2.3).

Notes to the consolidated financial statements

Section 3: Assets and liabilities continued

3.18 Fair value of financial instruments continued

Quantitative information about significant unobservable inputs in Level 3 valuations

The table below lists key unobservable inputs to Level 3 financial instruments, and provides the range of those inputs as at 30 September 2018.

	Fair value £m	Valuation technique	Unobservable inputs	Low range	High range
Financial assets					
AFS investments – unlisted	**5**	Discounted cash flow	Contingent litigation risk	0%	100%
AFS – other	**6**	Discounted cash flow	Funds under management attrition rate	10%	20%

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 input impacting the carrying value of the available for sale – other asset is the Funds Under Management Attrition rate. The Group currently assumes an annual 15% attrition rate. If this rate was 20% the fair value would reduce by £1m; if it was 10% the fair value would increase by £2m.

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.

Section 4: Capital

4.1 Equity

Accounting policy

Equity

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

(a) they include no contractual obligations upon the Company to deliver cash or other financial assets or to exchange financial assets or financial liabilities with another party under conditions that are potentially unfavourable to the Group; and

(b) where the instrument will or may be settled in the Company's own equity instruments, it is either a non-derivative that includes no obligation to deliver a variable number of the Company's own equity instruments or is a derivative that will be settled by the Company exchanging a fixed amount of cash or other financial assets for a fixed number of its own equity instruments.

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

Dividends

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

Final dividends on ordinary shares are recognised as a liability and deducted from equity when they are approved by the Company's shareholders. Interim dividends are deducted from equity when they are no longer at the discretion of the Company.

Proposed final dividends for the year are disclosed as an event after the balance sheet date.

4.1.1 Share capital

	2018 Number of shares	2017 Number of shares	**2018 £m**	2017 £m
Ordinary shares of £0.10 each – allotted, called up and fully paid				
Opening ordinary share capital	**883,606,066**	881,531,852	**88**	88
Issued under employee share schemes	**2,473,893**	2,074,214	**1**	–
Closing ordinary share capital	**886,079,959**	883,606,066	**89**	88

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 Company. All shares in issue at 30 September 2018 rank equally with regard to the Company's residual assets.

During the year 2,473,893 (2017: 2,074,214) ordinary shares were issued under employee share schemes with a nominal value of £0.2m (2017: £0.2m).

A final dividend in respect of the year ended 30 September 2017 of 1p (2016: £Nil) per ordinary share amounting to £9m (2016: £Nil), was paid in February 2018. These dividends were deducted from retained profits in the current year. The Directors have recommended a final dividend in respect of the year ended 30 September 2018 of 3.1p per ordinary share in the Company to be paid on 15 February 2019. The payment of the final dividend is subject to approval of the shareholders at the 2019 Annual General Meeting. These financial statements do not reflect the recommended dividend.

A description of the other equity categories included within the Consolidated statement of changes in equity, and significant movements during the year, is provided below:

4.1.2 Other equity instruments

Other equity instruments consist of Perpetual Contingent Convertible Notes (fixed 8%) which were issued on 8 February 2016 with a principal amount of £450m and an optional redemption on 8 December 2022. AT1 distributions of £36m were paid in the year, £29m net of tax (2017: £36m paid, £29m net of tax).

Section 4: Capital continued

4.1 Equity continued

4.1.3 Capital reorganisation reserve

The capital reorganisation reserve of £839m was recognised on the issuance of CYBG PLC ordinary shares in February 2016 in exchange for the acquisition of the entire share capital of the Group's previous parent company, CYBI. The reserve reflects the difference between the consideration for the issuance of CYBG PLC shares and CYBI's share capital and share premium.

4.1.4 Merger reserve

A merger reserve of £633m was recognised on the issuance of CYBG PLC ordinary shares in February 2016 in exchange for the acquisition of the entire share capital of CYBI. The merger reserve reflects the difference between the consideration for the issuance of CYBG PLC shares and the nominal value of the shares issued.

4.1.5 Other reserves

4.1.5.1 Asset revaluation reserve

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

4.1.5.2 Available for sale reserve

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

4.1.5.3 Cash flow hedge reserve

The cash flow hedge reserve represents the cumulative post-tax gains and losses on derivatives designated as cash flow hedging instruments that will be recycled to the income statement when the hedged items affect profit or loss.

As at 30 September 2018, the cash flow hedge reserve reflected a cumulative loss of £39m (2017: £1m cumulative loss), all of which is in relation to ongoing hedges. The fair value of derivatives in cash flow hedges decreased by £58m in the year (2017: £84m decrease), and a £3m loss (2017: £4m gain) was recycled to interest income in line with hedged items affecting profit or loss. A £6m loss (2017: £0.3m loss) was transferred to non interest income due to ineffectiveness arising from cash flow hedges. These movements were offset by a deferred tax credit of £11m (2017: credit of £21m).

4.1.5.4 Equity-based compensation reserve

The Group's equity based compensation reserve records the value of equity settled share based payment benefits provided to the Group's employees as part of their remuneration that has been charged through the income statement and adjusted for deferred tax.

4.2 Equity based compensation

Accounting policy

The Group operates a number of equity settled share based compensation plans in respect of services received from certain of its employees. The fair value of the services received is recognised as an expense. The total amount to be expensed is measured by reference to the fair value of the Company's shares, performance options or performance rights granted, including, where relevant, any market performance conditions and any non-vesting conditions. The impacts of any service and non-market performance vesting conditions are not included in the fair value and instead are included in estimating the number of awards or options that are expected to vest.

The total expense is recognised over the vesting period, which is the period over which all of the specified vesting conditions are to be satisfied. A corresponding credit is recognised in the equity based compensation reserve, adjusted for deferred tax. In some circumstances employees may provide services in advance of the grant date and therefore the grant date fair value is estimated for the purposes of recognising the expense during the period between the start of the service period and the grant date.

At the end of each reporting period, the Group revises its estimates of the number of shares, performance options and performance rights that are expected to vest based on the non-market and service vesting conditions. The impact of the revision to original estimates, if any, is recognised in the income statement, with a corresponding adjustment to the equity based compensation reserve.

The equity settled share based payment charge for the year is £9m (2017: £6m).

Section 4: Capital continued

4.2 Equity based compensation continued

CYBG awards

The Group made a number of awards under its share plans:

Plan	Eligible employees	Nature of award	Vesting conditions[1]	Grant dates[2]
Deferred Equity Plan[3]	Selected employees	Conditional rights to shares	Continuing employment or leaving in certain limited circumstances	2016, 2017 and 2018
Long Term Incentive Plan	Selected senior employees	Conditional rights to shares	Continuing employment or leaving in certain limited circumstances and achievement of delivery of the Group's strategic goals and growth in shareholder value	2017 and 2018
Share Incentive Plan	All employees	Non-conditional share award	Continuing employment	2016 and 2017

(1) All awards are subject to vesting conditions and therefore may or may not vest.
(2) The year in which grants have been made under the relevant plan.
(3) Grants made under the Deferred Equity Plan are made the year following the financial year to which they relate.

Further detail on each plan is provided below:

Deferred Equity Plan (DEP)

Under the plan employees were awarded conditional rights to CYBG PLC shares. The shares are subject to forfeiture conditions including forfeiture as a result of resignation, termination by the Group or failure to meet compliance requirements. Awards include:

- The upfront and deferred elements of bonus awards where required to comply with the PRA Remuneration Code or the Group's deferral policy.
- Buyout of equity from previous employment for senior new hires.
- Demerger awards which are also subject to the achievement of performance conditions over a three-year period. Details of the performance conditions are set out in the Directors' remuneration report contained within the Group's Annual Report and Accounts.

Long Term Incentive Plan (LTIP)

Under the plan employees were awarded conditional rights to CYBG PLC shares. The shares are subject to forfeiture conditions including forfeiture as a result of resignation, termination by the Group or failure to meet compliance requirements.

The performance conditions of the plan must be met over a three year period. The measures reflect a balanced approach between financial and non-financial performance and are aligned to the organisation's strategic goals. Measures, relative weightings and the quantum for assessing performance are outlined in the Directors' remuneration report section contained within the Group's Annual Report and Accounts.

Share Incentive Plan (SIP)

Eligible employees at the date of the award, were awarded Group shares, which are held in the Share Incentive Plan Trust (SIP Trust). Awards are not subject to performance conditions and participants are the beneficial owners of the shares granted to them, but not the registered owners. Voting rights over the shares are normally exercised by the registered owner at the direction of the participants. For the 2015 Demerger award, leavers (with the exception of gross misconduct) retain their awards but they must withdraw their shares from the SIP Trust.

Section 4: Capital continued

4.2 Equity based compensation continued

Awards/rights made during the year

Plan	Number outstanding at 1 October 2017	Number awarded	Number forfeited	Number released	**Number outstanding at 30 September 2018**	Average fair value of awards at grant pence
Deferred Equity Plan						
2015 Demerger	2,038,052	–	–	–	**2,038,052**	196.96
2015 Bonus	135,595	–	–	(80,642)	**54,953**	195.17
2015 Commencement	65,068	–	–	(39,383)	**25,685**	194.67
2016 Bonus	543,195	–	(1,276)	(520,516)	**21,403**	266.03
2016 Commencement	131,996	–	–	(74,725)	**57,271**	266.03
2017 Bonus	–	1,319,049	(4,263)	(721,979)	**592,807**	313.20
2017 Commencement	–	98,499	–	(30,332)	**68,167**	313.20
2018 Commencement	–	7,796	–	(7,796)	**–**	313.20
Long Term Incentive Plan						
2016 LTIP	2,243,387	–	(10,996)	–	**2,232,391**	266.03
2017 LTIP	–	2,332,462	(17,975)	–	**2,314,487**	313.20
Share Incentive Plan						
2015 Demerger	1,483,008	–	(1,536)(1)	(184,320)(2)	**1,297,152**	194.67
2017 Free Share	–	998,520	(636)	(91,743)	**906,141**	313.20

(1) Forfeited shares remain in the SIP Trust.
(2) Shares withdrawn from SIP Trust on leaving the Group.

Determination of grant date fair values

Participants of the DEP and LTIP plans are not entitled to dividends until the awards vest, but the number of shares which vest may be increased to reflect the value of dividends that would have been paid up to the end of the holding period for the awards, subject to the extent permitted under the relevant remuneration regulation. Accordingly, the grant date fair value of the awards with only service conditions and/or non-market performance conditions has been taken as the market value of the Company's ordinary shares at the grant date. Where awards are subject to non-market performance conditions, an estimate is made of the number of awards expected to vest in order to determine the overall share-based payment charge to be recognised over the vesting period.

The Group has not issued awards under any CYBG plan with market performance conditions.

Notes to the consolidated financial statements

Section 5: Other notes

5.1 Contingent liabilities and commitments

Accounting policy

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 and are primarily issued to support direct financial obligations such as commercial bills or other debt instruments issued by a counterparty. The rating of the Group as a guarantee provider enhances the marketability of the paper issued by the counterparty in these circumstances. Financial guarantee contracts are initially recorded at fair value which is equal to the premium received, unless there is evidence to the contrary.

Operating lease commitments

The leases entered into by the Group are primarily operating leases; with operating lease rentals charged to the income statement on a straight line basis over the period of the lease. The Group discloses its obligations for future minimum payments under non-cancellable leases.

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 benefit is uncertain or cannot be reliably measured. Contingent liabilities are not recognised on the balance sheet but are disclosed unless they are remote.

The table below sets out the amounts of financial guarantees and commitments which are not recorded on the balance sheet. Financial guarantees and commitments are credit-related instruments which include acceptances, letters of credit, guarantees and commitments to extend credit. The 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 customer defaults. Since a significant portion of guarantees and commitments is expected to expire without being drawn upon, the total of the contract amounts is not representative of future liquidity requirements.

Financial guarantees

	2018 £m	2017 £m
Guarantees and assets pledged as collateral security:		
Due in less than 3 months	**26**	19
Due between 3 months and 1 year	**36**	40
Due between 1 year and 3 years	**10**	7
Due between 3 years and 5 years	**2**	3
Due after 5 years	**45**	42
	119	111
Other credit commitments		
Undrawn formal standby facilities, credit lines and other commitments to lend at call	**7,016**	8,408

Capital commitments

The Group had future capital expenditure which had been contracted for but not provided for at 30 September 2018 of £1m (2017: £1m).

Section 5: Other notes continued

5.1 Contingent liabilities and commitments continued

Operating lease commitments

	2018 £m	2017 £m
Leases as lessor		
Future minimum lease payments under non-cancellable operating leases are:		
Within 1 year	**1**	1
Between 1 year and 5 years	**4**	4
Over 5 years	**1**	–
	6	5
Leases as lessee		
Future minimum lease payments under non-cancellable operating leases are:		
Within 1 year	**29**	30
Between 1 year and 5 years	**96**	100
Over 5 years	**124**	137
	249	267

Other contingent liabilities

Conduct risk related matters

There continues to be significant uncertainty and thus judgement is required in determining the quantum of conduct risk related liabilities, with note 3.14 reflecting the Group's current position in relation to redress provisions including those for PPI. The final amount required to settle the Group's potential liabilities for these, and other conduct related matters, is materially uncertain. Contingent liabilities include those matters where redress is likely to be paid and costs incurred but the amounts cannot currently be estimated.

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.

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.

Section 5: Other notes continued

5.2 Notes to the statement of cash flows

	2018 £m	2017 £m
Adjustments included in the profit before tax		
Interest receivable	**(1,113)**	(1,075)
Interest payable	**262**	231
Depreciation and amortisation (note 2.4)	**89**	87
Derivative financial instruments fair value movements	**(3)**	(6)
Impairment losses on credit exposures (note 3.6)	**41**	48
Fair value movement on investment properties	**–**	1
Equity based compensation	**9**	6
Gain on disposal of VocaLink	**–**	(20)
	(715)	(728)
Changes in operating assets		
Net (increase)/decrease in:		
Balances with supervisory central banks	**(31)**	(1)
Due from other banks	**339**	(221)
Derivative financial instruments	**18**	280
Financial assets at fair value through profit or loss	**117**	237
Loans and advances to customers	**(1,488)**	(2,140)
Other assets	**(14)**	(12)
	(1,059)	(1,857)
Changes in operating liabilities		
Net increase/(decrease) in:		
Due to other banks	**(1,053)**	608
Derivative financial instruments	**(16)**	(221)
Financial liabilities at fair value through profit or loss	**(11)**	(21)
Due to customers	**1,186**	699
Provisions for liabilities and charges	**(223)**	(298)
Defined benefit pension obligations	**(14)**	(128)
Other liabilities	**9**	280
	(122)	919

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. This includes cash and liquid assets and amounts due to other banks (to the extent less than 90 days).

	2018 £m	2017 £m
Cash and balances with central banks (note 3.1)	**6,498**	6,893
Other assets	**86**	99
Due to other banks	**(12)**	(12)
Other liabilities	**(30)**	(28)
	6,542	6,952

Notes to the consolidated financial statements

Section 5: Other notes continued

5.3 Related party transactions

For details of transactions with key management personnel (KMP) and compensation of KMP, refer to the Group's Annual Report and Accounts.

Other related party transactions

The Group and the Trustee to the pension scheme have entered into a contingent Security Arrangement which provides additional support to the Scheme by underpinning recovery plan contributions and some additional investment risk. The security is in the form of a pre-agreed maximum level of assets that are set aside for the benefit of the Pension Scheme in certain trigger events. These assets are held by Red Grey Square Funding LLP, an insolvency remote consolidated structured entity.

The Group incurred costs in relation to pension scheme administration. These costs, which amounted to £0.3m in the year ended 30 September 2018 (2017: £0.3m), were charged to the Group sponsored scheme. The Group has deposits of £36m (2017: £20m) at the year end placed by the Scheme at market rates.

Pension contributions of £18m (2017: £69m) were made during the year to the Yorkshire and Clydesdale Bank Pension Scheme sponsored by the Group (note 3.16).

Notes to the consolidated financial statements

Section 5: Other notes continued

5.4 Pillar 3 disclosures

Basel III Capital Requirements Directive IV

Pillar 3 disclosure requirements are set out in Part Eight of the CRR. The consolidated disclosures of the Group, for the 2018 financial year, will be issued concurrently with the Annual Report and Accounts and will be found at www.cybg.com/investor-centre/financial-results/.

5.5 Post balance sheet events

IRB accreditation

On 10 October 2018, the Group received IRB accreditation from the PRA for both its Mortgage and SME portfolios. The Group continues to progress its Retail unsecured lending IRB application.

Acquisition

On 15 October 2018, the Company acquired all the voting rights in Virgin Money by means of a scheme of arrangement under Part 26 of the UK Companies Act 2006 for a purchase consideration of £1.6bn. This comprised the fair value of approximately 541m new CYBG PLC ordinary shares in exchange for all Virgin Money shares at a ratio of 1.2125 CYBG shares for each Virgin Money share. Following completion, Virgin Money shareholders owned approximately 38% of the Combined Group (on a fully diluted basis).

The fair value of the shares issued was calculated using the market price of 286.4 pence per share, on the London Stock Exchange at its close of business on 12 October 2018.

In seeking to address the underlying trends of scale and adaptability within the banking industry, the combination will bring together the two challenger banks to create a national competitor to the large incumbent banks. The combination will offer retail and SME customers an alternative to the status quo.

Due to the acquisition date of Virgin Money taking place on 15 October 2018, there has been insufficient time to complete the fair value exercise as required by IFRS 3: 'Business combinations'. Accordingly, the fair value of the net assets acquired and any resultant goodwill to be recognised as a result of the acquisition have not yet been determined.

Following completion, CB PLC subsequently acquired all the voting rights in Virgin Money for a consideration of £1.6bn.

Guaranteed minimum payments (GMP) equalisation

On 26 October 2018 the High Court ruled on a landmark pensions case relating to the defined benefits pension schemes operated by Lloyds Banking Group. The case dealt with GMP provided by schemes which were contracted-out of the State Earnings-Related Pension Scheme (SERPS) up until 5 April 1997, with the High Court ruling concluding that the associated benefits were inherently unequal between males and females because of their different state pension retirement ages.

The High Court has confirmed that it is necessary for schemes to equalise benefits, for those pensions accrued between 17 May 1990 and 6 April 1997, to address the inherent inequality of GMP between males and females. There is no single prescribed solution in order to equalise following this judgment, and it is anticipated that significant discussion and guidance will be required as to the permissible equalisation method to be adopted in any particular case.

The Group is currently assessing the impact of this recent ruling on its defined benefit pension scheme, and will work with its key advisors to ensure compliance with the recent findings as appropriate. Due to the early stage of this assessment and the complexity involved in such an exercise, it is not possible to quantify the extent of any additional financial obligation at this time.

Measuring financial performance – glossary

Financial performance measures

As highlighted throughout the preliminary results announcement, the Group utilises a range of performance measures[1] to assess the Group's performance. These can be grouped under the following headings:

Profitability;

Asset quality; and

Capital optimisation.

The performance measures used are a combination of statutory, regulatory and alternative performance measures; with the type of performance measure used dependent on the component elements and source of what is being measured.

Statutory performance measures (S)
These are used when the basis of the calculation is derived from a measure that is required under generally accepted accounting principles (GAAP). An example of this would be references to earnings per share.

Regulatory performance measures (R)
These are used when the basis of the calculation is required and specified by the Group's regulators. Examples of this would be the leverage ratio and the Tier 1 ratio.

Alternative performance measures (A)
These are used when the basis of the calculation is derived from a non-GAAP measure – also referred to as APMs. Examples of this would be the cost to income ratio and the return on tangible equity.

Where a performance measure refers to an 'underlying' metric, the detail on how this measure is arrived at, along with management's reasoning for excluding the item from the Group's current underlying performance rationale, can be found on page 91, directly following this section. These adjustments to the Group's statutory results made by management are necessary to provide a more meaningful underlying basis.

Descriptions of the performance measures used, including the basis of calculation where appropriate, are set out below:

Profitability:

Term	Type	Definition
Net interest margin **(NIM)**	A	Net interest income as a percentage of average interest earning assets for a given period. Net interest income of £851m (2017: £844m) is divided by average interest earning assets for a given period of £39,417m (2017: £37,697m) (which is then adjusted to exclude short-term repos used for liquidity management purposes, amounts received under the Conduct Indemnity and not yet utilised, and any associated income). As a result of the exclusions noted above, average interest earning assets used as the denominator have reduced by £120m (2017: £491m) and the net interest income numerator has reduced by £0.4m (2017: £1.1m).
Underlying RoTE	A	Underlying profit after tax attributable to ordinary equity holders as a percentage of average tangible equity (total equity less intangible assets and AT1) for a given period.
Underlying CIR	A	Underlying total operating expenses as a percentage of underlying total operating income for a given period.
Underlying return on assets	A	Underlying profit after tax as a percentage of average total assets for a given period.
Underlying basic EPS	A	Underlying profit after tax attributable to ordinary equity holders divided by the weighted average number of ordinary shares in issue for a given period.
Underlying profit after tax attributable to ordinary equity holders	A	Underlying profit before tax of £331m (2017: £293m) less tax charge of £33m (2017: £73m), less AT1 distributions (net of tax relief) of £29m (2017: £29m) and was equal to £269m (2017: £191m). The underlying tax charge is calculated by applying the statutory tax rate for the relevant period to the taxable items adjusted on the underlying basis.
Statutory return on tangible equity **(RoTE)**	A	Statutory profit/(loss) after tax attributable to ordinary equity holders as a percentage of average tangible equity (total equity less intangible assets and AT1) for a given period.
Statutory cost to income ratio **(CIR)**	A	Statutory total operating expenses as a percentage of total operating income for a given period.
Statutory return on assets	A	Statutory profit/(loss) after tax as a percentage of average total assets for a given period.
Statutory basic earnings per share **(EPS)**	S	Statutory profit/(loss) attributable to ordinary equity shareholders including tax relief on any distributions made to other equity holders divided by the weighted average number of ordinary shares in issue for a given period.

(1) The term 'financial performance measure' covers all metrics, ratios and percentage calculations used to assess the Group's performance and is interchangeable with similar terminology used in the Annual Report and Accounts such as highlights, key metrics, key performance indicators (KPIs) and key credit metrics.

Measuring financial performance – glossary

Financial performance measures (continued)

Asset quality:

Term	Type	Definition
Impairment charge to average customer loans **(cost of risk)**	**A**	Impairment losses on credit exposures plus credit risk adjustment on fair value loans to average customer loans (defined as loans and advances to customers, other financial assets at fair value and due from customers on acceptances).
90+ days past due **(DPD)** plus impaired assets to customer loans	**A**	Customer loans that are either impaired or where the repayment is more than 90 days overdue as a percentage of total customer loans at a given date.
Specific provision to gross impaired assets	**A**	The specific impairment provision on credit exposures as a percentage of gross impaired assets at a given date.
Total provision to customer loans	**A**	Total impairment provision on credit exposures as a percentage of total customer loans at a given date.
Indexed loan to value **(LTV)** of the mortgage portfolio	**A**	The mortgage portfolio weighted by balance and indexed using the MIAC Acadametrics indices at a given date.
Net write offs to customer loans	**A**	Net write offs, including loans at fair value, as a percentage of total customer loans at a given date.

Capital optimisation:

Term	Type	Definition
Common Equity Tier 1 **(CET1)** ratio	**R**	CET1 capital divided by RWAs at a given date.
Tier 1 ratio	**R**	Tier 1 capital as a percentage of risk weighted assets.
Total capital ratio	**R**	Total capital resources divided by risk weighted assets at a given date.
Leverage ratio	**R**	This is a regulatory standard ratio proposed under Basel III as a supplementary measure to the risk based capital requirements. It is intended to constrain the build-up of excess leverage in the banking sector and is calculated by dividing Tier 1 capital resources by a defined measure of on and off-balance sheet items plus derivatives.
Modified leverage ratio	**R**	The Group's leverage ratio on a modified basis, excluding qualifying central bank claims from the exposure measure in accordance with the policy statement issued by the PRA in October 2017.
Tangible net asset value **(TNAV)** per share	**A**	Tangible equity as at the period end divided by the closing number of ordinary shares.
Loan to deposit ratio **(LDR)**	**R**	Customer loans as a percentage of customer deposits at a given date.
Liquidity coverage ratio **(LCR)**	**R**	Measures the surplus (or deficit) of the Group's high quality liquid assets relative to weighted net stressed cash outflows over a 30 day period. It assesses whether the Group has sufficient liquid assets to withstand a short-term liquidity stress based on cash outflow assumptions provided by regulators.
Net stable funding ratio **(NSFR)**	**R**	The total amount of available stable funding divided by the total amount of required stable funding, expressed as a percentage. 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.

Measuring financial performance – glossary

Underlying adjustments to the statutory view of performance

In arriving at an underlying basis, the effects of certain items that do not promote an understanding of historical or future trends of earnings or cash flows are removed; with management believing this presents a set of results that provide a more reflective year-on-year comparison. These items are:

Item	FY2018 £m	FY2017 £m	Description	Reason for exclusion from the Group's current underlying performance
Legacy conduct charges	**(396)**	(58)	These are customer redress and associated costs arising from legacy products and past sales practices.	These costs are historical in nature and are not indicative of the Group's current underlying performance.
Restructuring and related expense	**(38)**	(67)	Restructuring of the business is currently ongoing with costs including redundancy payments, property vacation costs, associated enablement costs and non-recurring costs arising from operational transformation.	These costs are significant and are part of the Group's strategic objective in simplifying and streamlining operations and processes to enhance productivity. Consequently, this expense is not viewed as a normal ongoing operating cost to the Group.
Virgin Money acquisition costs	**(37)**	–	Costs incurred directly relating to the acquisition of Virgin Money.	These costs are significant and not indicative of the Group's underlying performance
RBS alternative remedies package spend	**(16)**	–	Costs incurred, in relation to the RBS alternative remedies package, to enable strategic and inorganic growth.	These costs are part of delivering the Group's growth strategy. Consequently, this expense is not viewed as a normal ongoing operating cost to the Group.
Separation costs	**(8)**	(8)	Costs incurred directly relating to the Demerger.	Specific costs relating to the Demerger are historic and not indicative of the Group's current underlying performance.
Gain on disposal of VocaLink	**–**	20	A one-off gain recognised on the disposal of the Group's VocaLink share.	Losses or gains from one-off or infrequent transactions are not indicative of the Group's current underlying performance.
Gain on DB pension scheme reforms	**–**	88	A one-off gain on the closure of the defined benefit pension scheme to future accrual for the majority of members.	Losses or gains from one-off or infrequent transactions are not indicative of the Group's current underlying performance.

Glossary

Term	Definition
Additional Tier 1 securities **(AT1)**	Securities that are considered additional Tier 1 capital in the context of CRD IV.
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.
B	The Group's digital application suite, offering Retail customers money management capabilities across Web, Android and Apple platforms.
Bank	Clydesdale Bank PLC.
Basel II	The capital adequacy framework issued by the BCBS in June 2006 defining how firms should calculate their regulatory capital requirements.
Basel III	Reforms issued by the BCBS in December 2010 to strengthen global capital and liquidity rules with the goal of promoting a more resilient banking sector. In Europe the new requirements were implemented by CRD IV, on a phased basis from 1 January 2014 with full implementation by 1 January 2019.
basis points **(bps)**	One hundredth of a percent (0.01%); meaning that 100 basis points is equal to 1%. This term is commonly used in describing interest rate movements.
Board	Refers to the CYBG PLC Board or the Clydesdale Bank PLC Board as appropriate.
Capped Indemnity	The indemnity from NAB in favour of CYBG in respect of certain qualifying conduct costs incurred by the Group, which is capped at the Capped Indemnity Amount, subject to the Loss Sharing Arrangement, under the terms of the Conduct Indemnity Deed.
Capped Indemnity Amount	An amount equal to £1.58bn less any Pre Covered provision amount.
carrying value (also referred to as carrying amount)	The value of an asset or a liability in the balance sheet based on either amortised cost or fair value principles.
CMA9	The nine largest banks and building societies in Great Britain and Northern Ireland, based on the volume of personal and business current accounts, who are mandated to deliver Open Banking. The nine banks are AIB, Bank of Ireland, Barclays, HSBC, Lloyds, Nationwide, Danske Bank, RBS and Santander.
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.
Combined Group	CYBG and its controlled entities following the acquisition of Virgin Money
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.
Common Equity Tier 1 capital **(CET1)**	The highest quality form of regulatory capital that comprises total shareholders' equity and related non-controlling interests, less goodwill and intangible assets and certain other regulatory adjustments.
Company/CYBG	CYBG PLC.
conduct risk	The risk of treating customers unfairly and/or delivering inappropriate outcomes resulting in customer detriment, regulatory fines, compensation, redress costs and reputational damage.
counterparty	The other party that participates in a financial transaction, with every transaction requiring a counterparty in order for the transaction to complete.
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.

Glossary

Term	Definition
CRD IV	European legislation to implement Basel III. It replaces earlier European capital requirements directives with a revised package consisting of a new Capital Requirements Directive and a new Capital Requirements Regulation. CRD IV sets out capital and liquidity requirements for European banks and harmonises the European framework for bank supervision. See also 'Basel III'.
credit risk adjustment/credit valuation adjustment	An adjustment to the valuation of financial instruments held at fair value to reflect the creditworthiness of the counterparty.
customer deposits	Money deposited by individuals and corporate entities that are not credit institutions, and can be either interest bearing, non-interest bearing or term deposits.
CYBI	CYB Investments Limited
default	A customer is in default when either they are more than 90 days past due on a credit obligation to the Group, or are considered unlikely to pay their credit obligations in full without recourse to actions such as realisation of security (if held).
delinquency	See 'arrears'.
Demerger	The demerger of the Group from NAB pursuant to which all of the issued share capital of CYBI was transferred to CYBG by NAB in consideration for the issue and transfer of CYBG shares to NAB in part for the benefit of NAB (which NAB subsequently sold pursuant to the IPO) and in part for the benefit of NAB shareholders under a scheme of arrangement under part 5.1 of the Australian Corporations Act.
Demerger date	8 February 2016.
derivative	A financial instrument that 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	The carrying value of certain financial instruments which amortises the relevant fees over the expected life of the instrument.
encumbered assets	Assets that have been pledged as security, collateral or legally 'ring fenced' in some other way which prevents those assets being transferred, pledged, sold or otherwise disposed.
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.
Financial Ombudsman Service **(FOS)**	An independent body set up by the UK Parliament to resolve individual complaints between financial businesses and their customers.
Financial Services Compensation Scheme **(FSCS)**	The UK's compensation fund of last resort for customers of authorised financial services firms and is funded by the financial services industry. The FSCS 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.
forbearance	The term generally applied to the facilities provided or changes to facilities provided to assist borrowers, both retail and SME, who are experiencing, or are about to experience, a period of financial stress.
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	CYBG and its controlled entities.
hedge ineffectiveness	Represents the extent to which the income statement is impacted by changes in fair value or cash flows of hedging instruments not being fully offset by changes in fair value or cash flows of hedged items.
iB	The Group's IT digital platform, built on an open architecture framework providing integration and connectivity for our customer systems, applications and technology partners.
IFRS 9	The new financial instrument accounting standard which is applicable for accounting periods beginning on or after 1 January 2018, which the Group will adopt from 1 October 2018.

Glossary

Term	Definition
impaired loans	Loans in arrears with insufficient security to cover principal and arrears of interest revenue or where there is sufficient doubt about the ultimate collectability of principal and interest.
impairment allowances	A provision held on the balance sheet to recognise that a loan is impaired. This can be calculated at either the individual or collective level.
impairment losses	Where an asset's recoverable amount is less than its carrying value and the difference is recognised in the income statement with the carrying value of the asset reduced by creating an impairment allowance. This can be assessed at either the individual or collective level.
interest rate hedging products **(IRHP)**	This incorporates: (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.
Internal Capital Adequacy Assessment Process **(ICAAP)**	The Group's 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 Liquidity Adequacy Assessment Process **(ILAAP)**	The Group's assessment and management of balance sheet risks relating to funding and liquidity.
Internal Ratings-Based approach **(IRB)**	A method of calculating credit risk capital requirements using internal, rather than supervisory, estimates of risk parameters.
investment grade	The highest possible range of credit ratings, from 'AAA' to 'BBB', as measured by external credit rating agencies.
jaws	The net difference between movements in total income and underlying costs for the period expressed as a percentage.
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.
Listing Rules	Regulations applicable to any company listed on a United Kingdom stock exchange, subject to the oversight of the UK Listing Authority (UKLA). The Listing Rules set out mandatory standards for any company wishing to list its shares or securities for sale to the public.
loan to value ratio **(LTV)**	A ratio that expresses the amount of a loan as a percentage of the value of the property on which it is secured.
Loss Share	The percentage of a provision raised or an increase in a provision which CYBG will be responsible for under the Conduct Indemnity Deed. Fixed at 9.7% at the Demerger date.
Loss Sharing Arrangement	The arrangement relating to the Capped Indemnity pursuant to which CYBG will be responsible for the Loss Share.
medium-term notes	Debt instruments issued by corporates, including financial institutions, across a range of maturities.
minimum requirement for own funds and eligible liabilities **(MREL)**	MREL is a minimum requirement for institutions to maintain equity and eligible debt liabilities, to help ensure that when an institution fails the resolution authority can use these financial resources to absorb losses and recapitalise the continuing business. The BoE set out its approach to setting banks' MREL in November 2016.
net interest income	The amount of interest received or receivable on assets, net of interest paid or payable on liabilities.
net promoter score **(NPS)**	This is an externally collated customer loyalty metric that measures loyalty between a provider, who in this context is the Group, and a consumer.
operational risk	The risk of loss resulting from inadequate or failed internal processes, people strategies and systems or from external events.

Glossary

Term	Definition
Overall Liquidity Adequacy Rule **(OLAR)**	An FCA and PRA rule that firms must at all times maintain liquidity resources which are adequate both as to amount and quality, to ensure that there is no significant risk that its liabilities cannot be met as they fall due. This is included in the Group's risk appetite and subject to approval by the Board as part of the ILAAP.
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 redress	Includes PPI customer redress and all associated costs excluding fines.
Pre Covered provision amount	The amount of any provision(s) relating to Relevant Conduct Matters raised or increased by the Group between 31 March 2015 and the demerger date in respect of which NAB has provided specific support at any time after 31 March 2015 but before the Demerger date. This was £465m at the Demerger date.
probability of default **(PD)**	The probability that a customer will default (usually within a one-year time horizon); although the time horizon will change on 1 October 2018 in line with IFRS 9 requirements.
regulatory capital	The capital which the Group holds, determined in accordance with rules established by the PRA.
Relevant Conduct Matters	The legacy conduct issues covered by the Capped Indemnity, including certain conduct issues relating to PPI, standalone IRHP, voluntary scope TBLs and FRTBLs and other conduct matters in the period prior to the Demerger date whether or not known at the Demerger date.
residential mortgage-backed securities **(RMBS)**	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).
retail lending	Lending to individuals rather than institutions. This includes both secured and unsecured lending such as personal loans, residential and BTL mortgages, overdrafts and credit card balances.
Ring-fencing	A new regime of rules which require banks to change the way that they are structured by separating retail banking services from investment and international banking. This is to ensure the economy and taxpayers are protected in the event of any future financial crises.
risk appetite	The level and types of risk the Group is willing to assume within the boundaries of its risk capacity to achieve its strategic objectives.
risk weighted assets **(RWA)**	On and off balance sheet assets of the Group are allocated a risk weighting based on the amount of capital required to support the asset.
sale and repurchase agreement ('repo')	A 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 counterparty (buying the security and agreeing to sell in the future) it is a reverse repurchase agreement or a reverse repo.
Scheme	The Group's defined benefit pension scheme, the Yorkshire and Clydesdale Bank Pension Scheme.
secured lending	Lending in which the borrower pledges some asset (e.g. property) as collateral for the lending.
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.
SME 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.
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.

Glossary

Term	Definition
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.
stress testing	The term used to describe techniques where plausible events are considered as vulnerabilities to ascertain how this will impact the own funds or liquidity which a bank holds.
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 an SPV.
subordinated debt	Liabilities which rank after the claims of other creditors of the issuer in the event of insolvency or liquidation.
Term Funding Scheme **(TFS)**	Launched in 2016 by the BoE to allow banks and building societies to borrow from the BoE at rates close to base rate. This is designed to increase lending to businesses by lowering interest rates and increasing access to credit.
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.
total net capital absorbed	The amount of capital generated by the business in basis points over a given period, after non underlying items are included.
unaudited/unverified	Financial information that has not been subject to validation by the Group's external auditor.
underlying capital generation	The amount of capital generated by the business in basis points over a given period, before non-underlying items are included.
unsecured lending	Lending in which the borrower pledges no assets as collateral for the lending (such as credit cards and current account overdrafts).
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.
Virgin Money	Virgin Money Holdings (UK) plc

Abbreviations

ALCO	Assets and Liabilities Committee
ASX	Australian Securities Exchange
AT1	Additional Tier 1
BCAs	Business current accounts
BCBS	Basel Committee on Banking Supervision
BoE	Bank of England
bps	Basis points
BTL	Buy-to-let mortgages
CAGR	Compound Annual Growth Rate
CCB	Capital Conservation Buffer
CCyB	Countercyclical Capital Buffer
CET1	Common Equity Tier 1 Capital
CIR	Cost to income ratio
CMA	Competition and Markets Authority
CPI	Consumer Prices Index
CRD	Capital Requirements Directive
CRR	Capital Requirements Regulation
DB	Defined benefit
DPD	Days past due
DTR	Disclosure and Transparency Rules
EAD	Exposure at Default
EaR	Earnings at risk
eCRS	electronic Customer Rating System
EPS	Earnings per share
FCA	Financial Conduct Authority.
FPC	Financial Policy Committee
FRC	Financial Reporting Council
FSCS	Financial Services Compensation Scheme
FTE	Full time equivalent
GHG	Greenhouse Gases
HMRC	Her Majesty's Revenue and Customs
IAS	International Accounting Standards
IASB	International Accounting Standards Board
ICAAP	Internal Capital Adequacy Assessment Process
IFRS	International Financial Reporting Standards
ILAAP	Internal Liquidity Adequacy Assessment Process
IPO	Initial Public Offering
IRB	Internal ratings based
IRHP	Interest rate hedging products
IRRBB	Interest rate risk in the banking book
ISDA	International Swaps and Derivatives Association
LCR	Liquidity coverage ratio
LDR	Loan to deposit ratio
LGD	Loss Given Default
LIBOR	London Interbank Offered Rate
LSE	London Stock Exchange
LTIP	Long term incentive plan
LTV	Loan to value ratio
MREL	Minimum Requirement for Own Funds and Eligible Liabilities
MRT	Material Risk Takers
NAB	National Australia Bank
NIM	Net interest margin
NPS	Net promoter score
NSFR	Net stable funding ratio
OLAR	Overall liquidity adequacy rule
PBT	Profit before tax
PCA	Personal current accounts
PD	Probability of Default
PPI	Payment protection insurance
PRA	Prudential Regulation Authority
RAS	Risk Appetite Statement
RMBS	Residential mortgage-backed securities
RMF	Risk Management Framework
RoTE	Return on Tangible Equity
RPI	Retail Price Index
RWA	Risk weighted assets
SME	Small or medium sized enterprises
SRB	Systemic Risk Buffer
TCC	Transactional Credit Committee
TFS	Term Funding Scheme
NAV	Tangible net asset value
TSA	Transitional Services Agreements
VaR	Value at risk